

BAR HARBOR BANKSHARES

Form 10-Q

August 08, 2017

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: June 30, 2017

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-13349

BAR HARBOR BANKSHARES

(Exact name of registrant as specified in its charter)

Maine

(State or other jurisdiction of incorporation or organization) 01-0393663 (I.R.S. Employer Identification No.)

PO Box 400

82 Main Street, Bar Harbor, ME

(Address of principal executive offices)

04609-0400

(Zip Code)

Registrant's telephone number, including area code: (207) 288-3314

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  No

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

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes  No

The Registrant had 15,420,719 shares of common stock, par value \$2.00 per share, outstanding as of August 7, 2017.

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## PART I

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

BAR HARBOR BANKSHARES AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEET

| (In thousands, except share data)   | June 30,<br>2017 | December 31,<br>2016 |
|---|------------------|----------------------|
| <b>Assets</b>   |                  |                      |
| Cash and due from banks   | \$28,112         | \$ 8,219             |
| Interest-bearing deposit with the Federal Reserve Bank  | 90,881           | 220                  |
| Total cash and cash equivalents   | 118,993          | 8,439                |
| Securities available for sale, at fair value  | 718,346          | 528,856              |
| Federal Home Loan Bank stock  | 44,168           | 25,331               |
| Total securities  | 762,514          | 554,187              |
| Commercial real estate  | 738,584          | 418,119              |
| Commercial and industrial   | 350,002          | 151,240              |
| Residential real estate   | 1,160,832        | 506,612              |
| Consumer  | 127,229          | 53,093               |
| Total loans   | 2,376,647        | 1,129,064            |
| Less: Allowance for loan losses   | (11,442 )        | (10,419 )            |
| Net loans   | 2,365,205        | 1,118,645            |
| Premises and equipment, net   | 48,590           | 23,419               |
| Other real estate owned   | 122              | 90                   |
| Goodwill  | 100,255          | 4,935                |
| Other intangible assets   | 9,047            | 377                  |
| Cash surrender value of bank-owned life insurance   | 57,233           | 24,450               |
| Deferred tax assets, net  | 13,211           | 5,990                |
| Other assets  | 28,241           | 14,817               |
| Total assets  | \$3,503,411      | \$ 1,755,349         |
| <b>Liabilities</b>  |                  |                      |
| Demand and other non-interest bearing deposits  | \$332,339        | \$ 98,856            |
| NOW deposits  | 451,171          | 175,150              |
| Savings deposits  | 360,306          | 77,623               |
| Money market deposits   | 285,312          | 282,234              |
| Time deposits   | 783,876          | 416,437              |
| Total deposits  | 2,213,004        | 1,050,300            |
| Senior borrowings   | 872,021          | 531,596              |
| Subordinated borrowings   | 43,063           | 5,000                |
| Total borrowings  | 915,084          | 536,596              |
| Other liabilities   | 28,201           | 11,713               |
| Total liabilities   | 3,156,289        | 1,598,609            |
| <b>Shareholders' equity</b>   |                  |                      |
| Capital stock, par value \$2.00; authorized 20,000,000 shares; issued 16,425,168 and 10,182,611 shares at June 30, 2017 and December 31, 2016, respectively | 32,857           | 13,577               |
| Additional paid-in capital  | 186,154          | 23,027               |
| Retained earnings   | 135,456          | 130,489              |
| Accumulated other comprehensive loss  | (1,705 )         | (4,326 )             |

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|   |             |   |              |   |
|---|-------------|---|--------------|---|
| Less: cost of 1,017,987 and 1,067,016 shares of treasury stock at June 30, 2017 and December 31, 2016, respectively | (5,640      | ) | (6,027       | ) |
| Total shareholders' equity  | 347,122     |   | 156,740      |   |
| Total liabilities and shareholders' equity  | \$3,503,411 |   | \$ 1,755,349 |   |

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

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CONSOLIDATED STATEMENTS OF INCOME

|   | Three Months |          | Six Months |          |
|---|--------------|----------|------------|----------|
|   | Ended        |          | Ended      |          |
|   | June 30,     |          | June 30,   |          |
| (In thousands, except per share data)   | 2017         | 2016     | 2017       | 2016     |
| Interest and dividend income  |              |          |            |          |
| Loans   | \$24,226     | \$10,249 | \$45,420   | \$20,332 |
| Securities and other  | 5,439        | 4,105    | 10,430     | 8,186    |
| Total interest and dividend income  | 29,665       | 14,354   | 55,850     | 28,518   |
| Interest expense  |              |          |            |          |
| Deposits  | 2,539        | 1,599    | 4,749      | 3,176    |
| Borrowings  | 3,317        | 1,373    | 5,920      | 2,624    |
| Total interest expense  | 5,856        | 2,972    | 10,669     | 5,800    |
| Net interest income   | 23,809       | 11,382   | 45,181     | 22,718   |
| Provision for loan losses   | 736          | 150      | 1,531      | 615      |
| Net interest income after provision for loan losses                                     | 23,073       | 11,232   | 43,650     | 22,103   |
| Non-interest income   |              |          |            |          |
| Trust and investment management fee income  | 3,324        | 955      | 6,188      | 1,903    |
| Insurance and brokerage service income  | 327          | —        | 691        | —        |
| Customer service fees   | 1,991        | 252      | 3,351      | 463      |
| Gain on sales of securities, net  | —            | 1,699    | —          | 3,135    |
| Bank-owned life insurance income  | 386          | 118      | 785        | 343      |
| Other income  | 530          | 590      | 1,489      | 1,098    |
| Total non-interest income   | 6,558        | 3,614    | 12,504     | 6,942    |
| Non-interest expense  |              |          |            |          |
| Salaries and employee benefits  | 10,127       | 4,799    | 20,448     | 9,816    |
| Occupancy and equipment   | 3,013        | 1,152    | 5,679      | 2,310    |
| Loss on premises and equipment, net   | —            | —        | 95         | —        |
| Outside services  | 716          | 139      | 1,313      | 249      |
| Professional services   | 489          | 710      | 929        | 834      |
| Communication   | 290          | 271      | 658        | 364      |
| Amortization of intangible assets   | 188          | 1        | 345        | 2        |
| Merger expenses   | 2,459        | 492      | 5,571      | 492      |
| Other expenses  | 2,764        | 1,167    | 5,839      | 2,661    |
| Total non-interest expense  | 20,046       | 8,731    | 40,877     | 16,728   |
| Income before income taxes  | 9,585        | 6,115    | 15,277     | 12,317   |
| Income tax expense  | 3,029        | 1,804    | 4,510      | 3,600    |
| Net income  | \$6,556      | \$4,311  | \$10,767   | \$8,717  |
| Earnings per share:   |              |          |            |          |
| Basic   | \$0.43       | \$0.48   | \$0.72     | \$0.97   |
| Diluted   | \$0.42       | \$0.47   | \$0.72     | \$0.96   |
| Weighted average common shares outstanding:   |              |          |            |          |
| Basic   | 15,393       | 9,032    | 14,935     | 9,023    |
| Diluted   | 15,506       | 9,129    | 15,049     | 9,125    |
| The accompanying notes are an integral part of these consolidated financial statements. |              |          |            |          |





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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

|   | Three Months      |         | Six Months Ended |          |
|---|-------------------|---------|------------------|----------|
|   | Ended<br>June 30, |         | June 30,         |          |
| (In thousands)  | 2017              | 2016    | 2017             | 2016     |
| Net income  | \$6,556           | \$4,311 | \$10,767         | \$8,717  |
| Other comprehensive income, before tax:                     |                   |         |                  |          |
| Changes in unrealized loss on securities available-for-sale | 3,485             | 2,690   | 4,601            | 8,618    |
| Changes in unrealized loss on derivative hedges             | (481 )            | (503 )  | (704 )           | (1,217 ) |
| Changes in unrealized loss on pension                       | (15 )             | 7       | 42               | 78       |
| Income taxes related to other comprehensive income:         |                   |         |                  |          |
| Changes in unrealized loss on securities available-for-sale | (1,292 )          | (941 )  | (1,640 )         | (3,016 ) |
| Changes in unrealized loss on derivative hedges             | 242               | 176     | 325              | 426      |
| Changes in unrealized loss on pension                       | 18                | (3 )    | (3 )             | (27 )    |
| Total other comprehensive income                            | 1,957             | 1,426   | 2,621            | 4,862    |
| Total comprehensive income                                  | \$8,513           | \$5,737 | \$13,388         | \$13,579 |

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

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CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| (In thousands)   | Common<br>stock<br>amount | Additional<br>paid-in<br>capital | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income | Treasury<br>stock | Total      |
|--|---------------------------|----------------------------------|----------------------|---|-------------------|------------|
| Balance at December 31, 2015   | \$ 13,577                 | \$ 21,624                        | \$ 122,260           | \$ 3,629  | \$(6,938)         | \$ 154,152 |
| Comprehensive income:  |                           |                                  |                      |   |                   |            |
| Net income   | —                         | —                                | 8,717                | —   | —                 | 8,717      |
| Other comprehensive loss   | —                         | —                                | —                    | 4,862   | —                 | 4,862      |
| Total comprehensive income   | —                         | —                                | 8,717                | 4,862   | —                 | 13,579     |
| Cash dividends declared (\$0.36 per share)   | —                         | —                                | (3,219)              | —   | —                 | (3,219)    |
| Treasury stock purchased (22,425)  | —                         | —                                | —                    | —   | (481)             | (481)      |
| Net issuance (51,636) to employee stock plans,<br>including related tax effects        | —                         | 92                               | (86)                 | —   | 349               | 355        |
| Recognition of stock based compensation  | —                         | 845                              | —                    | —   | —                 | 845        |
| Balance at June 30, 2016   | \$ 13,577                 | \$ 22,561                        | \$ 127,672           | \$ 8,491  | \$(7,070)         | \$ 165,231 |
| Balance at December 31, 2016   | \$ 13,577                 | \$ 23,027                        | \$ 130,489           | \$ (4,326)                                      | \$(6,027)         | \$ 156,740 |
| Comprehensive income:  |                           |                                  |                      |   |                   |            |
| Net income   | —                         | —                                | 10,767               | —   | —                 | 10,767     |
| Other comprehensive loss   | —                         | —                                | —                    | 2,621   | —                 | 2,621      |
| Total comprehensive income   | —                         | —                                | 10,767               | 2,621   | —                 | 13,388     |
| Cash dividends declared (\$0.37 per share)   | —                         | —                                | (5,744)              | —   | —                 | (5,744)    |
| Acquisition of Lake Sunapee Bank Group   | 8,328                     | 173,591                          | —                    | —   | —                 | 181,919    |
| Treasury stock purchased (2,861 shares)  | —                         | —                                | —                    | —   | (86)              | (86)       |
| Net issuance (49,029 shares) to employee stock<br>plans, including related tax effects | —                         | (68)                             | (40)                 | —   | 473               | 365        |
| Three-for-two stock split  | 10,952                    | (10,952)                         | (16)                 | —   | —                 | (16)       |
| Recognition of stock based compensation  | —                         | 556                              | —                    | —   | —                 | 556        |
| Balance at June 30, 2017   | \$ 32,857                 | \$ 186,154                       | \$ 135,456           | \$ (1,705)                                      | \$(5,640)         | \$ 347,122 |

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | Six Months Ended<br>June 30, |            |
|---|------------------------------|------------|
| (In thousands)  | 2017                         | 2016       |
| Cash flows from operating activities:   |                              |            |
| Net income  | \$10,767                     | \$8,717    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |            |
| Provision for loan losses   | 1,531                        | 615        |
| Net amortization of securities  | 2,760                        | 1,273      |
| Deferred tax benefit  | (237)                        | )          |
| Change in unamortized net loan costs and premiums                                 | (148)                        | )          |
| Premises and equipment depreciation and amortization expense                      | 1,827                        | 788        |
| Stock-based compensation expense  | 556                          | 845        |
| Accretion of purchase accounting entries, net                                     | (1,594)                      | )          |
| Amortization of other intangibles   | 345                          | 2          |
| Income from cash surrender value of bank-owned life insurance policies            | (785)                        | (343)      |
| Gain on sales of securities, net  | —                            | (3,135)    |
| Loss on premises and equipment, net   | 95                           | —          |
| Net change in other   | (4,873)                      | (2,058)    |
| Net cash provided by operating activities   | 10,244                       | 6,704      |
| Cash flows from investing activities:   |                              |            |
| Proceeds from sales of securities available for sale                              | —                            | 44,656     |
| Proceeds from maturities, calls and prepayments of securities available for sale  | 61,299                       | 48,472     |
| Purchases of securities available for sale  | (104,833)                    | (110,269)  |
| Net change in loans   | (20,056)                     | (9,319)    |
| Purchase of loans   | (18,621)                     | (49,796)   |
| Purchase of Federal Home Loan Bank stock  | (7,388)                      | (5,234)    |
| Purchase of premises and equipment, net   | (2,413)                      | (3,065)    |
| Acquisitions, net of cash (paid) acquired   | 39,537                       | —          |
| Proceeds from sale of other real estate   | 322                          | —          |
| Net cash used in investing activities   | \$(52,153)                   | \$(84,555) |
| Cash flows from financing activities:   |                              |            |
| Net decrease in deposits  | \$12,419                     | \$47,029   |
| Net change in short-term advances from the Federal Home Loan Bank                 | 228,833                      | 63,750     |
| Repayments of long term advances from the Federal Home Loan Bank                  | (77,554)                     | (7,008)    |
| Net change in securities sold repurchase agreements                               | (5,754)                      | (6,431)    |
| Exercise of stock options   | 263                          | 355        |
| Purchase of treasury stock  | —                            | (481)      |
| Common stock cash dividends paid  | (5,744)                      | (3,219)    |
| Net cash provided by financing activities   | 152,463                      | 93,995     |
| Net change in cash and cash equivalents   | 110,554                      | 16,144     |
| Cash and cash equivalents at beginning of year                                    | 8,439                        | 9,720      |
| Cash and cash equivalents at end of year  | \$118,993                    | \$25,864   |
| Supplemental cash flow information:   |                              |            |
| Interest paid   | \$10,716                     | \$5,766    |

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|   |           |       |
|---|-----------|-------|
| Income taxes paid, net                            | 3,084     | 3,926 |
| Acquisition of non-cash assets and liabilities:   |           |       |
| Assets acquired                                   | 1,454,076 | —     |
| Liabilities assumed                               | 1,406,672 | —     |
| Other non-cash changes:                           |           |       |
| Real estate owned acquired in settlement of loans | 32        | —     |

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

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BAR HARBOR BANKSHARES AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

The consolidated financial statements (the “financial statements”) of Bar Harbor Bankshares and its subsidiaries (the “Company” or “Bar Harbor”) have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”). Bar Harbor Bankshares is a Maine Financial Institution Holding Company for the purposes of the laws of the state of Maine, and as such is subject to the jurisdiction of the Superintendent of the Maine Bureau of Financial Institutions. These financial statements include the accounts of the Company, its wholly-owned subsidiary Bar Harbor Bank & Trust (the “Bank”) and the Bank’s consolidated subsidiaries. In consolidation, all significant intercompany accounts and transactions are eliminated. The results of operations of companies or assets acquired are included only from the dates of acquisition. All material wholly-owned and majority-owned subsidiaries are consolidated unless U.S. GAAP requires otherwise.

In addition, these interim financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X, and accordingly, certain information and footnote disclosures normally included in financial statements prepared according to U.S. GAAP have been omitted.

The results for any interim period are not necessarily indicative of results for the full year. These consolidated financial statements should be read in conjunction with the audited financial statements and note disclosures for the Company's Annual Report on Form 10-K for the year ended December 31, 2016 previously filed with the Securities and Exchange Commission. In management's opinion, all adjustments necessary for a fair statement are reflected in the interim periods presented.

As a result of the Lake Sunapee Group acquisition, the Company has the following new significant and critical accounting policy regarding acquired loans:

**Acquired Loans:** Loans that the Company acquired in business combinations are initially recorded at fair value with no carryover of the related allowance for credit losses. Determining the fair value of the loans involves estimating the amount and timing of principal and interest cash flows initially expected to be collected on the loans and discounting those cash flows at an appropriate market rate of interest. Going forward, the Company continues to evaluate reasonableness of expectations for the timing and the amount of cash to be collected. Subsequent decreases or increases in expected cash flows may result in changes in the amortization or accretion of fair market value adjustments, and in some cases may result in the loan being considered impaired. For collateral dependent loans with deteriorated credit quality, the Company estimates the fair value of the underlying collateral of the loans. These values are discounted using market derived rates of return, with consideration given to the period of time and costs associated with the foreclosure and disposition of the collateral.

**Recently Adopted Accounting Principles**

In March 2016, the FASB issued ASU No. 2016-09, “Improvements to Employee Share-Based Payment Accounting.” This ASU includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. Some of the key provisions of this new ASU include: (1) companies will no longer record excess tax benefits and certain tax deficiencies in additional paid-in capital (“APIC”). Instead, they will record all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement, and APIC pools will be eliminated. The guidance also eliminates the requirement that excess tax benefits be realized before companies can recognize them. In addition, the guidance requires companies to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity; (2) increase the amount an employer can withhold to cover income taxes on awards and still qualify for the exception to liability classification for

shares used to satisfy the employer's statutory income tax withholding obligation. The new guidance will also require an employer to classify the cash paid to a tax authority when shares are withheld to satisfy its statutory income tax withholding obligation as a financing activity on its statement of cash flows (current guidance did not specify how these cash flows should be classified); and (3) permit companies to make an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures can be estimated, as required

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currently, or recognized when they occur. ASU No. 2016-09 is effective for interim and annual reporting periods beginning after December 15, 2016. The Company adopted ASU No. 2016-09 on January 1, 2017 and elected to recognize forfeitures as they occur. As allowed by the ASU, the Company's adoption was prospective, therefore, prior periods have not been adjusted. The adoption of ASU No. 2016-09 could result in increased volatility to reported income tax expense related to excess tax benefits and tax deficiencies for employee share-based transactions, however, the actual amounts recognized in income tax expense will be dependent on the amount of employee share-based transactions and the stock price at the time of vesting or exercise. In 2017, the adoption of ASU No. 2016-09 resulted in an insignificant decrease to the provision for income taxes primarily due to the tax benefit from the exercise of stock options and the vesting of restricted stock.

In March 2017, the FASB issued ASU No. 2017-08, "Premium Amortization on Purchased Callable Debt Securities." This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. Today, entities generally amortize the premium over the contractual life of the security. The new guidance does not change the accounting for purchased callable debt securities held at a discount; the discount continues to be amortized to maturity. ASU No. 2017-08 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. The guidance calls for a modified retrospective transition approach under which a cumulative-effect adjustment will be made to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company elected to adopt the provisions of ASU No. 2017-08 as of March 31, 2017, which had no impact on the Company's Consolidated Financial Statements.

### Future Application of Accounting Pronouncements

In May 2014, the FASB and the International Accounting Standards Board (the "IASB") jointly issued a comprehensive new revenue recognition standard that will supersede nearly all existing revenue recognition guidance under U.S. GAAP and International Financial Reporting Standards ("IFRS"). Current revenue recognition guidance in U.S. GAAP consists of broad revenue recognition concepts together with numerous revenue requirements for particular industries or transactions, which sometimes resulted in different accounting for economically similar transactions. In contrast, IFRS provided limited revenue recognition guidance and, consequently, could be difficult to apply to complex transactions. Accordingly, the FASB and the IASB initiated a joint project to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS that would: (1) remove inconsistencies and weaknesses in revenue requirements; (2) provide a more robust framework for addressing revenue issues; (3) improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) provide more useful information to users of financial statements through improved disclosure requirements; and (5) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. To meet those objectives, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers." The common revenue standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies generally will be required to use more judgment and make more estimates than under current guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The standard was initially effective for public entities for interim and annual reporting periods beginning after December 15, 2016; early adoption was not permitted. However, in August 2015, the FASB issued ASU No. 2015-14, "Revenue from Contracts with Customers - Deferral of the Effective Date" which deferred the effective date by one year (i.e., interim and annual reporting periods beginning after December 15, 2017). For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. In addition, the FASB has begun to issue targeted updates to clarify specific implementation issues of ASU 2014-09. These updates include ASU No. 2016-08, "Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," ASU No. 2016-10, "Identifying

Performance Obligations and Licensing,” ASU No. 2016-12, “Narrow-Scope Improvements and Practical Expedients,” and ASU No. 2016-20 “Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers.” Since the guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other U.S. GAAP, the Company does not expect the new guidance to have a material impact on revenue most



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closely associated with financial instruments, including interest income. The Company is currently performing an overall assessment of revenue streams and reviewing contracts potentially affected by the ASU including trust and asset management fees, deposit related fees, interchange fees, and merchant income, to determine the potential impact the new guidance is expected to have on the Company's Consolidated Financial Statements. In addition, the Company continues to follow certain implementation issues relevant to the banking industry which are still pending resolution. The Company plans to adopt ASU No. 2014-09 on January 1, 2018 utilizing the modified retrospective approach.

In January 2016, the FASB issued ASU No. 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities." This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to U.S. GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (8) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU No. 2016-01 is effective for interim and annual reporting periods beginning after December 15, 2017. Early application is permitted as of the beginning of the fiscal year of adoption only for provisions (3) and (6) above. Early adoption of the other provisions mentioned above is not permitted. The Company has performed a preliminary evaluation of the provisions of ASU No. 2016-01. Based on this evaluation, the Company has determined that ASU No. 2016-01 is not expected to have a material impact on the Company's Consolidated Financial Statements; however, the Company will continue to closely monitor developments and additional guidance.

In February 2016, the FASB issued ASU No. 2016-02, "Leases." Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases): 1) a lease liability, which is the present value of a lessee's obligation to make lease payments, and 2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Lessor accounting under the new guidance remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases, and operating leases. Leveraged leases have been eliminated, although lessors can continue to account for existing leveraged leases using the current accounting guidance. Other limited changes were made to align lessor accounting with the lessee accounting model and the new revenue recognition standard. All entities will classify leases to determine how to recognize lease-related revenue and expense. Quantitative and qualitative disclosures will be required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity's leasing activities. ASU No. 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. All entities are required to use a modified retrospective approach for

leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. They have the option to use certain relief; full retrospective application is prohibited. The Company has several lease agreements, such as branch locations, which are currently considered operating leases, and therefore, not recognized on the Company's consolidated statements of condition. The Company expects the new guidance will require these lease

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agreements to now be recognized on the consolidated statements of condition as a right-of-use asset and a corresponding lease liability. Therefore, the Company's preliminary evaluation indicates the provisions of ASU No. 2016-02 are expected to impact the Company's consolidated statements of condition. However, the Company continues to evaluate the extent of potential impact the new guidance will have on the Company's Consolidated Financial Statements.

