NORTHEAST BANCORP /ME/
Form 10-Q
May 08, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2014

Commission File Number: 1-14588

Northeast Bancorp

(Exact name of registrant as specified in its charter)

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

(207) 786-3245

Registrant s telephone number, including area code

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of April 30, 2014 the registrant had outstanding 9,550,031 shares of voting common stock, $1.00 par value per share and 880,963 shares of non-voting common stock, $1.00 par value per share.

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PART 1- FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(Unaudited)

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

		March 31, 2014		June 30, 2013
Assets				
Cash and due from banks	$	2,677	$	3,238
Short-term investments		71,686		62,696
Total cash and cash equivalents		74,363		65,934
Available-for-sale securities, at fair value		112,732		121,597
Loans held for sale		9,827		8,594
Loans				
Commercial real estate		299,898		264,448
Residential real estate		153,972		127,829
Construction				42
Commercial and industrial		49,554		29,720
Consumer		10,828		13,337
Total loans		514,252		435,376
Less: Allowance for loan losses		1,345		1,143
Loans, net		512,907		434,233
Premises and equipment, net		9,211		10,075
Real estate owned and other possessed collateral, net		2,000		2,134
Federal Home Loan Bank and Federal Reserve Bank stock, at cost		5,721		5,721
Intangible assets, net		2,962		3,544
Bank owned life insurance		14,726		14,385
Other assets		6,444		4,422
Total assets	$	750,893	$	670,639
Liabilities and Stockholders Equity				
Deposits				
Demand	$	43,294	$	46,425
Savings and interest checking		100,961		90,970
Money market		86,735		84,416
Time		332,320		262,812
Total deposits		563,310		484,623
Federal Home Loan Bank advances		42,878		28,040
Wholesale repurchase agreements		10,240		25,397
Short-term borrowings		2,585		625
Junior subordinated debentures issued to affiliated trusts		8,396		8,268
Capital lease obligation		1,604		1,739

Other liabilities		7,872		8,145
Total liabilities		636,885		556,837
Commitments and contingencies				
Stockholders equity				
Preferred stock, $1.00 par value, 1,000,000 shares authorized; no shares issued and outstanding at March 31, 2014 and June 30, 2013				
Voting common stock, $1.00 par value, 25,000,000 shares authorized; 9,551,531 and 9,565,680 shares issued and outstanding at March 31, 2014 and June 30, 2013, respectively		9,552		9,566
Non-voting common stock, $1.00 par value, 3,000,000 shares authorized; 880,963 shares issued and outstanding at March 31, 2014 and June 30, 2013		881		881
Additional paid-in capital		93,371		92,745
Retained earnings		11,856		12,524
Accumulated other comprehensive loss		(1,652)		(1,914)
Total stockholders equity		114,008		113,802
Total liabilities and stockholders equity	$	750,893	$	670,639

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

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

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013	Nine Months Ended March 31, 2014	Nine Months Ended March 31, 2013
Interest and dividend income:				
Interest on loans	$ 8,403	$ 9,601	$ 27,142	$ 25,209
Interest on available-for-sale securities	253	234	797	929
Other interest and dividend income	61	85	208	283
Total interest and dividend income	8,717	9,920	28,147	26,421
Interest expense:				
Deposits	1,022	1,084	3,048	3,090
Federal Home Loan Bank advances	324	232	975	750
Wholesale repurchase agreements	93	135	285	515
Short-term borrowings	6	4	17	15
Junior subordinated debentures issued to affiliated trusts	140	190	525	574
Obligation under capital lease agreements	20	22	63	69
Total interest expense	1,605	1,667	4,913	5,013
Net interest and dividend income before provision for loan losses	7,112	8,253	23,234	21,408
Provision for loan losses	180	346	407	821
Net interest and dividend income after provision for loan losses	6,932	7,907	22,827	20,587
Noninterest income:				
Fees for other services to customers	385	430	1,246	1,202
Net securities gains				792
Gain on sales of loans held for sale	265	625	1,145	2,295
Gain on sales of portfolio loans	373	1,228	603	2,226
Gain recognized on real estate owned and other repossessed collateral, net	165	230	50	681
Bank-owned life insurance income	108	118	342	599
Other noninterest income	12	12	46	68
Total noninterest income	1,308	2,643	3,432	7,863
Noninterest expense:				
Salaries and employee benefits	3,759	4,687	12,624	12,170
Occupancy and equipment expense	1,450	1,218	4,075	3,341
Professional fees	366	388	1,115	1,210
Data processing fees	257	239	770	671
Marketing expense	86	249	225	678
Loan acquisition and collection expense	440	352	1,203	1,285
FDIC insurance premiums	127	125	354	364
Intangible asset amortization	162	205	582	735
Legal settlement recovery			(250)	

Other noninterest expense		869		665		2,284		2,034
Total noninterest expense		7,516		8,128		22,982		22,488
Income from continuing operations before income tax expense		724		2,422		3,277		5,962
Income tax expense		287		792		1,119		1,913
Net Income from continuing operations		437		1,630		2,158		4,049
Income (loss) from discontinued operations before income tax expense (benefit)				55		(12)		253
Income tax expense (benefit)				19		(4)		87
Net income (loss) from discontinued operations				36		(8)		166
Net income	$	437	$	1,666	$	2,150	$	4,215
Net income available to common stockholders	$	437	$	1,666	$	2,150	$	3,860
Weighted-average shares outstanding:								
Basic		10,432,494		10,425,576		10,435,300		10,397,280
Diluted		10,432,494		10,425,576		10,435,300		10,397,280
Earnings per common share:								
Basic:								
Income from continuing operations	$	0.04	$	0.16	$	0.21	$	0.35
Income from discontinued operations		0.00		0.00		0.00		0.02
Net Income	$	0.04	$	0.16	$	0.21	$	0.37
Diluted:								
Income from continuing operations	$	0.04	$	0.16	$	0.21	$	0.35
Income from discontinued operations		0.00		0.00		0.00		0.02
Net Income	$	0.04	$	0