In June 2016, the FASB issued ASU No. 2016-13, "Measurement of Credit Losses on Financial Instruments." This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today's guidance delays recognition of credit losses. The standard will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). The Company's preliminary evaluation indicates the provisions of ASU No. 2016-13 are expected to impact the Company's Consolidated Financial Statements, in particular the level of the reserve for credit losses. However, the Company continues to evaluate the extent of the potential impact.

In August 2016, the FASB issued ASU No. 2016-15, "Classification of Certain Cash Receipts and Cash Payments." Current U.S. GAAP is unclear or does not include specific guidance on how to classify certain transactions in the statement of cash flows. This ASU is intended to reduce diversity in practice in how eight particular transactions are classified in the statement of cash flows. ASU No. 2016-15 is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted, provided that all of the amendments are adopted in the same period. Entities will be required to apply the guidance retrospectively. If it is impracticable to apply the guidance retrospectively for an issue, the amendments related to that issue would be applied prospectively. As this guidance only affects the classification within the statement of cash flows, ASU No. 2016-15 is not expected to have a material impact on the Company's Consolidated Financial Statements.

In January 2017, the FASB issued ASU No. 2017-04, "Simplifying the Test for Goodwill Impairment." The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. Goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. All other goodwill impairment guidance will remain largely unchanged. ASU No. 2017-04 is effective for interim and annual reporting periods beginning after December 15, 2019, applied prospectively. Early adoption is permitted for any impairment tests performed after January 1, 2017. The Company expects to early adopt upon the next goodwill impairment test in 2017. ASU No. 2017-04 is not expected to have a material impact on the Company's Consolidated Financial Statements.

In March 2017, the FASB issued ASU No. 2017-07, “Improving the Presentation of Net Periodic Pension Cost and Net Periodic Post-retirement Benefit Cost.” Under the new guidance, employers will present the service cost component of the net periodic benefit cost in the same income statement line item as other employee compensation costs (e.g., Salaries and Benefits) arising from services rendered during the period. In addition, only the service cost component will be eligible for capitalization in assets. Employers will present the other components separately from the line item(e.g., Other Noninterest Expense) that includes the service cost. ASU No. 2017-07 is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted, however, the Company has decided

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not to early adopt. Employers will apply the guidance on the presentation of the components of net periodic benefit cost in the income statement retrospectively. The guidance limiting the capitalization of net periodic benefit cost in assets to the service cost component will be applied prospectively. The Company expects to utilize the ASU's practical expedient allowing entities to estimate amounts for comparative periods using the information previously disclosed in their pension and other post-retirement benefit plan footnote. ASU No. 2017-07 is not expected to have a material impact on the Company's Consolidated Financial Statements.

In May 2017, the FASB issued ASU No. 2017-09, "Stock Compensation, Scope of Modification Accounting." This ASU clarifies when changes to the terms of conditions of a share-based payment award must be accounted for as modifications. Companies will apply the modification accounting guidance if the value, vesting conditions or classification of the award changes. The new guidance should reduce diversity in practice and result in fewer changes to the terms of an award being accounted for as modifications, as the guidance will allow companies to make certain non-substantive changes to awards without accounting for them as modifications. It does not change the accounting for modifications. ASU No. 2017-09 is effective for interim and annual reporting periods beginning after December 15, 2017; early adoption is permitted. ASU No. 2017-09 is not expected to have a material impact on the Company's Consolidated Financial Statements.

NOTE 2. ACQUISITION

Lake Sunapee Bank Group

On January 13, 2017, the Company completed its acquisition of Lake Sunapee Bank Group ("Lake Sunapee"). Lake Sunapee, as a holding company, had one banking subsidiary ("Lake Sunapee Bank") that had 33 full service branches located throughout New Hampshire and Vermont. As a result of the transaction, Lake Sunapee Bank Group merged into Bar Harbor Bankshares, and Lake Sunapee Bank merged into Bar Harbor Bank. This business combination expanded the Company's geographic footprint and increased market share in its New England based franchise. The goodwill recognized results from the expected synergies and earnings accretion from this combination, including future cost savings related to the operations of Lake Sunapee Bank Group.

On the acquisition date, Lake Sunapee had 8.38 million common shares outstanding, which were exchanged for 4.16 million of the Company's common shares based on a 0.4970 exchange ratio as defined in the merger agreement. The merger qualified as a reorganization for federal income tax purposes, and as a result, Lake Sunapee common shares exchanged for the Company's common shares were transferred on a tax-free basis. Bar Harbor Bankshares common stock issued in this exchange was valued at \$43.69 per share based on the closing price posted on January 13, 2017 resulting in a consideration value of \$181.92 million. The Company also paid \$27 thousand to Lake Sunapee shareholders in lieu of the issuance of fractional shares. Total consideration paid at closing reflected the increase in Bar Harbor Bankshare's stock price since the time of the announcement.

The results of Lake Sunapee's operations are included in the Company's Consolidated Statement of Income from the date of acquisition. The assets and liabilities in the Lake Sunapee acquisition were recorded at their fair value based on management's best estimate using information available as of the date of acquisition.



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Consideration paid, and fair values of Lake Sunapee's assets acquired and liabilities assumed, along with the resulting goodwill, are summarized in the following tables:

| (in thousands)  | As<br>Acquired | Fair Value<br>Adjustments | As<br>Recorded at<br>Acquisition |
|---|----------------|---------------------------|----------------------------------|
| Consideration paid:   |                |                           |                                  |
| Bar Harbor Bankshares common stock issued to Lake Sunapee Bank<br>Group stockholders (4,163,853 shares) |                |                           | \$ 181,919                       |
| Cash paid for fractional shares   |                |                           | 27                               |
| Total consideration paid  |                |                           | 181,946                          |
| Recognized amounts of identifiable assets acquired and liabilities assumed,<br>at fair value:           |                |                           |                                  |
| Cash and short-term investments   | \$40,970       | \$ (1,406 )               | (a) \$ 39,564                    |
| Investment securities   | 156,960        | (1,381 )                  | (b) 155,579                      |
| Loans   | 1,217,928      | (9,728 )                  | (c) 1,208,199                    |
| Premises and equipment  | 22,561         | (351 )                    | (d) 22,210                       |
| Core deposit intangible   | —              | 7,786                     | (e) 7,786                        |
| Other assets  | 102,300        | (50,419 )                 | (f) 51,879                       |
| Deposits  | (1,149,865 )   | (746 )                    | (g) (1,150,611 )                 |
| Borrowings  | (232,261 )     | (16 )                     | (h) (232,277 )                   |
| Deferred taxes, net   | (1,921 )       | 10,217                    | (i) 8,296                        |
| Other liabilities   | (19,924 )      | (4,087 )                  | (j) (24,011 )                    |
| Total identifiable net assets   | \$ 136,748     | \$ (50,131 )              | \$ 86,614                        |
| Goodwill  |                |                           | \$ 95,332                        |

## Explanation of Certain Fair Value Adjustments

a. Represents in-process payments that were made on the date of acquisition that were not recorded on Lake Sunapee's general ledger until after acquisition.

b. Represents the write down of the book value of investments to their estimated fair value based on fair values on the date of acquisition.

c. Represents the write down of the book value of loans to their estimated fair value based on current interest rates and expected cash flows, which includes an estimate of expected loan loss inherent in the portfolio. The adjustments also includes the reversal of Lake Sunapee Bank's historic allowance for loan losses. Loans that met the criteria and are being accounted for in accordance with ASC 310-30, Loans and Securities Acquired with Deteriorated Credit Quality, had a book value of \$23.34 million and have a fair value \$18.45 million. Non-impaired loans accounted for under ASC 310-10, Overall, had a book value of \$1.20 billion and have a fair value of \$1.188 billion. ASC 310-30 loans have a \$1.09 million fair value adjustment discount that is accretable in earnings over the weighted average life of three years using the effective yield as determined on the date of acquisition. The effective yield is periodically adjusted for changes in expected flows. ASC 310-10 loans have a \$11.40 million fair value adjustment discount that is amortized into expense over the remaining term of the loans using the effective interest method, or a straight-line method if the loan is a revolving credit facility.

d. Represents the adjustment of the book value of buildings and equipment, to their estimated fair value based on appraisals and other methods. The adjustments will be depreciated over the estimated economic lives of the assets.

e. Represents the value of the core deposit base assumed in the acquisition. The core deposit asset was recorded as an identifiable intangible asset and will be amortized using a straight-line method over the average life of the deposit base, which is estimated to be twelve years.

f. Primarily represents the write-off of historical goodwill and unamortized intangibles recorded by Lake Sunapee from prior acquisitions that are not carried over to the Company's balance sheet. These adjustments are not





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accretable into earnings in the statement of income. Also represents the value of customer list intangibles which are accretable into earnings in the statement of income.

- g. Represents adjustments made to time deposits due to the weighted average contractual interest rates exceeding the cost of similar funding at the time of acquisition. The amount will be amortized using a straight-line method over the estimated useful life of one year.
- h. Represents the present value difference between cash flows of current debt instruments using contractual rates and those of similar borrowings on the date of acquisition. The adjustment will be amortized over the remaining four year weighted average contractual life.
- i. Represents net deferred tax assets resulting from the fair value adjustments related to the acquired assets and liabilities, identifiable intangibles, and other purchase accounting adjustments.
- j. Primarily represents the impact of change in control effects on post-retirement liabilities assumed by the Company, which are not accretable into earnings in the statement of income.

Except for collateral dependent loans with deteriorated credit quality, the fair values for loans acquired were estimated using cash flow projections based on the remaining maturity and repricing terms. Cash flows were adjusted by estimating future credit losses and the rate of prepayments. Projected monthly cash flows were then discounted to present value using a risk-adjusted market rate for similar loans. To estimate the fair value for collateral dependent loans with deteriorated credit quality, we analyzed the underlying collateral of the loans assuming the fair values of the loans were derived from the eventual sale of the collateral. Those values were discounted using market derived rates of return, with consideration given to the period of time and costs associated with the foreclosure and disposition of the collateral. There was no carryover of the seller's allowance for credit losses associated with the loans that were acquired in the acquisition as the loans were initially recorded at fair value.

Information about the acquired loan portfolio subject to ASC 310-30 as of January 13, 2017 is, as follows (in thousands):

|  | ASC<br>310-30<br>Loans |
|--|------------------------|
| Gross contractual receivable amounts at acquisition                          | \$23,338               |
| Contractual cash flows not expected to be collected (nonaccretable discount) | (3,801 )               |
| Expected cash flows at acquisition   | 19,537                 |
| Interest component of expected cash flows (accretable discount)              | (1,089 )               |
| Fair value of acquired loans   | \$18,448               |

Direct acquisition and integration costs were expensed as incurred, and totaled \$5.6 million during the six months ending June 30, 2017 and were \$492 thousand for the same period of 2016. For the three months ending June 30, 2017 direct acquisition and integration costs totaled \$2.5 million and were \$492 thousand for the same period of 2016.

#### Pro Forma Information (unaudited)

The following table presents selected unaudited pro forma financial information reflecting the acquisition of Lake Sunapee Bank Group assuming the acquisition was completed as of January 1, 2016. The unaudited pro forma financial information includes adjustments for scheduled amortization and accretion of fair value adjustments recorded at the acquisition. These adjustments would have been different if they had been recorded on January 1, 2016, and they do not include the impact of prepayments. The unaudited pro forma financial information is presented for illustrative purposes only and is not necessarily indicative of the combined financial results of the Company and Lake Sunapee had the transaction actually been completed at the beginning of the periods presented, nor does it indicate future results for any other interim or full-year period. Pro forma basic and diluted earnings per common share were calculated using the Company's actual weighted-average shares outstanding for the periods presented plus 4.16 million shares issued as a result of the acquisition. The unaudited pro forma information is based on the actual

financial statements of the Company and Lake Sunapee for the periods shown until the date of acquisition, at which time Lake Sunapee operations became included in the Company's financial statements. The Company has determined it is impractical to report the amounts of revenue and earnings of the acquired entity since the acquisition date. Due to the integration of its operations with those of the organization, the Company does not record revenue and earnings separately for these operations.

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The unaudited pro forma information, for the six months ended June 30, 2017 and 2016, set forth below reflects adjustments related to amortization and accretion of purchase accounting fair value adjustments and an estimated tax rate of 37.57%. Direct acquisition expenses incurred by the Company during 2017, as noted above, are reversed for the purposes of this unaudited pro forma information. Furthermore, the unaudited pro forma information does not reflect management's estimate of any revenue-enhancing or anticipated cost-savings that could occur as a result of the acquisition.

Information in the following table is shown in thousands, except earnings per share:

|                               | Pro Forma<br>(unaudited)<br>Six Months<br>Ended June 30, |          |
|-------------------------------|--|----------|
|                               | 2017   | 2016     |
| Net interest income           | \$46,834   | \$45,318 |
| Non-interest income           | 13,116   | 17,259   |
| Net income                    | 15,693   | 14,670   |
| Pro forma earnings per share: |  |          |
| Basic                         | \$1.02   | \$0.96   |
| Diluted                       | \$1.01   | \$0.95   |

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## NOTE 3. SECURITIES AVAILABLE FOR SALE

The following is a summary of securities available for sale:

| (In thousands)   | Amortized Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
|--|----------------|------------------------------|-------------------------------|------------|
| June 30, 2017  |                |                              |                               |            |
| Securities available for sale                            |                |                              |                               |            |
| Debt securities:   |                |                              |                               |            |
| Obligations of US Government sponsored enterprises       | \$ 6,937       | \$ 36                        | \$ —                          | \$ 6,973   |
| Mortgage-backed securities:                              |                |                              |                               |            |
| US Government-sponsored enterprises                      | 456,840        | 3,344                        | 4,133                         | 456,051    |
| US Government agency                                     | 77,869         | 720                          | 527                           | 78,062     |
| Private label  | 744            | 174                          | 7                             | 911        |
| Obligations of states and political subdivisions thereof | 144,850        | 2,869                        | 1,434                         | 146,285    |
| Corporate bonds  | 29,774         | 308                          | 18                            | 30,064     |
| Total securities available for sale                      | \$ 717,014     | \$ 7,451                     | \$ 6,119                      | \$ 718,346 |
| December 31, 2016  |                |                              |                               |            |
| Securities available for sale                            |                |                              |                               |            |
| Debt securities:   |                |                              |                               |            |
| Obligations of US Government sponsored enterprises       | \$ —           | \$ —                         | \$ —                          | \$ —       |
| Mortgage-backed securities:                              |                |                              |                               |            |
| US Government-sponsored enterprises                      | 330,635        | 2,682                        | 4,865                         | 328,452    |
| US Government agency                                     | 76,722         | 797                          | 613                           | 76,906     |
| Private label  | 936            | 207                          | 11                            | 1,132      |
| Obligations of states and political subdivisions thereof | 123,832        | 1,941                        | 3,407                         | 122,366    |
| Corporate bonds  | —              | —                            | —                             | —          |
| Total securities available for sale                      | \$ 532,125     | \$ 5,627                     | \$ 8,896                      | \$ 528,856 |

The amortized cost and estimated fair value of available for sale (“AFS”) securities segregated by contractual maturity at June 30, 2017 are presented below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are shown in total, as their maturities are highly variable.

| (In thousands)                      | Available for sale |               |
|-------------------------------------|--------------------|---------------|
|                                     | Amortized<br>Cost  | Fair<br>Value |
| Within 1 year                       | \$3,595            | \$3,615       |
| Over 1 year to 5 years              | 19,509             | 19,714        |
| Over 5 years to 10 years            | 72,053             | 73,287        |
| Over 10 years                       | 621,857            | 621,730       |
| Total securities available for sale | \$717,014          | \$718,346     |

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Securities with unrealized losses, segregated by the duration of their continuous unrealized loss positions, are summarized as follows:

| (In thousands)   | Less Than Twelve Months |            | Over Twelve Months      |            | Total                   |            |
|--|-------------------------|------------|-------------------------|------------|-------------------------|------------|
|  | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value |
| June 30, 2017  |                         |            |                         |            |                         |            |
| Securities available for sale                            |                         |            |                         |            |                         |            |
| Debt securities:   |                         |            |                         |            |                         |            |
| Obligations of US Government sponsored enterprises       | \$ —                    | \$ —       | \$ —                    | \$ —       | \$ —                    | \$ —       |
| Mortgage-backed securities:                              |                         |            |                         |            |                         |            |
| US Government-sponsored enterprises                      | 3,161                   | 198,257    | 972                     | 27,076     | 4,133                   | 225,333    |
| US Government agency                                     | 391                     | 37,729     | 136                     | 5,774      | 527                     | 43,503     |
| Private label  | —                       | 7          | 7                       | 271        | 7                       | 278        |
| Obligations of states and political subdivisions thereof | 957                     | 33,058     | 477                     | 7,930      | 1,434                   | 40,988     |
| Corporate bonds  | 18                      | 4,025      | —                       | —          | 18                      | 4,025      |
| Total securities available for sale                      | \$ 4,527                | \$ 273,076 | \$ 1,592                | \$ 41,051  | \$ 6,119                | \$ 314,127 |

December 31, 2016

|  |          |            |        |           |          |            |
|--|----------|------------|--------|-----------|----------|------------|
| Securities available for sale                            |          |            |        |           |          |            |
| Debt securities:   |          |            |        |           |          |            |
| Obligations of US Government sponsored enterprises       | \$ —     | \$ —       | \$ —   | \$ —      | \$ —     | \$ —       |
| Mortgage-backed securities:                              |          |            |        |           |          |            |
| US Government-sponsored enterprises                      | 4,369    | 197,914    | 496    | 10,120    | 4,865    | 208,034    |
| US Government agency                                     | 472      | 36,941     | 141    | 4,263     | 613      | 41,204     |
| Private label  | —        | 107        | 11     | 312       | 11       | 419        |
| Obligations of states and political subdivisions thereof | 3,252    | 76,803     | 155    | 3,916     | 3,407    | 80,719     |
| Corporate bonds  | —        | —          | —      | —         | —        | —          |
| Total securities available for sale                      | \$ 8,093 | \$ 311,765 | \$ 803 | \$ 18,611 | \$ 8,896 | \$ 330,376 |

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Securities Impairment: As a part of the Company's ongoing security monitoring process, the Company identifies securities in an unrealized loss position that could potentially be other-than-temporarily impaired. For the three and six months ended June 30, 2017 and 2016 the Company did not record any other-than-temporary impairment ("OTTI") losses.

|  | Three Months<br>Ended June 30,<br>2017 2016 |         |
|--|---|---------|
| Estimated credit losses as of March 31,              | \$1,697                                     | \$2,793 |
| Reductions for securities paid off during the period | —   | 1,096   |
| Estimated credit losses at end of the period         | \$1,697                                     | \$1,697 |

|  | Six Months<br>Ended June 30,<br>2017 2016 |         |
|--|---|---------|
| Estimated credit losses as of prior year-end,        | \$1,697                                   | \$3,180 |
| Reductions for securities paid off during the period | —   | 1,483   |
| Estimated credit losses at end of the period         | \$1,697                                   | \$1,697 |

**Visa Class B Common Shares**

The Company was a member of the Visa USA payment network and was issued Class B shares in connection with the Visa Reorganization and the Visa Inc. initial public offering in March 2008. The Visa Class B shares are transferable only under limited circumstances until they can be converted into shares of the publicly traded class of Visa stock. This conversion cannot happen until the settlement of certain litigation, which is indemnified by Visa members. Since its initial public offering, Visa has funded a litigation reserve based upon a change in the conversion ratio of Visa Class B shares into Visa Class A shares. At its discretion, Visa may continue to increase the conversion rate in connection with any settlements in excess of amounts then in escrow for that purpose and reduce the conversion rate to the extent that it adds any funds to the escrow in the future. Based on the existing transfer restriction and the uncertainty of the litigation, the Company has recorded its Visa Class B shares on its statements of condition at zero value for all reporting periods since 2008. At June 30, 2017, the Company owned 11,623 of Visa Class B shares with a then current conversion ratio to Visa Class A shares of 1.648 (or 19,158 Visa Class A shares). Upon termination of the existing transfer restriction and settlement of the litigation, and to the extent that the Company continues to own such Visa Class B shares in the future, the Company expects to record its Visa Class B shares at fair value.

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

**Debt Securities**

The Company expects to recover its amortized cost basis on all debt securities in its AFS portfolio. Furthermore, the Company does not intend to sell nor does it anticipate that it will be required to sell any of its securities in an unrealized loss position as of June 30, 2017, prior to this recovery. The Company's ability and intent to hold these securities until recovery is supported by the Company's strong capital and liquidity positions as well as its historically low portfolio turnover.

The following summarizes, by investment security type, the basis for the conclusion that the debt securities in an unrealized loss position within the Company's AFS were not other-than-temporarily impaired at June 30, 2017:

**US Government-sponsored enterprises**

At June 30, 2017, 283 out of the total 797 securities in the Company's portfolios of AFS US Government sponsored enterprises were in unrealized loss positions. Aggregate unrealized losses represented 1.8% of the amortized cost of

securities in unrealized loss positions. The Federal National Mortgage Association (“FNMA”) and Federal Home Loan Mortgage Corporation (“FHLMC”) guarantee the contractual cash flows of all of the Company’s US government-sponsored enterprises. The securities are investment grade rated and there were no material underlying credit downgrades during the quarter. All securities are performing.

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US Government agencies

At June 30, 2017, 65 out of the total 208 securities in the Company's portfolios of AFS US Government agency securities were in unrealized loss positions. Aggregate unrealized losses represented 1.2% of the amortized cost of securities in unrealized loss positions. The Government National Mortgage Association ("GNMA") guarantees the contractual cash flows of all of the Company's US government agency securities. The securities are investment grade rated and there were no material underlying credit downgrades during the quarter. All securities are performing.

Private-label

At June 30, 2017, nine of the total 28 securities in the Company's portfolio of AFS private-label mortgage-backed securities were in unrealized loss positions. Aggregate unrealized losses represented 2.5% of the amortized cost of securities in unrealized loss positions. Based upon the foregoing considerations, and the expectation that the Company will receive all of the future contractual cash flows related to the amortized cost on these securities, the Company does not consider there to be any additional other-than-temporary impairment with respect to these securities.

Obligations of states and political subdivisions thereof

At June 30, 2017, 81 of the total 273 securities in the Company's portfolio of AFS municipal bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 3.4% of the amortized cost of securities in unrealized loss positions. The Company continually monitors the municipal bond sector of the market carefully and periodically evaluates the appropriate level of exposure to the market. At this time, the Company feels the bonds in this portfolio carry minimal risk of default and the Company is appropriately compensated for that risk. There were no material underlying credit downgrades during the quarter. All securities are performing.

Corporate bonds

At June 30, 2017, two out of 13 securities in the Company's portfolio of AFS corporate bonds were in an unrealized loss position. The aggregate unrealized loss represents 0.4% of the amortized cost of bonds in unrealized loss positions. The Company reviews the financial strength of all of these bonds and has concluded that the amortized cost remains supported by the expected future cash flows of these securities.



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## NOTE 4. LOANS

The Company's loan portfolio is comprised of the following segments: commercial real estate, commercial and industrial, residential real estate, and consumer loans. Commercial real estate loans includes single and multi-family, commercial construction and land, and other commercial real estate classes. Commercial and industrial loans includes loans to commercial businesses, agricultural and other loans to farmers, and tax exempt loans. Residential real estate loans consists of mortgages for 1 to 4 family housing. Consumer loans include home equity loans, indirect auto and other installment lending.

The Company's lending activities are principally conducted in Maine, New Hampshire, and Vermont.

Total loans include business activity loans and acquired loans. Acquired loans are those loans acquired from Lake Sunapee Bank Group. The following is a summary of total loans:

| (In thousands)                          | June 30, 2017             |                |             | December 31, 2016         |                |              |
|---|---------------------------|----------------|-------------|---------------------------|----------------|--------------|
|   | Business Activities Loans | Acquired Loans | Total       | Business Activities Loans | Acquired Loans | Total        |
| Commercial Real Estate:                 |                           |                |             |                           |                |              |
| Construction and land development       | \$27,428                  | \$16,467       | \$43,895    | \$14,695                  | \$             | —\$14,695    |
| Other commercial real estate            | 403,326                   | 291,363        | 694,689     | 403,424                   | —              | 403,424      |
| Total Commercial Real Estate:           | 430,754                   | 307,830        | 738,584     | 418,119                   | —              | 418,119      |
| Commercial and Industrial:              |                           |                |             |                           |                |              |
| Other Commercial                        | 158,434                   | 80,067         | 238,501     | 103,586                   | —              | 103,586      |
| Agricultural and other loans to farmers | 31,459                    | —              | 31,459      | 31,808                    | —              | 31,808       |
| Tax exempt                              | 38,258                    | 41,784         | 80,042      | 15,846                    | —              | 15,846       |
| Total Commercial and Industrial:        | 228,151                   | 121,851        | 350,002     | 151,240                   | —              | 151,240      |
| Total Commercial Loans:                 | 658,905                   | 429,681        | 1,088,586   | 569,359                   | —              | 569,359      |
| Residential Real Estate:                |                           |                |             |                           |                |              |
| Residential mortgages                   | 549,578                   | 611,254        | 1,160,832   | 506,612                   | —              | 506,612      |
| Total Residential Real Estate:          | 549,578                   | 611,254        | 1,160,832   | 506,612                   | —              | 506,612      |
| Consumer:                               |                           |                |             |                           |                |              |
| Home equity                             | 47,762                    | 68,707         | 116,469     | 46,921                    | —              | 46,921       |
| Other consumer                          | 7,693                     | 3,067          | 10,760      | 6,172                     | —              | 6,172        |
| Total Consumer:                         | 55,455                    | 71,774         | 127,229     | 53,093                    | —              | 53,093       |
| Total Loans:                            | \$1,263,938               | \$1,112,709    | \$2,376,647 | \$1,129,064               | \$             | —\$1,129,064 |

The carrying amount of the acquired loans at June 30, 2017 totaled \$1.113 billion. A subset of these loans was determined to have evidence of credit deterioration at acquisition date, which is accounted for in accordance with ASC 310-30. These purchased credit-impaired loans presently maintain a carrying value of \$15.6 million (and a note balance of \$21.1 million). These loans are evaluated for impairment through the periodic reforecasting of expected cash flows. Loans considered not impaired at acquisition date had a carrying amount of \$1.097 billion.



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The following table summarizes activity in the accretable yield for the acquired loan portfolio that falls under the purview of ASC 310-30, Accounting for Certain Loans or Debt Securities Acquired in a Transfer:

|   | Three Months<br>Ended June<br>30, |      |
|---|-----------------------------------|------|
| (In thousands)  | 2017                              | 2016 |
| Balance at beginning of period  | \$3,194                           | \$ — |
| Acquisitions  | —                                 | —    |
| Reclassification from nonaccretable difference for loans with improved cash flows | 1,745                             | —    |
| Accretion   | (372 )                            | —    |
| Balance at end of period  | \$4,567                           | \$ — |

  

|   | Six Months<br>Ended June<br>30, |      |
|---|---------------------------------|------|
| (In thousands)  | 2017                            | 2016 |
| Balance at beginning of period  | \$—                             | \$ — |
| Acquisitions  | 3,398                           | —    |
| Reclassification from nonaccretable difference for loans with improved cash flows | 1,745                           | —    |
| Accretion   | (576 )                          | —    |
| Balance at end of period  | \$4,567                         | \$ — |

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The following is a summary of past due loans at June 30, 2017 and December 31, 2016:

## Business Activities Loans

| (in thousands)                             | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | 90<br>Days or<br>Greater<br>Past<br>Due | Total Past<br>Due | Current      | Total<br>Loans | Past Due ><br>90 days and<br>Accruing |
|--|------------------------|------------------------|---|-------------------|--------------|----------------|---------------------------------------|
| June 30, 2017                              |                        |                        |   |                   |              |                |                                       |
| Commercial Real Estate:                    |                        |                        |   |                   |              |                |                                       |
| Construction and land development          | \$ —                   | \$ —                   | \$ 637                                  | \$ 637            | \$ 26,791    | \$ 27,428      | \$ —                                  |
| Other commercial real estate               | 640                    | 200                    | 635                                     | 1,475             | 401,851      | 403,326        | —                                     |
| Total Commercial Real Estate:              | 640                    | 200                    | 1,272                                   | 2,112             | 428,642      | 430,754        | —                                     |
| Commercial and Industrial:                 |                        |                        |   |                   |              |                |                                       |
| Other Commercial                           | 3,816                  | 29                     | 159                                     | 4,004             | 154,430      | 158,434        | —                                     |
| Agricultural and other loans to<br>farmers | 84                     | 105                    | —                                       | 189               | 31,270       | 31,459         | —                                     |
| Tax exempt                                 | —                      | —                      | —                                       | —                 | 38,258       | 38,258         | —                                     |
| Total Commercial and Industrial:           | 3,900                  | 134                    | 159                                     | 4,193             | 223,958      | 228,151        | —                                     |
| Total Commercial Loans:                    | 4,540                  | 334                    | 1,431                                   | 6,305             | 652,600      | 658,905        | —                                     |
| Residential Real Estate:                   |                        |                        |   |                   |              |                |                                       |
| Residential mortgages                      | 587                    | 3,291                  | 719                                     | 4,597             | 544,981      | 549,578        | —                                     |
| Total Residential Real Estate:             | 587                    | 3,291                  | 719                                     | 4,597             | 544,981      | 549,578        | —                                     |
| Consumer:                                  |                        |                        |   |                   |              |                |                                       |
| Home equity                                | 891                    | 55                     | 13                                      | 959               | 46,803       | 47,762         | —                                     |
| Other consumer                             | 104                    | 14                     | 9                                       | 127               | 7,566        | 7,693          | —                                     |
| Total Consumer:                            | 995                    | 69                     | 22                                      | 1,086             | 54,369       | 55,455         | —                                     |
| Total Loans:                               | \$ 6,122               | \$ 3,694               | \$ 2,172                                | \$ 11,988         | \$ 1,251,950 | \$ 1,263,938   | \$ —                                  |

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## Business Activities Loans

| (in thousands)                             | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | 90<br>Days or<br>Greater<br>Past<br>Due | Total Past<br>Due | Current      | Total Loans  | Past Due ><br>90 days and<br>Accruing |
|--|------------------------|------------------------|---|-------------------|--------------|--------------|---------------------------------------|
| December 31, 2016                          |                        |                        |   |                   |              |              |                                       |
| Commercial Real Estate:                    |                        |                        |   |                   |              |              |                                       |
| Construction and land development          | \$ —                   | \$ —                   | \$ —                                    | \$ —              | \$ 14,695    | \$ 14,695    | \$ —                                  |
| Other commercial real estate               | 195                    | 554                    | 1,665                                   | 2,414             | 401,010      | 403,424      | —                                     |
| Total Commercial Real Estate:              | 195                    | 554                    | 1,665                                   | 2,414             | 415,705      | 418,119      | —                                     |
| Commercial and Industrial:                 |                        |                        |   |                   |              |              |                                       |
| Other Commercial                           | 61                     | 45                     | 201                                     | 307               | 103,279      | 103,586      | —                                     |
| Agricultural and other loans to<br>farmers | 231                    | —                      | —                                       | 231               | 31,577       | 31,808       | —                                     |
| Tax exempt                                 | —                      | —                      | —                                       | —                 | 15,846       | 15,846       | —                                     |
| Total Commercial and Industrial:           | 292                    | 45                     | 201                                     | 538               | 150,702      | 151,240      | —                                     |
| Total Commercial Loans:                    | 487                    | 599                    | 1,866                                   | 2,952             | 566,407      | 569,359      | —                                     |
| Residential Real Estate:                   |                        |                        |   |                   |              |              |                                       |
| Residential mortgages                      | 4,484                  | 429                    | 938                                     | 5,851             | 500,761      | 506,612      | —                                     |
| Total Residential Real Estate:             | 4,484                  | 429                    | 938                                     | 5,851             | 500,761      | 506,612      | —                                     |
| Consumer:                                  |                        |                        |   |                   |              |              |                                       |
| Home equity                                | —                      | —                      | 15                                      | 15                | 46,906       | 46,921       | —                                     |
| Other consumer                             | 103                    | 1                      | 6                                       | 110               | 6,062        | 6,172        | —                                     |
| Total Consumer:                            | 103                    | 1                      | 21                                      | 125               | 52,968       | 53,093       | —                                     |
| Total Loans:                               | \$ 5,074               | \$ 1,029               | \$ 2,825                                | \$ 8,928          | \$ 1,120,136 | \$ 1,129,064 | \$ —                                  |

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## Acquired Loans

| (in thousands)                             | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | 90<br>Days or<br>Greater<br>Past<br>Due | Total Past<br>Due | Acquired<br>Credit<br>Impaired | Total Loans  | Past Due ><br>90 days and<br>Accruing |
|--|------------------------|------------------------|---|-------------------|--------------------------------|--------------|---------------------------------------|
| June 30, 2017                              |                        |                        |   |                   |                                |              |                                       |
| Commercial Real Estate:                    |                        |                        |   |                   |                                |              |                                       |
| Construction and land development          | \$ 21                  | \$ —                   | \$ —                                    | \$ 21             | \$ 300                         | \$ 16,467    | \$ —                                  |
| Other commercial real estate               | 400                    | 56                     | 196                                     | 652               | 10,416                         | 291,363      | —                                     |
| Total Commercial Real Estate:              | 421                    | 56                     | 196                                     | 673               | 10,716                         | 307,830      | —                                     |
| Commercial and Industrial:                 |                        |                        |   |                   |                                |              |                                       |
| Other Commercial                           | 459                    | 246                    | 33                                      | 738               | 1,217                          | 80,067       | 6                                     |
| Agricultural and other loans to<br>farmers | —                      | —                      | —                                       | —                 | —                              | —            | —                                     |
| Tax exempt                                 | —                      | —                      | —                                       | —                 | —                              | 41,784       | —                                     |
| Total Commercial and Industrial:           | 459                    | 246                    | 33                                      | 738               | 1,217                          | 121,851      | 6                                     |
| Total Commercial Loans:                    | 880                    | 302                    | 229                                     | 1,411             | 11,933                         | 429,681      | 6                                     |
| Residential Real Estate:                   |                        |                        |   |                   |                                |              |                                       |
| Residential mortgages                      | 680                    | 202                    | 469                                     | 1,351             | 3,640                          | 611,254      | —                                     |
| Total Residential Real Estate:             | 680                    | 202                    | 469                                     | 1,351             | 3,640                          | 611,254      | —                                     |
| Consumer:                                  |                        |                        |   |                   |                                |              |                                       |
| Home equity                                | 793                    | 13                     | —                                       | 806               | 42                             | 68,707       | —                                     |
| Other consumer                             | 15                     | 13                     | 3                                       | 31                | 19                             | 3,067        | —                                     |
| Total Consumer:                            | 808                    | 26                     | 3                                       | 837               | 61                             | 71,774       | —                                     |
| Total Loans:                               | \$ 2,368               | \$ 530                 | \$ 701                                  | \$ 3,599          | \$ 15,634                      | \$ 1,112,709 | \$ 6                                  |



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## Non Accrual Loans

The following is summary information pertaining to non-accrual loans at June 30, 2017 and December 31, 2016:

| (In thousands)                          | June 30, 2017                   |                   |         | December 31, 2016               |                   |          |
|---|---------------------------------|-------------------|---------|---------------------------------|-------------------|----------|
|   | Business<br>Activities<br>Loans | Acquired<br>Loans | Total   | Business<br>Activities<br>Loans | Acquired<br>Loans | Total    |
| Commercial Real Estate:                 |                                 |                   |         |                                 |                   |          |
| Construction and land development       | \$637                           | \$ —              | \$637   | \$—                             | \$ —              | —\$—     |
| Other commercial real estate            | 1,257                           | 197               | 1,454   | 2,564                           | —                 | 2,564    |
| Total Commercial Real Estate:           | 1,894                           | 197               | 2,091   | 2,564                           | —                 | 2,564    |
| Commercial and Industrial:              |                                 |                   |         |                                 |                   |          |
| Other Commercial                        | 191                             | 33                | 224     | 284                             | —                 | 284      |
| Agricultural and other loans to farmers | 46                              | —                 | 46      | 31                              | —                 | 31       |
| Tax exempt                              | —                               | —                 | —       | —                               | —                 | —        |
| Total Commercial and Industrial:        | 237                             | 33                | 270     | 315                             | —                 | 315      |
| Total Commercial Loans:                 | 2,131                           | 230               | 2,361   | 2,879                           | —                 | 2,879    |
| Residential Real Estate:                |                                 |                   |         |                                 |                   |          |
| Residential mortgages                   | 2,313                           | 469               | 2,782   | 3,419                           | —                 | 3,419    |
| Total Residential Real Estate:          | 2,313                           | 469               | 2,782   | 3,419                           | —                 | 3,419    |
| Consumer:                               |                                 |                   |         |                                 |                   |          |
| Home equity                             | 65                              | —                 | 65      | 90                              | —                 | 90       |
| Other consumer                          | 92                              | 3                 | 95      | 108                             | —                 | 108      |
| Total Consumer:                         | 157                             | 3                 | 160     | 198                             | —                 | 198      |
| Total Loans:                            | \$4,601                         | \$ 702            | \$5,303 | \$6,496                         | \$ —              | —\$6,496 |



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Loans evaluated for impairment as of June 30, 2017 and December 31, 2016 were as follows:

## Business Activities Loans

| (In thousands)                        | Commercial<br>real estate | Commercial<br>and<br>industrial | Residential<br>real estate | Consumer  | Total        |
|---------------------------------------|---------------------------|---------------------------------|----------------------------|-----------|--------------|
| June 30, 2017                         |                           |                                 |                            |           |              |
| Loans receivable:                     |                           |                                 |                            |           |              |
| Balance at end of period              |                           |                                 |                            |           |              |
| Individually evaluated for impairment | \$ 3,916                  | \$ 479                          | \$ 1,858                   | \$ 61     | \$ 6,314     |
| Collectively evaluated                | 426,838                   | 227,672                         | 547,720                    | 55,394    | 1,257,624    |
| Total                                 | \$ 430,754                | \$ 228,151                      | \$ 549,578                 | \$ 55,455 | \$ 1,263,938 |

## Business Activities Loans

| (In thousands)                        | Commercial<br>real estate | Commercial<br>and<br>industrial | Residential<br>real estate | Consumer  | Total        |
|---------------------------------------|---------------------------|---------------------------------|----------------------------|-----------|--------------|
| December 31, 2016                     |                           |                                 |                            |           |              |
| Loans receivable:                     |                           |                                 |                            |           |              |
| Balance at end of period              |                           |                                 |                            |           |              |
| Individually evaluated for impairment | \$ 4,481                  | \$ 486                          | \$ 1,709                   | \$ 33     | \$ 6,709     |
| Collectively evaluated                | 413,638                   | 150,754                         | 504,903                    | 53,060    | 1,122,355    |
| Total                                 | \$ 418,119                | \$ 151,240                      | \$ 506,612                 | \$ 53,093 | \$ 1,129,064 |

## Acquired Loans

| (In thousands)                        | Commercial<br>real estate | Commercial<br>and<br>industrial | Residential<br>real estate | Consumer  | Total        |
|---------------------------------------|---------------------------|---------------------------------|----------------------------|-----------|--------------|
| June 30, 2017                         |                           |                                 |                            |           |              |
| Loans receivable:                     |                           |                                 |                            |           |              |
| Balance at end of period              |                           |                                 |                            |           |              |
| Individually evaluated for impairment | \$ —                      | \$ —                            | \$ —                       | \$ —      | \$ —         |
| Purchased credit-impaired loans       | 10,716                    | 1,217                           | 3,640                      | 60        | 15,633       |
| Collectively evaluated                | 297,114                   | 120,634                         | 607,614                    | 71,714    | 1,097,076    |
| Total                                 | \$ 307,830                | \$ 121,851                      | \$ 611,254                 | \$ 71,774 | \$ 1,112,709 |

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The following is a summary of impaired loans at June 30, 2017 and December 31, 2016:

## Business Activities Loans

| (In thousands)                          | June 30, 2017 |                                     | Related Allowance |
|---|---------------|-------------------------------------|-------------------|
|   | Recorded      | Unpaid Principal Investment Balance |                   |
| With no related allowance:              |               |                                     |                   |
| Construction and land development       | \$—           | \$ —                                | \$ —              |
| Commercial real estate other            | 2,522         | 2,701                               | —                 |
| Commercial other                        | 366           | 368                                 | —                 |
| Agricultural and other loans to farmers | 69            | 73                                  | —                 |
| Tax exempt loans                        | —             | —                                   | —                 |
| Residential real estate                 | 1,700         | 1,855                               | —                 |
| Home equity                             | 13            | 13                                  | —                 |
| Consumer other                          | 48            | 50                                  | —                 |
| With an allowance recorded:             |               |                                     |                   |
| Construction and land development       | \$637         | \$ 2,562                            | \$ 59             |
| Commercial real estate other            | 757           | 812                                 | 321               |
| Commercial other                        | 44            | 44                                  | 4                 |
| Agricultural and other loans to farmers | —             | —                                   | —                 |
| Tax exempt loans                        | —             | —                                   | —                 |
| Residential real estate                 | 158           | 158                                 | 10                |
| Home equity                             | —             | —                                   | —                 |
| Consumer other                          | —             | —                                   | —                 |
| Total                                   |               |                                     |                   |
| Commercial real estate                  | \$3,916       | \$ 6,075                            | \$ 380            |
| Commercial and industrial               | 479           | 485                                 | 4                 |
| Residential real estate                 | 1,858         | 2,013                               | 10                |
| Consumer                                | 61            | 63                                  | —                 |
| Total impaired loans                    | \$6,314       | \$ 8,636                            | \$ 394            |

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## Business Activities Loans

| (In thousands)                          | December 31, 2016 |                                     |                   |
|---|-------------------|-------------------------------------|-------------------|
|   | Recorded          | Unpaid Principal Investment Balance | Related Allowance |
| With no related allowance:              |                   |                                     |                   |
| Construction and land development       | \$—               | \$ —                                | \$ —              |
| Commercial real estate other            | 2,831             | 2,919                               | —                 |
| Commercial other                        | 130               | 130                                 | —                 |
| Agricultural and other loans to farmers | 139               | 139                                 | —                 |
| Tax exempt loans                        | —                 | —                                   | —                 |
| Residential real estate                 | 1,387             | 1,504                               | —                 |
| Home equity                             | 16                | 16                                  | —                 |
| Consumer other                          | 2                 | 2                                   | —                 |
| With an allowance recorded:             |                   |                                     |                   |
| Construction and land development       | \$—               | \$ —                                | \$ —              |
| Commercial real estate other            | 1,650             | 3,575                               | 193               |
| Commercial other                        | 217               | 367                                 | 173               |
| Agricultural and other loans to farmers | —                 | —                                   | —                 |
| Tax exempt loans                        | —                 | —                                   | —                 |
| Residential real estate                 | 322               | 322                                 | 49                |
| Home equity                             | —                 | —                                   | —                 |
| Consumer other                          | 15                | 15                                  | 9                 |
| Total                                   |                   |                                     |                   |
| Commercial real estate                  | \$4,481           | \$ 6,494                            | \$ 193            |
| Commercial and industrial               | 486               | 636                                 | 173               |
| Residential real estate                 | 1,709             | 1,826                               | 49                |
| Consumer                                | 33                | 33                                  | 9                 |
| Total impaired loans                    | \$6,709           | \$ 8,989                            | \$ 424            |



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The following is a summary of the average recorded investment and interest income recognized on impaired loans as of June 30, 2017 and 2016:

## Business Activities Loan

| (in thousands)                          | Six Months Ended June 30,<br>2017 |                                       | Six Months Ended June 30,<br>2016 |                                       |
|---|-----------------------------------|---------------------------------------|-----------------------------------|---------------------------------------|
|   | Average Recorded Investment       | Cash Basis Interest Income Recognized | Average Recorded Investment       | Cash Basis Interest Income Recognized |
| With no related allowance:              |                                   |                                       |                                   |                                       |
| Construction and land development       | \$ —                              | \$ —                                  | \$ —                              | \$ —                                  |
| Commercial real estate other            | 2,499                             | 64                                    | 1,850                             | 32                                    |
| Commercial other                        | 349                               | 6                                     | 92                                | 2                                     |
| Agricultural and other loans to farmers | 70                                | 1                                     | 128                               | 3                                     |
| Tax exempt loans                        | —                                 | —                                     | —                                 | —                                     |
| Residential real estate                 | 2,130                             | 21                                    | 1,214                             | 17                                    |
| Home equity                             | 13                                | —                                     | 16                                | —                                     |
| Consumer other                          | 64                                | 2                                     | —                                 | —                                     |
| With an allowance recorded:             |                                   |                                       |                                   |                                       |
| Construction and land development       | \$ 637                            | \$ —                                  | \$ 865                            | \$ —                                  |
| Commercial real estate other            | 772                               | —                                     | 482                               | —                                     |
| Commercial other                        | 44                                | 1                                     | 221                               | —                                     |
| Agricultural and other loans to farmers | —                                 | —                                     | —                                 | —                                     |
| Tax exempt loans                        | —                                 | —                                     | —                                 | —                                     |
| Residential real estate                 | 156                               | 5                                     | 513                               | —                                     |
| Home equity                             | —                                 | —                                     | —                                 | —                                     |
| Consumer other                          | —                                 | —                                     | 7                                 | —                                     |
| Total                                   |                                   |                                       |                                   |                                       |
| Commercial real estate                  | \$ 3,908                          | \$ 64                                 | \$ 3,197                          | \$ 32                                 |
| Commercial and industrial               | 463                               | 8                                     | 441                               | 5                                     |
| Residential real estate                 | 2,286                             | 26                                    | 1,727                             | 17                                    |
| Consumer                                | 77                                | 2                                     | 23                                | —                                     |
| Total impaired loans                    | \$ 6,734                          | \$ 100                                | \$ 5,388                          | \$ 54                                 |

## Troubled Debt Restructuring Loans

The Company's loan portfolio also includes certain loans that have been modified in a Troubled Debt Restructuring ("TDR"), where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months. TDRs are evaluated individually for impairment and may result in a specific allowance amount allocated to an individual loan.



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The following tables include the recorded investment and number of modifications identified during the three and six months ended June 30, 2017 and for the three and six months ended June 30, 2016, respectively. The table includes the recorded investment in the loans prior to a modification and also the recorded investment in the loans after the loans were restructured. The modifications for the three and six months ended June 30, 2017 were attributable to interest rate concessions, maturity date extensions, reamortization or a combination of two concessions. The modifications for the three and six months ending June 30, 2016 were attributable to interest rate concessions, maturity date extensions or a combination of both.

| (Dollars in thousands)                  | Three Months Ended June 30, 2017  |  |
|---|---|--|
|   | Pre-Modification<br>Number of<br>Outstanding<br>Modifications<br>Investment | Post-Modification<br>Recorded<br>Outstanding<br>Recorded<br>Investment |
| Troubled Debt Restructurings            |   |  |
| Commercial installment                  | — \$ —  | \$ —   |
| Agricultural and other loans to farmers | 1 19  | 18   |
| Commercial real estate                  | 2 245   | 245  |
| Residential real estate                 | 1 118   | 117  |
| Home equity                             | 1 13  | 13   |
| Consumer other                          | —   | —  |
| Total                                   | 5 \$ 395  | \$ 393   |

| (Dollars in thousands)       | Three Months Ended June 30, 2016  |  |
|------------------------------|---|--|
|                              | Pre-Modification<br>Number of<br>Outstanding<br>Modifications<br>Investment | Post-Modification<br>Recorded<br>Outstanding<br>Recorded<br>Investment |
| Troubled Debt Restructurings |   |  |
| Commercial real estate       | 1 \$ 30   | \$ 30  |
| Total                        | 1 \$ 30   | \$ 30  |

| (Dollars in thousands)                  | Six Months Ended June 30, 2017  |  |
|---|---|--|
|   | Pre-Modification<br>Number of<br>Outstanding<br>Modifications<br>Investment | Post-Modification<br>Recorded<br>Outstanding<br>Recorded<br>Investment |
| Troubled Debt Restructurings            |   |  |
| Commercial installment                  | 1 \$ 80   | \$ 77  |
| Agricultural and other loans to farmers | 1 19  | 18   |
| Commercial real estate                  | 2 245   | 245  |
| Residential real estate                 | 3 692   | 682  |
| Home equity                             | 1 13  | 13   |
| Consumer other                          | 1 38  | 37   |
| Total                                   | 9 \$ 1,087  | \$ 1,072   |

| (Dollars in thousands)                  | Six Months Ended June 30, 2016  |  |
|---|---|--|
|   | Pre-Modification<br>Number of<br>Outstanding<br>Modifications<br>Investment | Post-Modification<br>Recorded<br>Outstanding<br>Recorded<br>Investment |
| Troubled Debt Restructurings            |   |  |
| Commercial real estate                  | 3 \$ 425  | \$ 418   |
| Agricultural and other loans to farmers | 2 30  | 25   |
| Total                                   | 5 \$ 455  | \$ 443   |

For the three and six months ended June 30, 2017, there were no loans that were restructured that had subsequently defaulted during the period.



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The evaluation of certain loans individually for specific impairment includes loans that were previously classified as TDRs or continue to be classified as TDRs.

As of June 30, 2017, the Company maintained foreclosed residential real estate property with a fair value of \$122 thousand. Additionally, residential mortgage loans collateralized by real estate property that are in the process of foreclosure as of June 30, 2017 and December 31, 2016 totaled \$991 thousand and \$2.4 million, respectively. As of December 31, 2016, foreclosed residential real estate property totaled \$90 thousand.

## NOTE 5. LOAN LOSS ALLOWANCE

Activity in the allowance for loan losses for the six months ended June 30, 2017 and 2016 was as follows:

| Business Activities Loans<br><br>(In thousands) | At or for the six months ended June 30, 2017 |                                 |                            |          |          |
|---|--|---------------------------------|----------------------------|----------|----------|
|   | Commercial<br>real estate                    | Commercial<br>and<br>industrial | Residential<br>real estate | Consumer | Total    |
| Balance at beginning of period                  | \$5,145                                      | \$ 1,952                        | \$ 2,721                   | \$ 601   | \$10,419 |
| Charged-off loans                               | (147 )                                       | (189 )                          | (226 )                     | (17 )    | (579 )   |
| Recoveries on charged-off loans                 | 3  | 2                               | 64                         | 2        | 71       |
| Provision/(releases) for loan losses            | 502  | 345                             | 560                        | 15       | 1,422    |
| Balance at end of period                        | \$5,503                                      | \$ 2,110                        | \$ 3,119                   | \$ 601   | \$11,333 |
| Individually evaluated for impairment           | 380  | 4                               | 10                         | —        | 394      |
| Collectively evaluated                          | 5,123  | 2,106                           | 3,109                      | 601      | 10,939   |
| Total   | \$5,503                                      | \$ 2,110                        | \$ 3,119                   | \$ 601   | \$11,333 |

| Business Activities Loans<br><br>(In thousands) | At or for the six months ended June 30, 2016 |                                 |                            |          |         |
|---|--|---------------------------------|----------------------------|----------|---------|
|   | Commercial<br>real estate                    | Commercial<br>and<br>industrial | Residential<br>real estate | Consumer | Total   |
| Balance at beginning of period                  | \$4,430                                      | \$ 1,590                        | \$ 2,747                   | \$ 672   | \$9,439 |
| Charged-off loans                               | (34 )  | (90 )                           | (122 )                     | (17 )    | (263 )  |
| Recoveries on charged-off loans                 | 13   | 44                              | 28                         | 15       | 100     |
| Provision/(releases) for loan losses            | 451  | 157                             | 30                         | (23 )    | 615     |
| Balance at end of period                        | \$4,860                                      | \$ 1,701                        | \$ 2,683                   | \$ 647   | \$9,891 |
| Individually evaluated for impairment           | 103  | 175                             | 54                         | 38       | 370     |
| Collectively evaluated                          | 4,757  | 1,526                           | 2,629                      | 609      | 9,521   |
| Total   | \$4,860                                      | \$ 1,701                        | \$ 2,683                   | \$ 647   | \$9,891 |

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| Acquired Loans<br><br>(In thousands)  | At or for the six months ended June 30, 2017   |                                 |                            |          |        |
|---------------------------------------|--|---------------------------------|----------------------------|----------|--------|
|                                       | Commercial<br>real estate<br>and<br>industrial | Commercial<br>and<br>industrial | Residential<br>real estate | Consumer | Total  |
| Balance at beginning of period        | \$—  | \$ —                            | \$ —                       | \$       | —\$—   |
| Charged-off loans                     | —  | —                               | —                          | —        | —      |
| Recoveries on charged-off loans       | —  | —                               | —                          | —        | —      |
| Provision/(releases) for loan losses  | 51   | 24                              | 34                         | —        | 109    |
| Balance at end of period              | \$51   | \$ 24                           | \$ 34                      | \$       | —\$109 |
| Individually evaluated for impairment | 51   | 24                              | 34                         | —        | 109    |
| Collectively evaluated                | —  | —                               | —                          | —        | —      |
| Total                                 | \$51   | \$ 24                           | \$ 34                      | \$       | —\$109 |

There were no loans meeting the definition of acquired for the six month period ending June 30, 2016

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

**Credit Quality Indicators/Classified Loans:** In monitoring the credit quality of the portfolio, management applies a credit quality indicator and uses an internal risk rating system to categorize commercial loans. These credit quality indicators range from one through nine, with a higher number correlating to increasing risk of loss. These ratings are used as inputs to the calculation of the allowance for loan losses. Consistent with regulatory guidelines, the Bank provides for the classification of loans which are considered to be of lesser quality as substandard, doubtful, or loss (i.e. risk rated 7, 8 and 9, respectively).

The following are the definitions of the Bank's credit quality indicators:

**Pass:** Loans within all classes of commercial portfolio segments that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan agreement. Management believes that there is a low risk of loss related to these loans that are considered pass.

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

**Substandard:** The Bank considers a loan substandard if it is inadequately protected by the current net worth and

paying capacity of the borrower or of the collateral pledged, if any. Substandard loans have a well-defined weakness that jeopardizes liquidation of the debt. Substandard loans include those loans where there is the distinct possibility of some loss of principal, if the deficiencies are not corrected.

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

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

The following tables present the Company's loans by risk rating at June 30, 2017 and December 31, 2016:

## Business Activities Loans

## Commercial Real Estate

## Credit Risk Profile by Creditworthiness Category

| (In thousands)  | Construction and land development |                   | Commercial real estate other |                   | Total commercial real estate |                   |
|-----------------|-----------------------------------|-------------------|------------------------------|-------------------|------------------------------|-------------------|
|                 | June 30, 2017                     | December 31, 2016 | June 30, 2017                | December 31, 2016 | June 30, 2017                | December 31, 2016 |
|                 | Grade:                            |                   |                              |                   |                              |                   |
| Pass            | \$26,762                          | \$14,695          | \$379,961                    | \$376,968         | \$406,723                    | \$391,663         |
| Special mention | 29                                | —                 | 6,882                        | 5,868             | 6,911                        | 5,868             |
| Substandard     | 637                               | —                 | 16,483                       | 20,588            | 17,120                       | 20,588            |
| Total           | \$27,428                          | \$14,695          | \$403,326                    | \$403,424         | \$430,754                    | \$418,119         |

## Commercial and Industrial

## Credit Risk Profile by Creditworthiness Category

| (In thousands)  | Commercial other |                   | Agricultural and other loans to farmers |                   | Tax exempt loans |                   | Total commercial and industrial |                   |
|-----------------|------------------|-------------------|---|-------------------|------------------|-------------------|---------------------------------|-------------------|
|                 | June 30, 2017    | December 31, 2016 | June 30, 2017                           | December 31, 2016 | June 30, 2017    | December 31, 2016 | June 30, 2017                   | December 31, 2016 |
|                 | Grade:           |                   |   |                   |                  |                   |                                 |                   |
| Pass            | \$154,639        | \$98,968          | \$31,014                                | \$31,279          | \$38,091         | \$15,679          | \$223,747                       | \$145,926         |
| Special mention | 2,036            | 2,384             | 181                                     | 251               | 167              | 167               | 2,384                           | 2,802             |
| Substandard     | 1,759            | 2,234             | 264                                     | 278               | —                | —                 | 2,023                           | 2,512             |
| Total           | \$158,434        | \$103,586         | \$31,459                                | \$31,808          | \$38,258         | \$15,846          | \$228,151                       | \$151,240         |

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## Acquired Loans

## Commercial Real Estate

## Credit Risk Profile by Creditworthiness Category

|                 | Commercial construction and land development |                   | Commercial real estate other |                   | Total commercial real estate |                   |
|-----------------|--|-------------------|------------------------------|-------------------|------------------------------|-------------------|
| (In thousands)  | June 30, 2017                                | December 31, 2016 | June 30, 2017                | December 31, 2016 | June 30, 2017                | December 31, 2016 |
| Grade:          |  |                   |                              |                   |                              |                   |
| Pass            | \$ 16,167                                    | \$ —              | —\$280,638                   | \$ —              | —\$ 296,805                  | \$ —              |
| Special mention | —  | —                 | 1,558                        | —                 | 1,558                        | —                 |
| Substandard     | 300  | —                 | 9,167                        | —                 | 9,467                        | —                 |
| Total           | \$ 16,467                                    | \$ —              | —\$291,363                   | \$ —              | —\$ 307,830                  | \$ —              |

## Commercial and Industrial

## Credit Risk Profile by Creditworthiness Category

|                 | Commercial other |                   | Agricultural and other loans to farmers |                   | Tax exempt loans |                   | Total commercial and industrial |                   |
|-----------------|------------------|-------------------|---|-------------------|------------------|-------------------|---------------------------------|-------------------|
| (In thousands)  | June 30, 2017    | December 31, 2016 | June 30, 2017                           | December 31, 2016 | June 30, 2017    | December 31, 2016 | June 30, 2017                   | December 31, 2016 |
| Grade:          |                  |                   |   |                   |                  |                   |                                 |                   |
| Pass            | \$ 78,141        | \$ —              | —\$ —                                   | —\$ —             | —\$41,784        | \$ —              | —\$119,925                      | \$ —              |
| Special mention | 875              | —                 | —                                       | —                 | —                | —                 | 875                             | —                 |
| Substandard     | 1,051            | —                 | —                                       | —                 | —                | —                 | 1,051                           | —                 |
| Total           | \$ 80,067        | \$ —              | —\$ —                                   | —\$ —             | —\$41,784        | \$ —              | —\$121,851                      | \$ —              |

The following table summarizes information about total loans rated Special Mention or higher as of June 30, 2017 and December 31, 2016. The table below includes consumer loans that are special mention and substandard accruing that are classified in the above table as performing based on payment activity.

| (In thousands)       | June 30, 2017       |                |          | December 31, 2016   |                |           |
|----------------------|---------------------|----------------|----------|---------------------|----------------|-----------|
|                      | Business Activities | Acquired Loans | Total    | Business Activities | Acquired Loans | Total     |
| Non-accrual          | \$4,601             | \$ 702         | \$5,303  | \$2,733             | \$ —           | —\$2,733  |
| Substandard accruing | 26,113              | 10,051         | 36,164   | 20,368              | —              | 20,368    |
| Total classified     | 30,714              | 10,753         | 41,467   | 23,101              | —              | 23,101    |
| Special mention      | 9,294               | 2,433          | 11,727   | 8,669               | —              | 8,669     |
| Total Criticized     | \$40,008            | \$ 13,186      | \$53,194 | \$31,770            | \$ —           | —\$31,770 |

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## NOTE 6. BORROWED FUNDS

Borrowed funds at June 30, 2017 and December 31, 2016 are summarized, as follows:

| (dollars in thousands)         | June 30, 2017 |                       | December 31, 2016 |                       |
|--------------------------------|---------------|-----------------------|-------------------|-----------------------|
|                                | Principal     | Weighted Average Rate | Principal         | Weighted Average Rate |
| Short-term borrowings          |               |                       |                   |                       |
| Advances from the FHLBB        | \$624,032     | 1.34 %                | \$372,700         | 0.97 %                |
| Other borrowings               | 35,174        | 0.51                  | 21,780            | 0.29                  |
| Total short-term borrowings    | 659,206       | 1.29                  | 394,480           | 0.93                  |
| Long-term borrowings           |               |                       |                   |                       |
| Advances from the FHLBB        | 212,815       | 1.45                  | 137,116           | 1.59                  |
| Subordinated borrowings        | 38,063        | 5.66                  | —                 | —                     |
| Junior subordinated borrowings | 5,000         | 4.69                  | 5,000             | 4.41                  |
| Total long-term borrowings     | 255,878       | 2.14                  | 142,116           | 1.69                  |
| Total                          | \$915,084     | 1.53 %                | \$536,596         | 1.13 %                |

Short term debt includes Federal Home Loan Bank of Boston (“FHLBB”) advances with an original maturity of less than one year. The Bank also maintains a \$1.0 million secured line of credit with the FHLBB that bears a daily adjustable rate calculated by the FHLBB. There was no outstanding balance on the FHLBB line of credit for the periods ended June 30, 2017 and December 31, 2016.

The Bank also had capacity to borrow funds on a secured basis utilizing the Borrower in Custody program and the Discount Window at the Federal Reserve Bank of Boston (the “FRB”). At June 30, 2017, the Bank’s available secured line of credit at the FRB was \$128.1 million. The Bank has pledged certain loans and securities to the FRB to support this arrangement. There were no borrowings with the FRB for the periods ended June 30, 2017 and December 31, 2016.

Long-term FHLBB advances consist of advances with a maturity of more than one year. The advances outstanding at June 30, 2017 include callable advances totaling \$29.9 million, and amortizing advances totaling \$691 thousand. The advances outstanding at December 31, 2016 include callable advances totaling \$17.0 million, and no amortizing advances. All FHLBB borrowings, including the line of credit, are secured by a blanket security agreement on certain qualified collateral, principally all residential first mortgage loans and certain securities.

A summary of maturities of FHLBB advances as of June 30, 2017 is as follows:

| (in thousands, except rates)  | June 30, 2017 |                       |
|-------------------------------|---------------|-----------------------|
|                               | Principal     | Weighted Average Rate |
| Fixed rate advances maturing: |               |                       |
| 2017                          | \$609,000     | 1.32 %                |
| 2018                          | 60,841        | 1.57                  |
| 2019                          | 104,927       | 1.63                  |
| 2020                          | 29,886        | 1.76                  |
| 2021                          | 31,470        | 0.56                  |
| 2022 and thereafter           | 691           | 1.48                  |
| Total FHLBB advances          | \$836,815     | 1.37 %                |

In April 2008, the Bank issued fifteen year junior subordinated notes in the amount of \$5.0 million. These debt securities qualify as Tier 2 capital for the Company and the Bank. The subordinated debt securities are callable by the bank

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after five years without penalty. The interest rate is three-month LIBOR plus 3.45%. At June 30, 2017 and December 31, 2016 the interest rate was 4.69% and 4.41%, respectively.

On January 13, 2017, the Company acquired \$17.0 million of subordinated debt in connection with the Lake Sunapee acquisition. The original subordinated debt was issued on October 29, 2014, in connection with the execution of a Subordinated Note Purchase Agreement between and among Lake Sunapee Bank Group and certain accredited investors pursuant to which Lake Sunapee Bank Group issued an aggregate of \$17.0 million of subordinated notes (the "Notes") to the accredited investors. The Notes have a maturity date of November 1, 2024, and will bear interest at a fixed rate of 6.75% per annum. The Company may, at its option, beginning with the interest payment date of November 1, 2019, and on any interest payment date thereafter, redeem the Notes, in whole or in part, at par plus accrued and unpaid interest to the date of redemption. Any partial redemption will be made pro rata among all of the noteholders. The Notes are not subject to repayment at the option of the noteholders. The Notes are unsecured, subordinated obligations of the Company and rank junior in right of payment to the Company's senior indebtedness and to the Company's obligations to its general creditors.

Also in connection with the Lake Sunapee acquisition, the Company acquired 100% of the common securities totaling \$600 thousand and \$20.0 million of Junior Subordinated Deferrable Interest Debentures ("Debentures") issued by NHTB Capital Trust II and NHTB Capital Trust III, which are both Connecticut statutory trusts. The Debentures were originally issued on March 30, 2014, carry a variable interest rate of 3-month LIBOR plus 2.79%, and mature in 2034. The debt is callable by the Company at the time when any interest payment is made. NHTB Trust II and Trust III are considered variable interest entities for which the Company is not the primary beneficiary. Accordingly, Trust II and Trust III are not consolidated into the Company's financial statements.

## NOTE 7. DEPOSITS

A summary of time deposits is as follows:

| (In thousands)           | June 30,<br>2017 | December 31,<br>2016 |
|--------------------------|------------------|----------------------|
| Time less than \$100,000 | \$581,196        | \$ 304,393           |
| Time \$100,000 or more   | 202,680          | 112,044              |
| Total time deposits      | \$783,876        | \$ 416,437           |

Included in time deposits are brokered deposits of \$429.0 million and \$237.9 million at June 30, 2017 and December 31, 2016, respectively. Included in the deposit balances contained on the balance sheet are reciprocal deposits of \$38.4 million and \$43.1 million at June 30, 2017 and December 31, 2016, respectively.



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## NOTE 8. CAPITAL RATIOS AND SHAREHOLDERS' EQUITY

The actual and required capital ratios were as follows:

|  | June 30,<br>2017 | Regulatory<br>Minimum to be<br>Well Capitalized | December 31,<br>2016 | Regulatory<br>Minimum to be<br>Well Capitalized |
|--|------------------|---|----------------------|---|
| Company (consolidated)                               |                  |   |                      |   |
| Total capital to risk weighted assets                | 13.6 %           | 10.0 %  | 16.5 %               | 10.0 %  |
| Common equity tier 1 capital to risk weighted assets | 11.1             | 6.5   | 15.0                 | 6.5   |
| Tier 1 capital to risk weighted assets               | 12.1             | 8.0   | 15.0                 | 8.0   |
| Tier 1 capital to average assets                     | 7.6              | 5.0   | 8.9                  | 5.0   |
| Bank   |                  |   |                      |   |
| Total capital to risk weighted assets                | 13.6 %           | 10.0 %  | 16.7 %               | 10.0 %  |
| Common equity tier 1 capital to risk weighted assets | 12.8             | 6.5   | 15.2                 | 6.5   |
| Tier 1 capital to risk weighted assets               | 12.8             | 8.0   | 15.2                 | 8.0   |
| Tier 1 capital to average assets                     | 8.3              | 5.0   | 9.1                  | 5.0   |

At each date shown, the Company and the Bank met the conditions to be classified as “well capitalized” under the relevant regulatory framework. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table above.

Effective January 1, 2015, the Company and the Bank became subject to the Basel III rule that requires the Company and the Bank to assess their Common equity tier 1 capital to risk weighted assets and the Company and the Bank each exceed the minimum to be well capitalized. In addition, the final capital rules added a requirement to maintain a minimum conservation buffer, composed of common equity tier 1 capital, of 2.5% of risk-weighted assets, to be phased in over three years and applied to the common equity tier 1 risk-based capital ratio, the Tier 1 risk-based capital ratio and the Total risk-based capital ratio. Accordingly, banking organizations, on a fully phased in basis no later than January 1, 2019, must maintain a minimum Common equity tier 1 risk-based capital ratio of 7.0%, a minimum Tier 1 risk-based capital ratio of 8.5% and a minimum Total risk-based capital ratio of 10.5%.

The required minimum conservation buffer began to be phased in incrementally, starting at 0.625% on January 1, 2016 and increasing to 1.25% on January 1, 2017. The buffer will increase to 1.875% on January 1, 2018 and 2.5% on January 1, 2019. The final capital rules impose restrictions on capital distributions and certain discretionary cash bonus payments if the minimum capital conservation buffer is not met.

At June 30, 2017, the capital levels of both the Company and the Bank exceeded all regulatory capital requirements and their regulatory capital ratios were above the minimum levels required to be considered well capitalized for regulatory purposes. The capital levels of both the Company and the Bank at June 30, 2017 also exceeded the minimum capital requirements including the currently applicable capital conservation buffer of 0.625%.

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## Accumulated other comprehensive loss

Components of accumulated other comprehensive income is as follows:

| (In thousands)   | June 30,<br>2017 | December<br>31, 2016 |
|--|------------------|----------------------|
| Other accumulated comprehensive loss, before tax:                      |                  |                      |
| Net unrealized holding gain/(loss) on AFS securities                   | \$ 1,332         | \$ (3,269 )          |
| Net unrealized loss on effective cash flow hedging derivatives         | (3,470 )         | (2,766 )             |
| Net unrealized holding loss on post-retirement plans                   | (580 )           | (622 )               |
| Income taxes related to items of accumulated other comprehensive loss: |                  |                      |
| Net unrealized holding gain/(loss) on AFS securities                   | (496 )           | 1,144                |
| Net unrealized loss on effective cash flow hedging derivatives         | 1,293            | 968                  |
| Net unrealized holding loss on post-retirement plans                   | 216              | 219                  |
| Accumulated other comprehensive loss                                   | \$(1,705)        | \$(4,326 )           |

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The following tables presents the components of other comprehensive income for the three and six months ended June 30, 2017 and 2016:

| (In thousands)  | Before Tax | Tax Effect  | Net of Tax |
|---|------------|-------------|------------|
| Three Months Ended June 30, 2017  |            |             |            |
| Net unrealized holding gain on AFS securities:                              | x          |             |            |
| Net unrealized gain arising during the period                               | \$ 3,485   | \$ (1,292 ) | \$ 2,193   |
| Less: reclassification adjustment for gains (losses) realized in net income | —          | —           | —          |
| Net unrealized holding gain on AFS securities                               | 3,485      | (1,292 )    | 2,193      |
| Net unrealized loss on cash flow hedging derivatives:                       |            |             |            |
| Net unrealized loss arising during the period                               | (481 )     | 242         | (239 )     |
| Less: reclassification adjustment for gains (losses) realized in net income | —          | —           | —          |
| Net unrealized gain on cash flow hedging derivatives                        | (481 )     | 242         | (239 )     |
| Net unrealized holding loss on post-retirement plans:                       |            |             |            |
| Net unrealized gain/(loss) arising during the period                        | (15 )      | 18          | 3          |
| Less: reclassification adjustment for gains (losses) realized in net income | —          | —           | —          |
| Net unrealized holding gain/(loss) on post-retirement plans                 | (15 )      | 18          | 3          |
| Other comprehensive income  | \$ 2,989   | \$ (1,032 ) | \$ 1,957   |
| Three Months Ended June 30, 2016  |            |             |            |
| Net unrealized holding gains on AFS securities:                             |            |             |            |
| Net unrealized gains arising during the period                              | \$ 2,690   | \$ (941 )   | \$ 1,749   |
| Less: reclassification adjustment for gains realized in net income          | —          | —           | —          |
| Net unrealized holding gains on AFS securities                              | 2,690      | (941 )      | 1,749      |
| Net unrealized (loss) on cash flow hedging derivatives:                     |            |             |            |
| Net unrealized (loss) arising during the period                             | (503 )     | 176         | (327 )     |
| Less: reclassification adjustment for gains (losses) realized in net income | —          | —           | —          |
| Net unrealized (loss) on cash flow hedging derivatives                      | (503 )     | 176         | (327 )     |
| Net unrealized holding gain on post-retirement plans:                       |            |             |            |
| Net unrealized gain arising during the period                               | 7          | (3 )        | 4          |
| Less: reclassification adjustment for gains (losses) realized in net income | —          | —           | —          |
| Net unrealized holding gain on post-retirement plans                        | 7          | (3 )        | 4          |
| Other comprehensive income  | \$ 2,194   | \$ (768 )   | \$ 1,426   |

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| (In thousands)  | Before Tax | Tax Effect  | Net of Tax |
|---|------------|-------------|------------|
| Six Months Ended June 30, 2017  |            |             |            |
| Net unrealized holding gain on AFS securities:                              | x          |             |            |
| Net unrealized gain arising during the period                               | \$ 4,601   | \$ (1,640 ) | \$ 2,961   |
| Less: reclassification adjustment for gains (losses) realized in net income | —          | —           | —          |
| Net unrealized holding gain on AFS securities                               | 4,601      | (1,640 )    | 2,961      |
| Net unrealized loss on cash flow hedging derivatives:                       |            |             |            |
| Net unrealized loss arising during the period                               | (704 )     | 325         | (379 )     |
| Less: reclassification adjustment for gains (losses) realized in net income | —          | —           | —          |
| Net unrealized gain on cash flow hedging derivatives                        | (704 )     | 325         | (379 )     |
| Net unrealized holding loss on post-retirement plans:                       |            |             |            |
| Net unrealized gain arising during the period                               | 42         | (3 )        | 39         |
| Less: reclassification adjustment for gains (losses) realized in net income | —          | —           | —          |
| Net unrealized holding gain on post-retirement plans                        | 42         | (3 )        | 39         |
| Other comprehensive income  | \$ 3,939   | \$ (1,318 ) | \$ 2,621   |
| Six Months Ended June 30, 2016  |            |             |            |
| Net unrealized holding gains on AFS securities:                             |            |             |            |
| Net unrealized gains arising during the period                              | \$ 8,618   | \$ (3,016 ) | \$ 5,602   |
| Less: reclassification adjustment for gains realized in net income          | —          | —           | —          |
| Net unrealized holding gains on AFS securities                              | 8,618      | (3,016 )    | 5,602      |
| Net unrealized (loss) on cash flow hedging derivatives:                     |            |             |            |
| Net unrealized (loss) arising during the period                             | (1,217 )   | 426         | (791 )     |
| Less: reclassification adjustment for gains (losses) realized in net income | —          | —           | —          |
| Net unrealized (loss) on cash flow hedging derivatives                      | (1,217 )   | 426         | (791 )     |
| Net unrealized holding gain on post-retirement plans:                       |            |             |            |
| Net unrealized gain arising during the period                               | 78         | (27 )       | 51         |
| Less: reclassification adjustment for gains (losses) realized in net income | —          | —           | —          |
| Net unrealized holding gain on post-retirement plans                        | 78         | (27 )       | 51         |
| Other comprehensive income  | \$ 7,479   | \$ (2,617 ) | \$ 4,862   |



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The following table presents the changes in each component of accumulated other comprehensive income (loss), for the three and six months ended June 30, 2017 and 2016:

| (in thousands)   | Net unrealized<br>holding gain<br>on AFS<br>Securities | Net loss on<br>effective cash<br>flow hedging<br>derivatives | Net unrealized<br>holding loss<br>on pension<br>plans | Total     |
|--|--|--|---|-----------|
| <b>Three Months Ended June 30, 2017</b>                                |  |  |   |           |
| Balance at beginning of period   | \$ (1,357 )  | \$ (1,938 )  | \$ (367 )   | \$(3,662) |
| Other comprehensive gain(loss) before reclassifications                | 2,193  | (239 )   | 3   | 1,957     |
| Less: amounts reclassified from accumulated other comprehensive income | —  | —  | —   | —         |
| Total other comprehensive income                                       | 2,193  | (239 )   | 3   | 1,957     |
| Balance at end of period   | \$ 836   | \$ (2,177 )  | \$ (364 )   | \$(1,705) |
| <b>Three Months Ended June 30, 2016</b>                                |  |  |   |           |
| Balance at beginning of period   | \$ 9,566   | \$ (2,085 )  | \$ (416 )   | \$7,065   |
| Other comprehensive gain before reclassifications                      | 1,749  | (327 )   | 4   | 1,426     |
| Less: amounts reclassified from accumulated other comprehensive income | —  | —  | —   | —         |
| Total other comprehensive income                                       | 1,749  | (327 )   | 4   | 1,426     |
| Balance at end of period   | \$ 11,315  | \$ (2,412 )  | \$ (412 )   | \$8,491   |
| <b>Six Months Ended June 30, 2017</b>                                  |  |  |   |           |
| Balance at beginning of period   | \$ (2,125 )  | \$ (1,798 )  | \$ (403 )   | \$(4,326) |
| Other comprehensive gain(loss) before reclassifications                | 2,961  | (379 )   | 39  | 2,621     |
| Less: amounts reclassified from accumulated other comprehensive income | —  | —  | —   | —         |
| Total other comprehensive income                                       | 2,961  | (379 )   | 39  | 2,621     |
| Balance at end of period   | \$ 836   | \$ (2,177 )  | \$ (364 )   | \$(1,705) |
| <b>Six Months Ended June 30, 2016</b>                                  |  |  |   |           |
| Balance at beginning of period   | \$ 5,713   | \$ (1,621 )  | \$ (463 )   | \$3,629   |
| Other comprehensive gain before reclassifications                      | 5,602  | (791 )   | 51  | 4,862     |
| Less: amounts reclassified from accumulated other comprehensive income | —  | —  | —   | —         |
| Total other comprehensive income                                       | 5,602  | (791 )   | 51  | 4,862     |
| Balance at end of period   | \$ 11,315  | \$ (2,412 )  | \$ (412 )   | \$8,491   |

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The following tables presents the amounts reclassified out of each component of accumulated other comprehensive income (loss) for the three and six months ended June 30, 2017 and 2016:

| (in thousands)                         | Three                      | Affected Line Item in the Statement where Net Income is Presented |  |
|--|----------------------------|---|--|
|  | Months Ended June 30, 2017 |   |  |
| Realized gains on AFS securities:      |                            |   |  |
|  | \$-\$1,699                 | Non-interest income   |  |
|  | —(595 )                    | Tax expense   |  |
| Total reclassifications for the period | \$-\$1,104                 | Net of tax  |  |

| (in thousands)                         | Six                        | Affected Line Item in the Statement where Net Income is Presented |  |
|--|----------------------------|---|--|
|  | Months Ended June 30, 2017 |   |  |
| Realized gains on AFS securities:      |                            |   |  |
|  | \$-\$3,135                 | Non-interest income   |  |
|  | —(1,097 )                  | Tax expense   |  |
| Total reclassifications for the period | \$-\$2,038                 | Net of tax  |  |

## NOTE 9. EARNINGS PER SHARE

Earnings per share have been computed based on the following (average diluted shares outstanding are calculated using the treasury stock method):

| (In thousands, except per share and share data)               | Three Months Ended June 30, |            | Six Months Ended June 30, |            |
|---|-----------------------------|------------|---------------------------|------------|
|   | 2017                        | 2016       | 2017                      | 2016       |
| Net income  | \$6,556                     | \$ 4,311   | \$10,767                  | \$ 8,717   |
| Average number of basic common shares outstanding             | 15,393,458                  | 13,974,031 | 14,934,850                | 14,022,886 |
| Plus: dilutive effect of stock options and awards outstanding | 112,800                     | 97,478     | 114,467                   | 102,165    |
| Average number of diluted common shares outstanding           | 15,506,258                  | 14,071,512 | 15,049,317                | 14,125,051 |
| Anti-dilutive options excluded from earnings calculation      | 8,347                       | 113,645    | 9,045                     | 120,394    |
| Earnings per share:   |                             |            |                           |            |
| Basic   | \$0.43                      | \$ 0.48    | \$0.72                    | \$ 0.97    |
| Diluted   | \$0.42                      | \$ 0.47    | \$0.72                    | \$ 0.96    |

## NOTE 10. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

As part of its overall asset and liability management strategy, the Bank periodically uses derivative instruments to minimize significant unplanned fluctuations in earnings and cash flows caused by interest rate volatility. The Bank's interest rate risk management strategy involves modifying the re-pricing characteristics of certain assets or liabilities so that changes in interest rates do not have a significant effect on net interest income.

The Company recognizes its derivative instruments on the consolidated balance sheet at fair value. On the date the derivative instrument is entered into, the Bank designates whether the derivative is part of a hedging relationship (i.e., cash flow or fair value hedge). The Bank formally documents relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking hedge transactions. The Bank also assesses,



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both at the hedge's inception and on an ongoing basis, whether the derivatives used in hedging transactions are highly effective in offsetting the changes in cash flows or fair values of hedged items.

Changes in fair value of derivative instruments that are highly effective and qualify as cash flow hedges are recorded in other comprehensive income or loss. Any ineffective portion is recorded in earnings. The Bank discontinues hedge accounting when it is determined that the derivative is no longer effective in offsetting changes of the hedged risk on the hedged item, or management determines that the designation of the derivative as a hedging instrument is no longer appropriate.

Information about derivative assets and liabilities at June 30, 2017, follows:

|                                | Notional<br>Amount | Weighted Average Maturity | Estimated<br>Fair Value<br>Asset<br>(Liability) |
|--------------------------------|--------------------|---------------------------|---|
|                                | (In thousands)     | (In years)                | (In thousands)                                  |
| Cash flow hedges:              |                    |                           |   |
| Interest rate caps agreements  | \$ 90,000          | 5.6                       | \$ 950  |
| Total cash flow hedges         | 90,000             | 5.6                       | 950   |
| Economic hedges:               |                    |                           |   |
| Forward sale commitments       | 18,219             | 0.2                       | (231 )  |
| Total economic hedges          | 18,219             | 0.2                       | (231 )  |
| Non-hedging derivatives:       |                    |                           |   |
| Interest rate lock commitments | 14,636             | 0.2                       | (3 )  |
| Total non-hedging derivatives  | 14,636             | 0.2                       | (3 )  |
| Total                          | \$ 122,855         |                           | \$ 716  |

As of December 31, 2016, the Company had interest rate cap agreements totaling \$90 million (notional amount), with a weighted average maturity of 6.1 years, and an estimated fair value of \$1,748.

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Information about derivative assets and liabilities for the three and six months ended June 30, 2017 and June 30, 2016, follows:

|                              | Three<br>Months<br>Ended<br>June 30,<br>2017 | Six<br>Months<br>Ended<br>June 30,<br>2016 | Three<br>Months<br>Ended<br>June 30,<br>2017 | Six<br>Months<br>Ended<br>June 30,<br>2016 |
|------------------------------|--|--|--|--|
| (In thousands)               |  |  |  |  |
| Cash flow hedges:            |  |  |  |  |
| Interest rate cap agreements |  |  |  |  |
| Realized in interest expense | \$55   | \$ 8                                       | \$94   | \$ 11                                      |

## Economic hedges:

## Forward commitments

|  |      |   |       |   |
|--|------|---|-------|---|
| Realized loss in other non-interest income | (9 ) | — | (87 ) | — |
|--|------|---|-------|---|

## Non-hedging derivatives:

## Interest rate lock commitments

|  |       |   |       |   |
|--|-------|---|-------|---|
| Realized loss in other non-interest income | (26 ) | — | (24 ) | — |
|--|-------|---|-------|---|

## Cash flow hedges

In 2014, interest rate cap agreements were purchased to limit the Bank's exposure to rising interest rates on four rolling, three-month borrowings indexed to three month LIBOR. Under the terms of the agreements, the Bank paid total premiums of \$4,566 for the right to receive cash flow payments if 3-month LIBOR rises above the caps of 3.00%, thus effectively ensuring interest expense on the borrowings at maximum rates of 3.00% for the duration of the agreements. The interest rate cap agreements were designated as cash flow hedges. The fair values of the interest rate cap agreements are included in other assets on the Company's consolidated balance sheets. Changes in the fair value, representing unrealized gains or losses, are recorded in accumulated other comprehensive income, net of tax. The premiums paid on the interest rate cap agreements are being recognized as increases in interest expense over the duration of the agreements using the caplet method.

## Economic hedges

The Company utilizes forward sale commitments to hedge interest rate risk and the associated effects on the fair value of interest rate lock commitments and loans originated for sale. The forward sale commitments are accounted for as derivatives with changes in fair value recorded in current period earnings. The Company typically uses mandatory delivery contracts, which are loan sale agreements where the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. Generally, the Company may enter into mandatory delivery contracts shortly after the loan closes with a customer.

## Non-hedging derivatives

The Company enters into interest rate lock commitments ("IRLCs") for residential mortgage loans, which commit the Company to lend funds to a potential borrower at a specific interest rate and within a specified period of time. IRLCs that relate to the origination of mortgage loans that will be held for sale are considered derivative financial instruments under applicable accounting guidance. Outstanding IRLCs expose the Company to the risk that the price of the mortgage loans underlying the commitments may decline due to increases in mortgage interest rates from inception of the rate lock to the funding of the loan. The IRLCs are free-standing derivatives which are carried at fair value with changes recorded in noninterest income in the Company's consolidated statements of income. Changes in the fair value of IRLCs subsequent to inception are based on changes in the fair value of the underlying loan resulting from the fulfillment of the commitment and changes in the probability that the loan will fund within the terms of the

commitment, which is affected primarily by changes in interest rates and the passage of time.

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## NOTE 11. FAIR VALUE MEASUREMENTS

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities that are carried at fair value.

## Recurring Fair Value Measurements

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of June 30, 2017 and December 31, 2016, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value.

| (In thousands)   | June 30, 2017     |                   |                   |                     |
|--|-------------------|-------------------|-------------------|---------------------|
|  | Level 1<br>Inputs | Level 2<br>Inputs | Level 3<br>Inputs | Total<br>Fair Value |
| Available for sale securities:                           |                   |                   |                   |                     |
| Obligations of US Government sponsored enterprises       | \$ 6,973          | —                 | —                 | \$ 6,973            |
| Mortgage-backed securities:                              |                   |                   |                   |                     |
| US Government-sponsored enterprises                      | —                 | 456,051           | —                 | 456,051             |
| US Government agency                                     | —                 | 78,062            | —                 | 78,062              |
| Private label  | —                 | 911               | —                 | 911                 |
| Obligations of states and political subdivisions thereof | —                 | 146,285           | —                 | 146,285             |
| Corporate bonds  | —                 | 30,064            | —                 | 30,064              |
| Derivative assets  | —                 | 950               | —                 | 950                 |
| Derivative liabilities                                   | —                 | —                 | (234)             | (234)               |
|  |                   |                   |                   |                     |
| (In thousands)   | December 31, 2016 |                   |                   |                     |
|  | Level 1<br>Inputs | Level 2<br>Inputs | Level 3<br>Inputs | Total<br>Fair Value |
| Available for sale securities:                           |                   |                   |                   |                     |
| Obligations of US Government sponsored enterprises       | \$ —              | —                 | —                 | \$ —                |
| Mortgage-backed securities:                              |                   |                   |                   |                     |
| US Government-sponsored enterprises                      | —                 | 328,452           | —                 | 328,452             |
| US Government agency                                     | —                 | 76,906            | —                 | 76,906              |
| Private label  | —                 | 1,132             | —                 | 1,132               |
| Obligations of states and political subdivisions thereof | —                 | 122,366           | —                 | 122,366             |
| Corporate bonds  | —                 | —                 | —                 | —                   |
| Derivative assets  | —                 | 1,748             | —                 | 1,748               |

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



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## Derivative Assets and Liabilities

Interest Rate Lock Commitments. The Company enters into IRLCs for residential mortgage loans, which commit the Company to lend funds to a potential borrower at a specific interest rate and within a specified period of time. The estimated fair value of commitments to originate residential mortgage loans for sale is based on quoted prices for similar loans in active markets. However, this value is adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close. The closing ratio is derived from the Bank's internal data and is adjusted using significant management judgment. As such, IRLCs are classified as Level 3 measurements.

Forward Sale Commitments. The Company utilizes forward sale commitments as economic hedges against potential changes in the values of the IRLCs and loans originated for sale. The fair values of the Company's mandatory delivery loan sale commitments are determined similarly to the IRLCs using quoted prices in the market place that are observable. However, closing ratios included in the calculation are internally generated and are based on management's judgment and prior experience, which are considered factors that are not observable. As such, mandatory delivery forward commitments are classified as Level 3 measurements.

The table below presents the changes in Level 3 assets and liabilities that were measured at fair value on a recurring basis for the three and six months ended June 30, 2017 and 2016.

| (In thousands)                                     | Assets (Liabilities)                 |                        |
|--|--------------------------------------|------------------------|
|  | Interest Rate<br>Lock<br>Commitments | Forward<br>Commitments |
| Three Months Ended June 30, 2017                   |                                      |                        |
| March 31, 2017                                     | \$ 98                                | \$ (55 )               |
| Goodwill adjustment Lake Sunapee Bank Merger       | (75 )                                | (167 )                 |
| Realized (loss) recognized in non-interest income  | (26 )                                | (9 )                   |
| June 30, 2017                                      | \$ (3 )                              | \$ (231 )              |
| Six Months Ended June 30, 2017                     |                                      |                        |
| December 31, 2016                                  | \$ —                                 | \$ —                   |
| Acquisition of Lake Sunapee Bank, January 13, 2017 | 96                                   | 23                     |
| Goodwill adjustment Lake Sunapee Bank Merger       | (75 )                                | (167 )                 |
| Realized (loss) recognized in non-interest income  | (24 )                                | (87 )                  |
| June 30, 2017                                      | \$ (3 )                              | \$ (231 )              |

Quantitative information about the significant unobservable inputs within Level 3 recurring assets and liabilities is as follows:

| (In thousands, except ratios) | Fair Value June 30, 2017 | Valuation Techniques                               | Unobservable Inputs         | Significant Unobservable Input Value |
|-------------------------------|--------------------------|--|-----------------------------|--------------------------------------|
| Assets (Liabilities)          |                          |  |                             |                                      |
| Interest Rate Lock Commitment | \$ (3 )                  | Historical trend                                   | Closing Ratio               | 90 %                                 |
|                               |                          | Pricing Model                                      | Origination Costs, per loan | \$ 1.7                               |
| Forward Commitments           | (231 )                   | Quoted prices for similar loans in active markets. | Freddie Mac pricing system  | Pair-off contract                    |

|       |           |       |
|-------|-----------|-------|
| Total | \$ (234 ) | price |
|-------|-----------|-------|

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## Non-Recurring Fair Value Measurements

The Company is required, on a non-recurring basis, to adjust the carrying value or provide valuation allowances for certain assets using fair value measurements in accordance with U.S. GAAP. The following is a summary of applicable non-recurring fair value measurements. There are no liabilities measured at fair value on a non-recurring basis.

| (In thousands)               | June 30, December 31 |                | Three                      | Six months           | Fair Value Measurement Date as of |
|------------------------------|----------------------|----------------|----------------------------|----------------------|-----------------------------------|
|                              | 2017                 | 2016           | months ended June 30, 2017 | ended June 30, 2017  | June 30, 2017                     |
|                              | Level 3 Inputs       | Level 3 Inputs | Total Gains (Losses)       | Total Gains (Losses) | Level 3 Inputs                    |
| Assets                       |                      |                |                            |                      |                                   |
| Impaired loans               | \$ 6,314             | \$ 6,709       | \$ (96 )                   | (96 )                | June 2017                         |
| Capitalized servicing rights | 3,355                | 5              | —                          | —                    | May 2017                          |
| Other real estate owned      | 122                  | 90             | —                          | —                    | Jan 2017 - March 2017             |
| Total                        | \$ 9,791             | \$ 6,804       | \$ (96 )                   | (96 )                |                                   |

Quantitative information about the significant unobservable inputs within Level 3 non-recurring assets is as follows:

| (in thousands, except ratios) | Fair Value June 30, 2017 | Valuation Techniques                       | Unobservable Inputs                             | Range (Weighted Average) (a) |
|-------------------------------|--------------------------|--|---|------------------------------|
| Assets                        |                          |  |   |                              |
| Impaired loans                | \$ 2,067                 | Fair value of collateral - appraised value | Loss severity<br>Appraised value                | 0% to 32%<br>\$0 to \$950    |
| Impaired loans                | 4,247                    | Discount cash flow                         | Discount rate<br>Cash flows                     | 0% to 18%<br>\$0 to \$874    |
| Capitalized servicing rights  | 3,355                    | Discounted cash flow                       | Constant prepayment rate (CPR)<br>Discount rate | 14.33 %<br>7.55 %            |
| Other real estate owned       | 122                      | Fair value of collateral                   | Appraised value                                 | \$122                        |
| Total                         | \$ 9,791                 |  |   |                              |

Where dollar amounts are disclosed, the amounts represent the lowest and highest fair value of the respective assets (a) in the population except for adjustments for market/property conditions, which represents the range of adjustments to individuals properties.



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| (in thousands)               | Fair Value<br>December 31,<br>2016 | Valuation Techniques                       | Unobservable Inputs                             | Range (Weighted Average) (a)    |
|------------------------------|------------------------------------|--|---|---------------------------------|
| <b>Assets</b>                |                                    |  |   |                                 |
| Impaired loans               | \$ 3,268                           | Fair value of collateral - appraised value | Loss severity<br>Appraised value                | 0% to 51%<br>\$0 to \$1,732     |
| Impaired loans               | 3,441                              | Discount cash flow                         | Discount rate<br>Cash flows                     | 3.25% to 18.25%<br>\$6 to \$861 |
| Capitalized servicing rights | 5                                  | Discounted cash flow                       | Constant prepayment rate (CPR)<br>Discount rate | 17.09 %<br>7.55 %               |
| Other real estate owned      | 90                                 | Fair value of collateral                   | Appraised value                                 | 120                             |
| Total                        | \$ 6,804                           |  |   |                                 |

Where dollar amounts are disclosed, the amounts represent the lowest and highest fair value of the respective assets (a) in the population except for adjustments for market/property conditions, which represents the range of adjustments to individual properties.

There were no Level 1 or Level 2 non-recurring fair value measurements for the periods ended June 30, 2017 and December 31, 2016.

**Impaired Loans.** Loans are generally not recorded at fair value on a recurring basis. Periodically, the Company records non-recurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Non-recurring adjustments can also include certain impairment amounts for collateral-dependent loans calculated when establishing the allowance for credit losses. Such amounts are generally based on the fair value of the underlying collateral supporting the loan and, as a result, the carrying value of the loan less the calculated valuation amount does not necessarily represent the fair value of the loan. Real estate collateral is typically valued using appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace. However, the choice of observable data is subject to significant judgment, and there are often adjustments based on judgment in order to make observable data comparable and to consider the impact of time, the condition of properties, interest rates, and other market factors on current values. Additionally, commercial real estate appraisals frequently involve discounting of projected cash flows, which relies inherently on unobservable data. Therefore, nonrecurring fair value measurement adjustments that relate to real estate collateral have generally been classified as Level 3. Estimates of fair value for other collateral that supports commercial loans are generally based on assumptions not observable in the marketplace and therefore such valuations have been classified as Level 3.

**Capitalized loan servicing rights.** A loan servicing right asset represents the amount by which the present value of the estimated future net cash flows to be received from servicing loans exceed adequate compensation for performing the servicing. The fair value of servicing rights is estimated using a present value cash flow model. The most important assumptions used in the valuation model are the anticipated rate of the loan prepayments and discount rates. Adjustments are only recorded when the discounted cash flows derived from the valuation model are less than the carrying value of the asset. Although some assumptions in determining fair value are based on standards used by market participants, some are based on unobservable inputs and therefore are classified in Level 3 of the valuation

hierarchy.

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Other real estate owned (“OREO”). OREO results from the foreclosure process on residential or commercial loans issued by the Bank. Upon assuming the real estate, the Company records the property at the fair value of the asset less the estimated sales costs. Thereafter, OREO properties are recorded at the lower of cost or fair value less the estimated sales costs. OREO fair values are primarily determined based on Level 3 data including sales comparables and appraisals.

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Summary of Estimated Fair Values of Financial Instruments. The estimated fair values, and related carrying amounts, of the Company's financial instruments follow. Certain financial instruments and all non-financial instruments are excluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented herein may not necessarily represent the underlying fair value of the Company.

| (In thousands)   | June 30, 2017     |              |            |              |           |
|--|-------------------|--------------|------------|--------------|-----------|
|  | Carrying Amount   | Fair Value   | Level 1    | Level 2      | Level 3   |
| <b>Financial Assets</b>                                    |                   |              |            |              |           |
| Cash and cash equivalents                                  | \$ 118,993        | \$ 118,993   | \$ 118,993 | \$—          | \$ —      |
| Securities available for sale                              | 718,364           | 718,364      | —          | 718,364      | —         |
| FHLBB bank stock   | 44,168            | 44,168       | —          | 44,168       | —         |
| Net loans  | 2,365,205         | 2,342,877    | —          | —            | 2,342,877 |
| Accrued interest receivable                                | 3,386             | 3,386        | —          | 3,386        | —         |
| Cash surrender value of bank-owned life insurance policies | 57,233            | 57,233       | —          | 57,233       | —         |
| Derivative assets  | 950               | 950          | —          | 950          | —         |
| <b>Financial Liabilities</b>                               |                   |              |            |              |           |
| Total deposits   | \$2,213,004       | \$2,190,676  | \$—        | \$2,190,676  | \$ —      |
| Securities sold under agreements to repurchase             | 35,174            | 35,155       | —          | 35,155       | —         |
| Federal Home Loan Bank advances                            | 837,267           | 837,126      | —          | 837,126      | —         |
| Subordinated borrowings                                    | 37,642            | 37,921       | —          | 37,921       | —         |
| Junior subordinated borrowings                             | 5,000             | 3,569        | —          | 3,569        | —         |
| Derivative liabilities                                     | (234 )            | (234 )       | —          | —            | (234 )    |
| (In thousands)   | December 31, 2016 |              |            |              |           |
|  | Carrying Amount   | Fair Value   | Level 1    | Level 2      | Level 3   |
| <b>Financial Assets</b>                                    |                   |              |            |              |           |
| Cash and cash equivalents                                  | \$ 8,439          | \$ 8,439     | \$ 8,439   | \$—          | \$ —      |
| Securities available for sale                              | 528,856           | 528,856      | —          | 528,856      | —         |
| FHLBB bank stock   | 25,331            | 25,331       | —          | 25,331       | —         |
| Net loans  | 1,118,645         | 1,100,601    | —          | —            | 1,100,601 |
| Accrued interest receivable                                | 6,051             | 6,051        | —          | 6,051        | —         |
| Cash surrender value of bank-owned life insurance policies | 24,450            | 24,450       | —          | 24,450       | —         |
| Derivative assets  | 1,748             | 1,748        | —          | 1,748        | —         |
| <b>Financial Liabilities</b>                               |                   |              |            |              |           |
| Total deposits   | \$ 1,050,300      | \$ 1,048,932 | \$—        | \$ 1,048,932 | \$ —      |
| Securities sold under agreements to repurchase             | 21,780            | 21,773       | —          | 21,773       | —         |
| Federal Home Loan Bank advances                            | 509,816           | 509,793      | —          | 509,793      | —         |
| Subordinated borrowings                                    | —                 | —            | —          | —            | —         |
| Junior subordinated borrowings                             | —                 | 3,560        | —          | 3,560        | —         |

Other than as discussed above, the following methods and assumptions were used by management to estimate the fair value of significant classes of financial instruments for which it is practicable to estimate that value.

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Cash and cash equivalents. Carrying value is assumed to represent fair value for cash and cash equivalents that have original maturities of ninety days or less.

FHLBB bank stock and restricted securities. Carrying value approximates fair value based on the redemption provisions of the issuers.

Cash surrender value of life insurance policies. Carrying value approximates fair value.

Loans, net. The carrying value of the loans in the loan portfolio is based on the cash flows of the loans discounted over their respective loan origination rates. The origination rates are adjusted for substandard and special mention loans to factor the impact of declines in the loan's credit standing. The fair value of the loans is estimated by discounting future cash flows using the current interest rates at which similar loans with similar terms would be made to borrowers of similar credit quality.

Accrued interest receivable. Carrying value approximates fair value.

Deposits. The fair value of demand, non-interest bearing checking, savings and money market deposits is determined as the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting the estimated future cash flows using market rates offered for deposits of similar remaining maturities.

Borrowed funds. The fair value of borrowed funds is estimated by discounting the future cash flows using market rates for similar borrowings. Such funds include all categories of debt and debentures in the table above.

Subordinated borrowings. The Company utilizes a pricing service along with internal models to estimate the valuation of its junior subordinated debentures. The junior subordinated debentures re-price every ninety days.

Off-balance-sheet financial instruments. Off-balance-sheet financial instruments include standby letters of credit and other financial guarantees and commitments considered immaterial to the Company's financial statements.

NOTE 12. SUBSEQUENT EVENTS

There were no significant subsequent events between June 30, 2017 and through the date the financial statements are available to be issued.

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

GENERAL

Management's discussion and analysis of financial condition and results of operations is intended to assist in understanding the financial condition and results of operations of the Company. The following discussion and analysis should be read in conjunction with the Company's consolidated financial statements and the notes thereto appearing in Part I, Item 1 of this document and with the Company's consolidated financial statements and the notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's 2016 Annual Report on Form 10-K. In the following discussion, income statement comparisons are against the same period of the previous year and balance sheet comparisons are against the previous fiscal year-end, unless otherwise noted. Operating results discussed herein are not necessarily indicative of the results for the year 2017 or any future period. In management's discussion and analysis of financial condition and results of operations, certain reclassifications have been made to make prior periods comparable.

Bar Harbor Bankshares is the parent of Bar Harbor Bank & Trust, a true community bank in New England with branches in Maine, New Hampshire and Vermont.

- Community bank with \$3.5 billion in assets
- 47 branches plus 2 additional limited service locations
- Commercial banking, retail banking, wealth management and insurance

On January 13, 2017, Bar Harbor completed the acquisition of Lake Sunapee Bank Group ("Lake Sunapee"), that geographically expanded our brand and business model. Lake Sunapee is a like-minded partner that operated in markets with similar geographic attributes. Through the acquisition we deepened our seasoned leadership and added to our accomplished team members, providing significant financial benefit to both sets of shareholders without sacrificing the culture of either institution.

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**FORWARD-LOOKING STATEMENTS**

Certain statements contained in this document that are not historical facts may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (referred to as the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (referred to as the Securities Exchange Act), and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. You can identify these statements from the use of the words “may,” “will,” “should,” “could,” “would,” “plan,” “potential,” “estimate,” “believe,” “intend,” “anticipate,” “expect,” “target” and similar expressions. These forward-looking statements are subject to significant risks, assumptions and uncertainties, including among other things, changes in general economic and business conditions, increased competitive pressures, changes in the interest rate environment, legislative and regulatory change, changes in the financial markets, and other risks and uncertainties disclosed from time to time in documents that the Company files with the Securities and Exchange Commission, including the Annual Report on Form 10-K for the fiscal year ended December 31, 2016 and the Risk Factors in Item 1A of this report. Because of these and other uncertainties, the Company’s actual results, performance or achievements, or industry results, may be materially different from the results indicated by these forward-looking statements. In addition, the Company's past results of operations do not necessarily indicate future results.

Additional factors that could cause results to differ materially from those described in the forward-looking statements relate to the recently completed acquisition of Lake Sunapee Bank Group. These additional factors that could cause actual results to differ materially from expected results include difficulties in achieving cost savings from the merger or in achieving such cost savings within the expected time frame and difficulties in integrating the Company and Lake Sunapee, increased competitive pressures, changes in the interest rate environment, changes in general economic conditions, legislative and regulatory changes that adversely affect the business in which the Company is engaged, changes in the securities markets and other risks and uncertainties disclosed from time to time in documents that the Company files with the Securities and Exchange Commission.

No undue reliance should be placed on any of the forward-looking statements, which speak only as of the dates on which they were made. The Company is not undertaking an obligation to update forward-looking statements, even though its situation may change in the future, except as required under federal securities law. The Company qualifies all of its forward-looking statements by these cautionary statements.

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## SELECTED FINANCIAL DATA

The following summary data is based in part on the consolidated financial statements and accompanying notes and other information appearing elsewhere in this or prior Forms 10-Q

|   | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |         |
|---|--------------------------------|---------|------------------------------|---------|
|   | 2017                           | 2016    | 2017                         | 2016    |
| <b>PER SHARE DATA</b>   |                                |         |                              |         |
| Net earnings, diluted   | \$0.42                         | \$0.47  | \$0.72                       | \$0.96  |
| Adjusted earnings, diluted (1) (2)                                | 0.52                           | 0.39    | 0.95                         | 0.77    |
| Total book value  | 22.53                          | 18.27   | 22.53                        | 18.27   |
| Tangible book value (2)   | 15.44                          | 17.67   | 15.44                        | 17.67   |
| Market price at period end  | 30.82                          | 23.40   | 30.82                        | 23.40   |
| Dividends   | 0.19                           | 0.18    | 0.37                         | 0.36    |
| <b>PERFORMANCE RATIOS</b>   |                                |         |                              |         |
| Return on assets  | 0.76                           | % 1.04  | % 0.63                       | % 1.07  |
| Adjusted return on assets (1) (2)                                 | 0.94                           | 0.85    | 0.84                         | 0.86    |
| Return on equity  | 7.55                           | 10.67   | 6.26                         | 10.89   |
| Adjusted return on equity (1) (2)                                 | 9.32                           | 8.72    | 8.31                         | 8.74    |
| Adjusted return on tangible equity (1) (2)                        | 13.78                          | 9.03    | 12.20                        | 9.02    |
| Net interest margin, fully taxable equivalent (FTE) (4)           | 3.16                           | 3.04    | 3.13                         | 2.93    |
| Net interest margin (FTE), excluding purchased loan accretion (4) | 3.02                           | 3.04    | 3.01                         | 2.93    |
| Efficiency ratio (2)  | 0.56                           | 0.60    | 0.59                         | 0.59    |
| <b>GROWTH (Year-to-date)</b>                                      |                                |         |                              |         |
| Total commercial loans, (organic annualized) (2)                  | (5.4                           | )% (0.1 | )% 5.0                       | % 4.5   |
| Total loans, (organic annualized) (2)                             | 0.7                            | 16.9    | 7.0                          | 6.0     |
| Total deposits, (organic annualized) (2)                          | 7.1                            | 11.3    | 2.3                          | 5.0     |
| <b>FINANCIAL DATA (In millions)</b>                               |                                |         |                              |         |
| Total assets  | \$3,503                        | \$1,688 | \$3,503                      | \$1,688 |
| Total earning assets  | 3,139                          | 1,608   | 3,139                        | 1,608   |
| Total investments   | 763                            | 559     | 763                          | 559     |
| Total loans   | 2,377                          | 1,049   | 2,377                        | 1,049   |
| Allowance for loan losses   | 11                             | 10      | 11                           | 10      |
| Total goodwill and intangible assets                              | 109                            | 5       | 109                          | 5       |
| Total deposits  | 2,213                          | 990     | 2,213                        | 990     |
| Total shareholders' equity  | 347                            | 165     | 347                          | 165     |
| Net income  | 7                              | 4       | 11                           | 9       |
| Adjusted income (4)   | 8                              | 4       | 14                           | 7       |
| <b>ASSET QUALITY AND CONDITION RATIOS</b>                         |                                |         |                              |         |
| Net charge-offs (current quarter annualized)/average loans (5)    | 0.03                           | % 0.03  | % 0.03                       | % 0.03  |
| Allowance for loan losses/total loans (5)                         | 0.48                           | 0.94    | 0.48                         | 0.94    |
| Loans/deposits  | 107                            | 106     | 107                          | 106     |
| Shareholders' equity to total assets                              | 9.91                           | 9.79    | 9.91                         | 9.79    |
| Tangible shareholders' equity to tangible assets (2)              | 7.01                           | 9.50    | 7.01                         | 9.50    |





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Adjusted measurements are non-GAAP financial measures that are adjusted to exclude net non-operating charges (1) primarily related to acquisitions, and gain on sale of securities. Refer to the Reconciliation of Non-GAAP Financial Measures section of Management's Discussion and Analysis for additional information.

(2) Non-GAAP financial measure.

(3) All performance ratios are annualized and are based on average balance sheet amounts, where applicable.

(4) Fully taxable equivalent considers the impact of tax advantaged investment securities and loans.

Generally accepted accounting principles require that loans acquired in a business combination be recorded at fair value, whereas loans from business activities are recorded at cost. The fair value of loans acquired in a business combination includes expected loan losses, and there is no loan loss allowance recorded for these loans at the time of acquisition. Accordingly, the ratio of the loan loss allowance to total loans is reduced as a result of the existence of such loans, and this measure is not directly comparable to prior periods. Similarly, net loan charge-offs are normally reduced for loans acquired in a business combination since these loans are recorded net of expected loan losses. Therefore, the ratio of net loan charge-offs to average loans is reduced as a result of the existence of such loans, and this measure is not directly comparable to prior periods. Other institutions may have loans acquired in a business combination, and therefore there may be no direct comparability of these ratios between and among other institutions.

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BAR HARBOR BANKSHARES  
CONSOLIDATED LOAN & DEPOSIT ANALYSIS - UNAUDITED  
LOAN ANALYSIS

| (in thousands)            | Jun 30,<br>2017<br>Balance | Mar 31,<br>2017<br>Balance | Acquired<br>Lake<br>Sunapee<br>Bank<br>Balance (2) | Dec 31,<br>2016<br>Balance | Organic<br>Annualized<br>Growth % (1)<br>June 30, 2017 |                 |
|---------------------------|----------------------------|----------------------------|--|----------------------------|--|-----------------|
|                           |                            |                            |  |                            | Quarter<br>End   | Year to<br>Date |
| Commercial real estate    | \$738,584                  | \$779,635                  | \$345,586  | \$418,119                  | (21.1)%  | (12.0)%         |
| Commercial and industrial | 263,903                    | 236,526                    | 89,259   | 135,564                    | 46.3   | 57.7            |
| Total commercial loans    | 1,002,487                  | 1,016,161                  | 434,845  | 553,683                    | (5.4 )   | 5.0             |
| Residential real estate   | 1,160,832                  | 1,155,436                  | 652,255  | 506,612                    | 1.9  | 0.8             |
| Consumer                  | 127,229                    | 127,370                    | 76,489   | 53,093                     | (0.4 )   | (8.9 )          |
| Tax exempt and other      | 86,099                     | 73,469                     | 44,611   | 15,676                     | 68.8   | 329.3           |
| Total loans               | \$2,376,647                | \$2,372,436                | \$1,208,200  | \$1,129,064                | 0.7 %  | 7.0 %           |

(1) Non-GAAP financial measure.

(2) Acquired Lake Sunapee Bank loans are as of January 13, 2017.

## DEPOSIT ANALYSIS

| (in thousands)              | Jun 30,<br>2017<br>Balance | Mar 31,<br>2017<br>Balance | Acquired<br>Lake<br>Sunapee<br>Bank<br>Balance (2) | Dec 31,<br>2016<br>Balance | Organic<br>Annualized Growth<br>% (1) June 30, 2017 |                 |
|-----------------------------|----------------------------|----------------------------|--|----------------------------|---|-----------------|
|                             |                            |                            |  |                            | Quarter<br>End                                      | Year to<br>Date |
| Demand                      | \$332,339                  | \$349,896                  | \$248,051  | \$98,856                   | (20.1 )%  | (29.5 )%        |
| NOW                         | 451,171                    | 242,876                    | 39,999   | 175,150                    | 343.0   | 269.5           |
| Money market                | 285,312                    | 349,491                    | 103,142  | 282,234                    | (73.5 )   | (70.9 )         |
| Savings                     | 360,306                    | 511,091                    | 467,735  | 77,623                     | (118.0)   | (476.8)         |
| Total non-maturity deposits | 1,429,128                  | 1,453,354                  | 858,927  | 633,863                    | (6.7 )  | (20.1 )         |
| Total time deposits         | 783,876                    | 720,899                    | 291,684  | 416,437                    | 34.9  | 36.4            |
| Total deposits              | \$2,213,004                | \$2,174,253                | \$1,150,611  | \$1,050,300                | 7.1 %   | 2.3 %           |

(1) Non-GAAP financial measure.

(2) Acquired Lake Sunapee Bank Deposits are as of January 13, 2017.

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## AVERAGE BALANCES AND AVERAGE YIELDS/RATES

The following table presents average balances and an analysis of average rates and yields on an annualized fully taxable equivalent basis for the periods included:

| (In thousands)                             | Three Months Ended June 30 |                                  | Six Months Ended June 30 |                                  | 2017               |                                  | 2016               |                                  | Yield/Rate<br>(FTE basis)<br>(3) |
|--|----------------------------|----------------------------------|--------------------------|----------------------------------|--------------------|----------------------------------|--------------------|----------------------------------|----------------------------------|
|  | Average<br>Balance         | Yield/Rate<br>(FTE basis)<br>(3) | Average<br>Balance       | Yield/Rate<br>(FTE basis)<br>(3) | Average<br>Balance | Yield/Rate<br>(FTE basis)<br>(3) | Average<br>Balance | Yield/Rate<br>(FTE basis)<br>(3) |                                  |
| <b>Assets</b>                              |                            |                                  |                          |                                  |                    |                                  |                    |                                  |                                  |
| Loans (1)                                  | \$2,377,141                | 4.14 %                           | \$1,028,748              | 4.03 %                           | \$2,387,524        | 4.05 %                           | \$1,020,341        | 4.03 %                           |                                  |
| Securities and other (2)                   | 761,546                    | 3.19                             | 546,917                  | 3.37                             | 759,197            | 3.12                             | 539,501            | 3.38                             |                                  |
| Total earning assets                       | 3,138,687                  | 3.91 %                           | 1,575,665                | 3.80 %                           | 3,146,721          | 3.82 %                           | 1,559,842          | 3.81 %                           |                                  |
| Other non-earning assets                   | 295,277                    |                                  | 75,911                   |                                  | 275,354            |                                  | 74,711             |                                  |                                  |
| Total assets                               | \$3,433,964                |                                  | \$1,651,576              |                                  | \$3,422,075        |                                  | \$1,634,553        |                                  |                                  |
| <b>Liabilities</b>                         |                            |                                  |                          |                                  |                    |                                  |                    |                                  |                                  |
| Interest bearing deposits                  | \$1,811,226                | 0.56 %                           | \$845,042                | 0.76 %                           | \$1,835,198        | 0.52 %                           | \$863,021          | 0.74 %                           |                                  |
| Borrowings                                 | 941,789                    | 1.41                             | 557,593                  | 0.99                             | 911,044            | 1.31                             | 523,293            | 1.01                             |                                  |
| Total interest-bearing liabilities         | 2,753,015                  | 0.85 %                           | 1,402,635                | 0.85 %                           | 2,746,242          | 0.78 %                           | 1,386,314          | 0.84 %                           |                                  |
| Non-interest-bearing demand deposits       | 320,503                    |                                  | 80,119                   |                                  | 307,265            |                                  | 81,697             |                                  |                                  |
| Other non-earning liabilities              | 13,145                     |                                  | 7,147                    |                                  | 24,324             |                                  | 6,444              |                                  |                                  |
| Total liabilities                          | 3,086,663                  |                                  | 1,489,901                |                                  | 3,077,831          |                                  | 1,474,455          |                                  |                                  |
| Total shareholders' equity                 | 347,301                    |                                  | 161,675                  |                                  | 344,244            |                                  | 160,098            |                                  |                                  |
| Total liabilities and shareholders' equity | \$3,433,964                |                                  | \$1,651,576              |                                  | \$3,422,075        |                                  | \$1,634,553        |                                  |                                  |
| Net interest spread                        |                            | 3.06 %                           |                          | 2.95 %                           |                    | 3.03 %                           |                    | 2.97 %                           |                                  |
| Net interest margin                        |                            | 3.16                             |                          | 3.04                             |                    | 3.13                             |                    | 2.93                             |                                  |

(1) The average balances of loans include nonaccrual loans and deferred fees and costs.

(2) The average balance for securities available for sale is based on amortized cost. The average balance of equity also reflects this adjustment.

(3) Fully taxable equivalent considers the impact of tax advantaged investment securities and loans.

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NON-GAAP FINANCIAL MEASURES

This document contains certain non-GAAP financial measures in addition to results presented in accordance with U.S. Generally Accepted Accounting Principles (“GAAP”). These non-GAAP measures are intended to provide the reader with additional supplemental perspectives on operating results, performance trends, and financial condition.

Non-GAAP financial measures are not a substitute for GAAP measures; they should be read and used in conjunction with the Company’s GAAP financial information. The Company’s non-GAAP measures may not be comparable to similar non-GAAP information which may be presented by other companies. In all cases, it should be understood that non-GAAP operating measures do not depict amounts that accrue directly to the benefit of shareholders. An item which management excludes when computing non-GAAP adjusted earnings can be of substantial importance to the Company’s results and condition for any particular quarter or year. A reconciliation of non-GAAP financial measures to GAAP measures is provided below.

The Company utilizes the non-GAAP measure of adjusted earnings in evaluating operating trends, including components for operating revenue and expense. These measures exclude amounts which the Company views as unrelated to its normalized operations, including securities gains/losses, merger costs, restructuring costs, and systems conversion costs. These adjustments are presented net of an adjustment for related income tax expense. This adjustment is determined as the difference between the GAAP tax rate and the effective tax rate applicable to adjusted income. The Company calculates several non-GAAP performance measures based on its measure of adjusted earnings, including adjusted earnings per share, adjusted return on assets, adjusted return on equity, and the efficiency ratio. The Company views these amounts as important to understanding its performance trends, particularly due to the impact of accounting standards related to merger and acquisition activity. Several of these measures are used as performance metrics in assessing the achievement of short and long term incentive compensation for management. Analysts also rely on these measures in estimating and evaluating the Company’s performance. Management also believes that the computation of non-GAAP earnings and earnings per share may facilitate the comparison of the Company to other companies in the financial services industry. The Company adjusts certain equity related measures to exclude intangible assets due to the importance of these measures to the investment community and as components of regulatory capital supervision.

Charges related to merger and acquisition activity consist primarily of severance and retention, systems conversion and integration, and professional costs.

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## RECONCILIATION OF NON-GAAP FINANCIAL MEASURES

The following table summarizes the reconciliation of non-GAAP items recorded for the time periods and dates indicated

|   |             | At or for the Three        |          | At or for the Six          |          |   |
|---|-------------|----------------------------|----------|----------------------------|----------|---|
|   |             | Months Ended June 30, 2017 | 2016     | Months Ended June 30, 2017 | 2016     |   |
| (in thousands)  |             |                            |          |                            |          |   |
| GAAP Net income   |             | \$6,556                    | \$4,311  | \$10,767                   | \$8,716  |   |
| Less: Security Gains                                      |             | —                          | (1,699 ) | —                          | (3,135 ) |   |
| Plus: Loss on premises and equipment, net                 |             | —                          | —        | 95                         | —        |   |
| Plus: Merger expenses                                     |             | 2,459                      | 492      | 5,571                      | 492      |   |
| (Less)Plus: Income taxes (37.57% in 2017, 35.0% in 2016)  |             | (924 )                     | 422      | (2,129 )                   | 925      |   |
| Total adjusted income (4)                                 | (A)         | \$8,091                    | \$3,526  | \$14,304                   | \$6,998  |   |
| Net-interest income                                       |             | \$23,809                   | \$11,382 | \$45,181                   | \$22,718 |   |
| Plus: Non-interest income                                 |             | 6,558                      | 3,614    | 12,504                     | 6,942    |   |
| GAAP Total revenue  |             | 30,367                     | 14,996   | 57,685                     | 29,660   |   |
| Less: Net security gains                                  |             | —                          | (1,699 ) | —                          | (3,135 ) |   |
| Total operating revenue (4)                               | (B)         | \$30,367                   | \$13,297 | \$57,685                   | \$26,525 |   |
| GAAP Total non-interest expense                           |             | \$20,046                   | \$8,731  | \$40,877                   | \$16,729 |   |
| Less: Merger and acquisition expense                      |             | (2,459 )                   | (492 )   | (5,571 )                   | (492 )   |   |
| Operating non-interest expense (4)                        | (C)         | \$17,587                   | \$8,239  | \$35,306                   | \$16,237 |   |
| (in millions, except per share data)                      |             |                            |          |                            |          |   |
| Total average assets                                      | (D)         | \$3,434                    | \$1,652  | \$3,422                    | \$1,635  |   |
| Total average shareholders' equity                        | (E)         | 347                        | 162      | 344                        | 160      |   |
| Total average tangible shareholders' equity               | (F)         | 238                        | 156      | 238                        | 155      |   |
| Total tangible shareholders' equity, period-end (1)       | (G)         | 238                        | 160      | 238                        | 160      |   |
| Total tangible assets, period-end (1)                     | (H)         | 3,394                      | 1,682    | 3,394                      | 1,682    |   |
| Total common shares outstanding, period-end (thousands)   | (I)         | 15,407                     | 9,045    | 15,407                     | 9,045    |   |
| Average diluted shares outstanding (thousands)            | (J)         | 15,506                     | 9,129    | 15,049                     | 9,125    |   |
| Adjusted earnings per share, diluted                      | (A/J)       | \$0.52                     | \$0.39   | \$0.95                     | \$0.77   |   |
| Tangible book value per share, period-end                 | (G/I)       | 15.44                      | 17.67    | 15.44                      | 17.67    |   |
| Total tangible shareholders' equity/total tangible assets | (G)/(H)     | 7.01                       | 9.50     | 7.01                       | 9.50     |   |
| Performance ratios (2)                                    |             |                            |          |                            |          |   |
| GAAP return on assets                                     |             | 0.76                       | % 1.04   | % 0.63                     | % 1.07   | % |
| Adjusted return on assets (4)                             | (A/D)       | 0.94                       | 0.85     | 0.84                       | 0.86     |   |
| GAAP return on equity                                     |             | 7.55                       | 10.67    | 6.26                       | 10.89    |   |
| Adjusted return on equity (4)                             | (A/E)       | 9.32                       | 8.72     | 8.31                       | 8.74     |   |
| Adjusted return on tangible equity (3) (4)                | (A/F)       | 13.78                      | 9.03     | 12.20                      | 9.02     |   |
| Efficiency ratio (4)(5)                                   | (C-M)/(B+N) | 0.56                       | 0.60     | 0.59                       | 0.59     |   |
| Net interest margin                                       |             | 3.16                       | 3.04     | 3.13                       | 2.93     |   |

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Supplementary data (in thousands)

|  |     |       |       |         |         |
|--|-----|-------|-------|---------|---------|
| Fully taxable equivalent income adjustment | (N) | \$813 | \$526 | \$1,567 | \$1,063 |
| Intangible amortization                    | (M) | 188   | 1     | 345     | 2       |

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- (1) Total tangible shareholders' equity is computed by taking total shareholders' equity less the intangible assets at period-end. Total tangible assets is computed by taking total assets less the intangible assets at period-end.
- (2) Ratios are annualized and based on average balance sheet amounts, where applicable. Quarterly data may not sum to year-to-date data due to rounding.
- Adjusted return on tangible equity is computed by dividing the total core income adjusted for the tax-effected amortization of intangible assets, assuming a marginal rate of 37.57% in 2017 and 35.0% in 2016, by tangible equity.
- (3) Non-GAAP financial measure.
- (4) Efficiency ratio is computed by dividing total core tangible non-interest expense by the sum of total net interest income on a fully taxable equivalent basis and total core non-interest income. The Company uses this non-GAAP measure to provide important information about its operating efficiency.
- (5)



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SECOND QUARTER FINANCIAL SUMMARY

The Company reported second quarter 2017 net income of \$6.6 million, or 42 cents per share. Adjusted earnings totaled \$8.1 million, or 52 cents per share. Net income increased 56% over the prior quarter and adjusted earnings increased 21% reflecting the strength of the expanded operations. Merger-related and systems conversion costs in the second quarter of 2017 totaled \$0.10 per share (after-tax). As discussed in an earlier section, the Company uses the non-GAAP measure of adjusted earnings, and related metrics, to evaluate the results of its operations

Second quarter financial highlights include the following (comparisons are to prior quarter unless otherwise stated):

- ▲1% increase in net interest income
- ▲10% increase in fee income
- ▲20 bps improvement in core ROA to 0.94% (non-GAAP measure)
- ▲56.0% efficiency ratio (non-GAAP measure)
- ▲7.1% annualized deposit growth
- ▲0.22% non-performing loans to total loans

The second quarter results reflect the Company's focus on executing profitability strategies across its newly expanded footprint. All performance metrics improved as the Company grew revenue and increased operational efficiencies through disciplined expense management during the quarter. The Company also successfully completed a systems conversion on time and according to plan.

The Company delivered positive operating leverage during the quarter resulting in higher earnings per share and a strengthening of the balance sheet position. Asset quality remains strong and is demonstrated by a ratio of non-performing loans to total loans in the second quarter 2017 of 22 basis points compared to 52 basis for the same quarter of 2016.

COMPARISON OF OPERATING RESULTS FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2017 AND 2016

Summary

Results in 2017 include the Lake Sunapee operations acquired on January 13, 2017. As a result, many measures of revenue, expense, income, and average balances increased compared to prior periods.

As previously noted, the Company uses a non-GAAP measure of adjusted net income to supplement its evaluation of its operating results. Adjusted net income excludes certain amounts not viewed as part of normalized operations. These non-operating items consist primarily of merger, acquisition, conversion, and net gains realized from sales of assets from the Company's security portfolio. The Company views its net merger related costs as part of the economic investment for its acquisition.

Second quarter GAAP net income per share was \$0.42 in 2017 compared to \$0.47 in 2016. Adjusted net income increased by 33% to \$0.52 per share from \$0.39 for these respective periods. Results increased due to expanded operations and improved profitability. GAAP results in the current year include charges related to the Lake Sunapee Bank Group merger, and prior year net income benefited from gains from sales of securities.

First half GAAP net income per share was \$0.72 in 2017 compared to \$0.96 in 2016. Adjusted earnings increased by 23% to \$0.95 per share from \$0.77 for these respective periods. These changes largely reflected the same trends discussed above that drove second quarter earnings growth.



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Adjusted return on equity and adjusted return on assets improved on a year-over-year basis while respective GAAP basis performance metrics varied in the past five quarters depending upon merger related charges and gains on security sales. The Company's profitability has benefited from both a higher net interest margin as well as improved efficiency, with the efficiency ratio decreasing to 56% in the most recent quarter. The efficiency ratio is a non-GAAP financial measure that compares adjusted expenses and revenues to assess how well the Company is managing its costs. Higher ratios in prior periods represent gradual investments made in infrastructure and key employees to support operations across a broader footprint and larger revenue producing institution.

### Net Interest Income

Second quarter net interest income increased year-over-year by \$12.4 million to \$23.8 million. This included the benefit of a \$1.6 billion increase in average earning assets due to growth from the Lake Sunapee Bank Group merger and business activities. Net interest margin increased to 3.16% in the second quarter compared to 3.04% in the same quarter of 2016. Net interest margin in 2017 benefited from purchased loan accretion totaling \$1.7 million in the second quarter while yields from other earning assets remained consistent with prior year.

For the first six months of the year, net interest income increased year to year by \$22.5 million to \$45.2 million. The increase primarily reflects the inclusion of Lake Sunapee Bank's operations, and purchased loan accretion of \$1.9 million during 2017.

### Non-Interest Income

Second quarter non-interest income increased to \$6.6 million from \$3.6 million in the same quarter of 2016. Non-interest income, excluding gains on securities, increased \$4.6 million from the same quarter in 2016. Trust and investment management fee revenue added \$2.4 million, which is principally due to the addition of Charter Trust Company (now a wholly owned subsidiary of the Bank) from the Lake Sunapee Bank Group merger. Customer service fees increased \$1.7 million compared to the prior quarter also as a result of the acquisition given the broader customer deposit base and higher number of ATM transactions.

Non-interest income for the six months of 2017 increased year-over-year by \$5.6 million to \$12.5 million. The increase in fee income for the six month period is driven by the same reasons as the quarterly period. However, income in 2016 also included \$3.1 million from gains on security sales.

### Loan Loss Provision

The provision for loan losses in the second quarter 2017 increased to \$736 thousand from \$150 thousand for the same quarter in 2016. On a year-to-date basis, the loan loss provision was \$1.5 million in 2017 compared to \$615 thousand in 2016. The provision for loan losses is a charge to earnings in an amount sufficient to maintain the allowance for loan losses at a level deemed adequate by the Company as an estimate of the probable and estimable loan losses in the portfolio as of period-end. The level of the allowance is a critical accounting estimate, which is subject to uncertainty. The level of the allowance was included in the discussion of financial condition. The amount of the provision exceeded net charge-offs in all periods shown, as the amount of the allowance has risen gradually based on loan portfolio growth and reflecting the ongoing improvement in loan performance and credit quality.

### Non-Interest Expense

Second quarter non-interest expense increased to \$20.0 million from \$8.7 million for the same quarter of 2016. Merger related expenses were \$2.5 million during the second quarter of 2017 and \$492 thousand for the same period of 2016. Salary and employee benefit costs increased by \$5.3 million compared with the second quarter of 2016 principally due to the Lake Sunapee Bank Group merger. Full time equivalent staff totaled 487 as of the second quarter end compared to 207 of the same quarter end of 2016. Occupancy expenses increased \$1.9 million as compared to the second quarter of 2016 due to costs of operating additional branches from the merger. On a year to date basis 2017 non-interest expense increased to \$40.9 million from \$16.7 million in 2016. Merger related expenses

for the first six months of 2017 totaled \$5.6 compared to \$492 thousand in the same period of 2016. All other increases in non-interest expense on a year-to-date basis are consistent with quarterly trends.

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### Income Tax Expense

The effective tax was 31.6% in the second quarter 2017 compared to 29.5% in the same quarter of 2016, which reflects higher pretax income. On a year to date basis, the 2017 rate was 29.5% compared with 29.2% in the prior year. The rate in 2017 includes a merger related discrete tax adjustment that reduced the quarterly rate based on the revaluation of the Company's net deferred tax assets to take into consideration the Company's increased taxability in New Hampshire resulting from the Lake Sunapee acquisition.

## COMPARISON OF FINANCIAL CONDITION AT JUNE 30, 2017 AND DECEMBER 31, 2016

### Summary

Total assets increased to \$3.5 billion at June 30, 2017 from \$1.8 billion at year end 2016. All major categories of assets, liabilities and equity increased due to the acquired balances which included \$1.2 billion in loans, \$155.6 million in securities, \$1.2 billion in deposits, and \$182 million in equity as a result of the issuance of common shares of the Company to Lake Sunapee shareholders. The loan to deposit ratio improved to 107% from 108% at year-end 2016 despite loan growth and the seasonal lows in deposits typically experienced in the first half of the year.

The Company's book value per share increased to \$22.53 from \$17.19 in the fourth quarter primarily due to the shares issued in the first quarter 2017 in connection with the merger. However, strong GAAP net income increased book value per share by \$0.36 in the second quarter of 2017.

Asset quality continues to improve as the ratio of non-accruing loans to total loans decreased to 0.22% in the second quarter from 0.58% at year-end 2016. The ratio of net charge-offs to total loans remain close to zero in past five quarters ending the second quarter at 4 basis points.

### Securities

Total securities increased \$208.3 million which includes \$155.6 million of securities acquired from Lake Sunapee and \$112.3 million in securities purchased during the six months ended June 30, 2017. Securities purchased included \$85.3 million of mortgage-backed securities guaranteed by US Government-sponsored enterprises, \$19.6 million of corporate bonds, and \$7.4 million of FHLBB stock. The increase was offset by \$61.3 million of maturities, calls and pay-downs of amortizing securities. The securities portfolio continues to be a strong source of liquidity for the Company and is comprised primarily of highly rated mortgage-backed securities guaranteed by U.S. Government-sponsored enterprises and U.S. Government agencies, obligations of state and political subdivisions thereof and FHLBB stock. We continually evaluate our investment securities portfolio in response to established asset/liability management objectives, changing market conditions and the level of interest rate risk to which we are exposed.

### Loans

The acquisition of Lake Sunapee increased the legal lending limit of the Bank and expanded the lending area across all three of the northern New England states which resulted in organic growth in the loan portfolio. Excluding the impact of the acquired balances, total loans increased during the six month period of 2017 by 7.0% on an annualized basis with 5.0% annualized growth in commercial loans led mostly by commercial and industrial loans. Loan growth was affected by a large commercial real estate payoff that occurred just prior to the second quarter end.

### Allowance for loan losses

During the six months ending June 30, 2017, the allowance for loan losses increased \$1.0 million to \$11.4 million, which is due to the increase in business activity loans and lower charge-off activity reflecting improved asset quality. The determination of the allowance for loan losses is a critical accounting estimate. The Company considers the allowance for loan losses appropriate to cover probable losses which can be reasonably estimated in the loan portfolio

as of the balance sheet date. Under accounting standards for business combinations, acquired loans are recorded at fair value with no loan loss allowance on the date of acquisition. An allowance for loan loss is recorded by the Company for the emergence of new probable and estimable losses on acquired loans which were not impaired as of the acquisition date. Because of the accounting for acquired loans, some measures of the loan loss allowance are not comparable to periods prior to the acquisition date or to peer measures.

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### Deposits

Excluding the impact of acquired balances, total deposits increased \$12.1 million as of June 30, 2017 when compared to December 31, 2016. Core deposits are still the primary funding source for loan growth and the Company took on additional FHLBB borrowings in order to fund additional loan growth in the period. Historically, the Bank's deposit market area has been seasonal, with lower deposits in the winter and spring months and higher deposits in the summer and autumn months; however, this seasonality is less present in the expanded deposit market areas of New Hampshire and Vermont.

### Borrowings

Excluding the impact of the Lake Sunapee acquisition, total borrowings increased by \$146.2 million in the first half of 2017, which was largely used to fund loan growth and investment purchases. The increase was mostly in short term FHLBB advances. The cost of borrowings increased to 1.41% in the most recent quarter from 1.05% in the fourth quarter of 2016. The increase in borrowing rates is due in part to increases in Fed Funds rates at the end of December 2016, March 2017, and June 2017, which caused short term FHLBB rates to increase.

### Equity

Excluding the \$181.9 million of common stock of the Company issued to Lake Sunapee shareholders, total equity increased by \$8.4 million, or 5.4%. Accumulated other comprehensive loss decreased by \$2.6 million primarily due to an improvement in net after-tax fair value of available for sale securities. The improvement is related to an overall decrease in market yields since year-end 2016.

The Company evaluates changes in tangible book value, a non-GAAP financial measure which is a commonly considered valuation metric used by the investment community and which parallels some regulatory capital measures. Tangible book value per share decreased to \$15.44 as of June 30, 2017 from the \$16.61 at year-end 2016. The decrease is due to the goodwill and other intangible assets recorded for the Lake Sunapee Group merger in the first quarter 2017. The merger resulted in a \$95.3 million increase in goodwill. The Company's ratio of tangible equity to tangible assets stood at 7.01% at the end of the second quarter, compared to 8.65% at the end of 2016.

The Company and the Bank remained well capitalized under regulatory guidelines at period-end.

### Liquidity and Cash Flows

Liquidity is measured by the Company's ability to meet short-term cash needs at a reasonable cost or minimal loss. The Company seeks to obtain favorable sources of liabilities and to maintain prudent levels of liquid assets in order to satisfy varied liquidity demands. Besides serving as a funding source for maturing obligations, liquidity provides flexibility in responding to customer initiated needs. Many factors affect the Company's ability to meet liquidity needs, including variations in the markets served by its network of offices, its mix of assets and liabilities, reputation and credit standing in the marketplace, and general economic conditions.

The Bank actively manages its liquidity position through target ratios established under its Asset Liability Management Policy. Continual monitoring of these ratios, both historical and through forecasts under multiple rate and stress scenarios, allows the Bank to employ strategies necessary to maintain adequate liquidity. A portion of the Bank's deposit base has been historically seasonal in nature, with balances typically declining in the winter months through late spring, during which period the Bank's liquidity position tightens.

The Bank uses a basic surplus model to measure its liquidity over 30 and 90-day time horizons. The relationship between liquid assets and short-term liabilities that are vulnerable to non-replacement are routinely monitored. The Bank's policy is to maintain a liquidity position of at least 4% of total assets. At June 30, 2017, liquidity, as measured by the basic surplus model, was 8.2% over the 30-day horizon and 9.1% over the 90-day horizon.

As of June 30, 2017, the Bank had unused lines of credit and net unencumbered qualifying collateral availability to support its credit line with the FHLB approximating \$427.9 million. The Bank also had capacity to borrow funds on a secured basis utilizing the Borrower in Custody program and the Discount Window at the Federal Reserve Bank of Boston (the “FRB”). At December 31, 2016, the Bank’s available secured line of credit at the FRB stood at \$133.0

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million or 7.5% of the Bank's total assets. The Bank also has access to the national brokered deposit market, and has used this funding source to bolster its on balance sheet liquidity position.

The Bank maintains a liquidity contingency plan approved by the Bank's Board of Directors. This plan addresses the steps that would be taken in the event of a liquidity crisis, and identifies other sources of liquidity available to the Company. Company management believes that the level of liquidity is sufficient to meet current and future funding requirements. However, changes in economic conditions, including consumer savings habits and availability or access to the brokered deposit market could potentially have a significant impact on the Company's liquidity position.

### Capital Resources

Please see the "Shareholders' Equity" section of the Comparison of Financial Condition for a discussion of shareholders' equity together with the "Shareholders' Equity" note to the consolidated financial statements. At June 30, 2017, the regulatory capital ratios of the Bank and the Company continued to be consistent with the requirements to be classified as "well capitalized." Additional information about regulatory capital is contained in the notes to the consolidated financial statements and in the Company's 2016 Form 10-K. The Company views its earnings and related internal capital generation as a primary source of capital to support dividends and growth of the franchise.

Additionally, the Company will generally use the issuance of common stock as the primary source of consideration for a bank acquisition, and such acquisitions may result in net increases or decreases in its capital ratios. The Company's long term objective is to generate a double digit annual return on equity, and the Company evaluates lending, investment, and acquisition decisions with this objective as a benchmark. The Company also evaluates its return on tangible equity as an indicator of its capital generation to support ongoing balance sheet growth. The Risk Management/Capital Committee of the Company's Board of Directors is responsible for assisting the Board in planning for future capital needs and for ensuring compliance with regulations pertaining to capital structure and levels. The Company believes that the market for its stock is an additional capital resource over the long run and that the Company's common stock is a significant resource available as merger consideration in the event of future acquisitions and business combinations. Additionally, the Company continues to monitor market conditions for other forms of regulatory capital such as preferred stock or subordinated debt, which are additional potential future capital resources to the Company and/or the Bank.

### APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES, AND RECENT ACCOUNTING PRONOUNCEMENTS

The Company's significant accounting policies are described in Note 1 to the consolidated financial statements in this Form 10-Q and in the most recent Form 10-K. Please see those policies in conjunction with this discussion. The accounting and reporting policies followed by the Company conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While the Company bases estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

The SEC defines "critical accounting policies" as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods. Please see those policies in conjunction with this discussion. Management believes that the following policies would be considered critical under the SEC's definition:

**Allowance for Loan Losses:** The allowance for loan losses represents probable credit losses that are inherent in the loan portfolio at the financial statement date and which may be estimated. Management uses historical information, as

well as current economic data, to assess the adequacy of the allowance for loan losses as it is affected by changing economic conditions and various external factors, which may impact the portfolio in ways currently unforeseen. Although management believes that it uses appropriate available information to establish the allowance for loan losses, future additions to the allowance may be necessary if certain future events occur that cause actual results to differ from the assumptions used in making the evaluation. Conditions in the local economy and real estate values could require the Company to increase provisions for loan losses, which would negatively impact earnings.

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**Acquired Loans:** Loans that the Company acquired in business combinations are initially recorded at fair value with no carryover of the related allowance for credit losses. Determining the fair value of the loans involves estimating the amount and timing of principal and interest cash flows initially expected to be collected on the loans and discounting those cash flows at an appropriate market rate of interest. Going forward, the Company continues to evaluate reasonableness of expectations for the timing and the amount of cash to be collected. Subsequent decreases in expected cash flows may result in changes in the amortization or accretion of fair market value adjustments, and in some cases may result in the loan being considered impaired. For collateral dependent loans with deteriorated credit quality, the Company estimates the fair value of the underlying collateral of the loans. These values are discounted using market derived rates of return, with consideration given to the period of time and costs associated with the foreclosure and disposition of the collateral.

**Income Taxes:** Significant management judgment is required in determining income tax expense and deferred tax assets and liabilities. The Company uses the asset and liability method of accounting for income taxes in which deferred tax assets and liabilities are established for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. The realization of the net deferred tax asset generally depends upon future levels of taxable ordinary income, taxable capital gain income, and the existence of prior years' taxable income, to which carry back refund claims could be made. A valuation allowance would be established for deferred tax assets that management estimates are more likely than not to be unrealizable based on available evidence at the time the estimate is made. There was no valuation allowance as of June 30, 2017.

**Goodwill and Identifiable Intangible Assets:** Goodwill and identifiable intangible assets are recorded as a result of business acquisitions and combinations. These assets are evaluated for impairment annually or whenever events or changes in circumstances indicate the carrying value of these assets may not be recoverable. When these assets are evaluated for impairment, if the carrying amount exceeds fair value, an impairment charge is recorded to income. The fair value is based on observable market prices, when practicable. Other valuation techniques may be used when market prices are unavailable, including estimated discounted cash flows and analysis of market pricing multiples. These types of analyses contain uncertainties because they require management to make assumptions and to apply judgment to estimate industry economic factors and the profitability of future business strategies. In the event of future changes in fair value, the Company may be exposed to an impairment charge that could be material.

**Determination of Other-Than-Temporary Impairment of Securities:** The Company evaluates debt and equity securities within the Company's available for sale for other-than-temporary impairment (OTTI), at least quarterly. If the fair value of a debt security is below the amortized cost basis of the security, OTTI is required to be recognized if any of the following are met: (1) the Company intends to sell the security; (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) for debt securities, the present value of expected cash flows is not sufficient to recover the entire amortized cost basis. For all impaired debt securities that the Company intends to sell, or more likely than not will be required to sell, the full amount of the loss is recognized as OTTI through earnings. Credit-related OTTI for all other impaired debt securities is recognized through earnings. Noncredit related OTTI for such debt securities is recognized in other comprehensive income, net of applicable taxes. In evaluating its marketable equity securities portfolios for OTTI, the Company considers its intent and ability to hold an equity security to recovery of its cost basis in addition to various other factors, including the length of time and the extent to which the fair value has been less than cost and the financial condition and near term prospects of the issuer. Any OTTI on marketable equity securities is recognized immediately through earnings. Should actual factors and conditions differ materially from those expected by management, the actual realization of gains or losses on investment securities could differ materially from the amounts recorded in the financial statements.

**Fair Value of Financial Instruments:** The Company uses fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. Trading assets, securities available for sale, and

derivative instruments are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, or to establish a loss allowance or write-down based on the fair value of impaired assets. Further, the notes to financial statements include information about the extent to which fair value is used to measure assets and liabilities, the valuation methodologies used and its impact to earnings. For financial instruments not recorded at fair value, the notes to financial statements disclose the estimate

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of their fair value. Due to the judgments and uncertainties involved in the estimation process, the estimates could result in materially different results under different assumptions and conditions.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

Market risk is the risk of loss in a financial instrument arising from adverse changes in market rates/prices, such as interest rates, foreign currency exchange rates, commodity prices and equity prices. Interest rate risk is the most significant market risk affecting the Company. Other types of market risk do not arise in the normal course of the Company's business activities.

The responsibility for interest rate risk management oversight is the function of the Bank's Asset and Liability Committee ("ALCO"), chaired by the Chief Financial Officer and composed of various members of senior management. ALCO meets regularly to review balance sheet structure, formulate strategies in light of current and expected economic conditions, adjust product prices as necessary, implement policy, monitor liquidity, and review performance against guidelines established to control exposure to the various types of inherent risk.

**Interest Rate Risk:** Interest rate risk can be defined as an exposure to movement in interest rates that could have an adverse impact on the Bank's net interest income. Interest rate risk arises from the imbalance in the re-pricing, maturity and or cash flow characteristics of assets and liabilities. Management's objectives are to measure, monitor and develop strategies in response to the interest rate risk profile inherent in the Bank's balance sheet. The objectives in managing the Bank's balance sheet are to preserve the sensitivity of net interest income to actual or potential changes in interest rates, and to enhance profitability through strategies that promote sufficient reward for understood and controlled risk.

The Bank's interest rate risk measurement and management techniques incorporate the re-pricing and cash flow attributes of balance sheet and off-balance sheet instruments as they relate to current and potential changes in interest rates. The level of interest rate risk, measured in terms of the potential future effect on net interest income, is determined through the use of modeling and other techniques under multiple interest rate scenarios. Interest rate risk is evaluated in depth on a quarterly basis and reviewed by ALCO and the Company's Board of Directors.

The Bank's Asset Liability Management Policy, approved annually by the Bank's Board of Directors, establishes interest rate risk limits in terms of variability of net interest income under rising, flat, and decreasing rate scenarios. It is the role of the ALCO to evaluate the overall risk profile and to determine actions to maintain and achieve a posture consistent with policy guidelines.

**Interest Rate Sensitivity Modeling:** The Bank utilizes an interest rate risk model widely recognized in the financial industry to monitor and measure interest rate risk. The model simulates the behavior of interest income and expense for all balance sheet and off-balance sheet instruments, under different interest rate scenarios together with a dynamic future balance sheet. Interest rate risk is measured in terms of potential changes in net interest income based upon shifts in the yield curve.

The interest rate risk sensitivity model requires that assets and liabilities be broken down into components as to fixed, variable, and adjustable interest rates, as well as other homogeneous groupings, which are segregated as to maturity and type of instrument. The model includes assumptions about how the balance sheet is likely to evolve through time and in different interest rate environments. The model uses contractual re-pricing dates for variable products, contractual maturities for fixed rate products, and product-specific assumptions for deposit accounts, such as money market accounts, that are subject to re-pricing based on current market conditions. Re-pricing margins are also determined for adjustable rate assets and incorporated in the model. Investment securities and borrowings with call provisions are examined on an individual basis in each rate environment to estimate the likelihood of a call.

Prepayment assumptions for mortgage loans and mortgage-backed securities are developed from industry median estimates of prepayment speeds, based upon similar coupon ranges and degree of seasoning. Cash flows and maturities are then determined, and for certain assets, prepayment assumptions are estimated under different interest rate scenarios. Interest income and interest expense are then simulated under several hypothetical interest rate conditions including:

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• A flat interest rate scenario in which current prevailing rates are locked in and the only balance sheet fluctuations that occur are due to cash flows, maturities, new volumes, and re-pricing volumes consistent with this flat rate assumption;

• A 200 basis point rise or decline in interest rates applied against a parallel shift in the yield curve over a twelve-month horizon together with a dynamic balance sheet anticipated to be consistent with such interest rate changes;

• Various non-parallel shifts in the yield curve, including changes in either short-term or long-term rates over a twelve-month horizon, together with a dynamic balance sheet anticipated to be consistent with such interest rate changes; and

An extension of the foregoing simulations to each of two, three, four and five year horizons to determine the interest rate risk with the level of interest rates stabilizing in years two through five. Even though rates remain stable during this two to five year time period, re-pricing opportunities driven by maturities, cash flow, and adjustable rate products will continue to change the balance sheet profile for each of the interest rate conditions.

Changes in net interest income based upon the foregoing simulations are measured against the flat interest rate scenario and actions are taken to maintain the balance sheet interest rate risk within established policy guidelines.

As of June 30, 2017 interest rate sensitivity modeling results indicate that the Bank's balance sheet was moderately liability sensitive over the one- and two-year horizons (i.e., moderately exposed to rising interest rates).

Assuming short-term and long-term interest rates decline 100 basis points from current levels (i.e., a parallel yield curve shift) and the Bank's balance sheet structure and size remain at current levels, management believes net interest income will modestly improve over the one year horizon (+.7% versus the base case) while remaining relatively stable over the two-year horizon (+.8% versus the base case). Should the yield curve steepen as rates fall, the model suggests that accelerated earning asset prepayments will slow, resulting in a more stabilized level of net interest income. Management anticipates that moderate to strong earning asset growth will be needed to meaningfully increase the Bank's current level of net interest income should both long-term and short-term interest rates decline in parallel.

Assuming the Bank's balance sheet structure and size remain at current levels and the Federal Reserve increases short-term interest rates by 200 basis points with the balance of the yield curve shifting in parallel with these increases, management believes net interest income will decline moderately over the one and two-year horizons (-3.8% and -6.2%, respectively, versus the base case) as increased funding costs outpace increases in earning asset yields. The interest rate sensitivity simulation model suggests that as interest rates rise, the Bank's funding costs will initially re-price disproportionately with earning asset yields to a moderate degree. As funding costs begin to stabilize early in the third year of the simulation, the model suggests that the earning asset portfolios will continue to re-price at prevailing interest rate levels and cash flows from the Bank's earning asset portfolios will be reinvested into higher yielding earning assets, resulting in a widening of spreads and a stabilization of net interest income over the three year horizon and beyond. Management believes moderate to strong earning asset growth will be necessary to meaningfully increase the current level of net interest income over the one-year and two-year horizons should short-term and long-term interest rates rise in parallel.

As compared to March 31, 2017, the year-one sensitivity in the down 100 basis points scenario remained in line for the quarter (+.43% prior, versus +.74% current). The year-two sensitivities in the down 100 basis points scenario showed a modest improvement going from -.94% to +.79%. In the year-one up 200 basis points scenario, results are consistent with the prior quarter (-3.20% prior, versus -3.78% current). Year-two, up 200 basis points shows a slightly more negative result (-4.87% prior, versus -6.23% current), although on balance, the current aggregate position is consistent with the prior quarter's.

Despite four rate hikes over the last eighteen months, the Federal Reserve continues to maintain short-term interest rates at low levels, threatening net interest income. Net interest income exposure is also significantly affected by the shape and level of the U.S. Government securities and interest rate swap yield curve, and changes in the size and



composition of the Bank's loan, investment and deposit portfolios.

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The preceding sensitivity analysis does not represent a Company forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions including: the nature and timing of interest rate levels and yield curve shape, prepayment speeds on loans and securities, deposit rates, pricing decisions on loans and deposits, reinvestment or replacement of asset and liability cash flows, and renegotiated loan terms with borrowers. While assumptions are developed based upon current economic and local market conditions, the Company cannot make any assurances as to the predictive nature of these assumptions including how customer preferences or competitor influences might change.

As market conditions vary from those assumed in the sensitivity analysis, actual results may also differ due to: prepayment and refinancing levels deviating from those assumed; the impact of interest rate changes, caps or floors on adjustable rate assets; the potential effect of changing debt service levels on customers with adjustable rate loans; depositor early withdrawals and product preference changes; and other such variables. The sensitivity analysis also does not reflect additional actions that the Bank's Senior Executive Team and Board of Directors might take in responding to or anticipating changes in interest rates, and the anticipated impact on the Bank's net interest income.

The Bank engages an independent consultant to periodically review its interest rate risk position and the reasonableness of assumptions used, with periodic reports provided to the Bank's Board of Directors. At June 30, 2017, there were no significant differences between the views of the independent consultant and management regarding the Bank's interest rate risk exposure.

ITEM 4. CONTROLS AND PROCEDURES

a) Disclosure controls and procedures.

The principal executive officers, including the principal financial officer, based on their evaluation of disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q, have concluded that the Company's disclosure controls and procedures were effective.

b) Changes in internal control over financial reporting.

There were no changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

The Company and its subsidiaries are parties to certain ordinary routine litigation incidental to the normal conduct of their respective businesses, which in the opinion of management based upon currently available information will have no material effect on the Company's consolidated financial statements.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed below and in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016, which could materially affect our business, financial condition or future results. The risks described in this form are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.



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## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Not applicable.

(b) Not applicable.

(c) The following table provides certain information with regard to shares repurchased by the Company in the second quarter of 2017:

| Period           | Total number of shares purchased | Average price paid per share | Total number of shares purchased as a part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs (1) |
|------------------|----------------------------------|------------------------------|--|--|
| April 1-30, 2017 | 2,861                            | \$ 30                        | 2,861  | 411,448  |
| May 1-31, 2017   | —                                | —                            | —  | 411,448  |
| June 1-30, 2017  | —                                | —                            | —  | 411,448  |
| Total            | 2,861                            | \$ 30                        | 2,861  | 411,448  |

(1) In August 2008, the Company's Board of Directors approved a twenty-four month program to repurchase up to 450,000 shares of the Company's common stock, or approximately 10.2% of the shares then outstanding. The Company's Board of Directors authorized the continuance of this program for additional twenty-four month periods in August 2010, 2012 and 2014. On August 16, 2016, Bar Harbor Bankshares issued a press release announcing the Company's Board of Directors has approved the continuation of the Company's existing stock repurchase plan through August 16, 2018. No other changes were made to the plan. Depending on market conditions and other factors, stock repurchases may be commenced or suspended at any time, or from time to time, without prior notice and may be made in the open market or through privately negotiated transactions. The Company records repurchased shares as treasury stock.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

|      |  |  |
|------|--|--|
| 3.1  | Articles of Incorporation, as amended to date  | Incorporated herein by reference to Form 10-Q, Part II, Item 6, Exhibit 3.1, filed with the commission on November 5, 2015 (Commission File No. 00113349). |
| 3.2  | Bylaws, as amended to date   | Incorporated herein by reference to Form 8-K, Item 5.03, Exhibit 3.2, filed with the Commission on November 29, 2011.                                      |
| 4.1  | Certificate of Designations, Fixed Rate Cumulative Perpetual Preferred Stock, Series A                                       | Incorporated herein by reference to Form 8-K, Exhibit 3.1, filed with the Commission on January 21, 2009 (Commission File No. 00113349).                   |
| 4.2  | Form of Specimen Stock Certificate for Series A Preferred Sock   | Incorporated by reference to Form 8-K, Exhibit 4.1, filed with the Commission on January 21, 2009 (Commission File No. 00113349).                          |
| 4.3  | Debt Securities Purchase Agreement   | Incorporated herein by reference to Form 10-K, Part IV, Item 15, Exhibit 4.5, filed with the commission on March 16, 2009 (Commission File No. 00113349).  |
| 4.4  | Form of Subordinated Debt Security of Bar Harbor Bank & Trust  | Incorporated herein by reference to Form 10-K, Part IV, Item 15, Exhibit 4.6, filed with the commission on March 16, 2009 (Commission File No. 00113349).  |
| 4.5  | Description of Company Common Stock  | Incorporated by reference to Form 8-K, Items 8.01 and 9.01, Exhibit 99.1, filed August 7, 2015 (Commission File No. 00113349).                             |
| 10.1 | Employment Agreement by and between William J. McIver, Bar Harbor Bankshares and Bar Harbor Bank & Trust, dated May 5, 2016. | Incorporated by reference to Form 8-K, 8.01, Exhibit 10.2, filed May 9, 2016 (Commission File No. 00113349).   |
| 11.1 | Statement of re computation of per share earnings  | Statement of re computation of per share earnings is provided in Note 1 to the Consolidated Financial Statements in this Report                            |
| 31.1 | Certification of Chief Executive Officer under Rule 13a-14(a)/15d-14(a)  | Filed herewith   |
| 31.2 | Certification of Chief Financial Officer under Rule 13a-14(a)/15d-14(a)  | Filed herewith   |
| 32.1 | Certification of Chief Executive Officer under 18 U.S.C. Sec. 1350.  | Furnished herewith   |
| 32.2 | Certification of Chief Financial Officer under 18 U.S.C. Sec. 1350.  | Furnished herewith   |

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The following financial information from the Company's Annual Report on Form 10-Q for the quarter ended June 30, 2017 is formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Condensed  
101 Statements of Income, (ii) the Condensed Consolidated Balance Sheets, (iii) the Condensed Consolidated  
Statements of Changes in Shareholders' Equity, (iv) Consolidated Statements of Cash Flows and (v) Notes to the  
Consolidated Condensed Financial Statements

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SIGNATURES

Pursuant to the requirements 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.

BAR HARBOR BANKSHARES

Dated: August 8, 2017 By: /s/ Curtis C. Simard  
Curtis C. Simard  
President & Chief Executive Officer

Dated: August 8, 2017 By: /s/ Josephine Iannelli  
Josephine Iannelli  
Executive Vice President, Chief Financial Officer, & Principal Accounting Officer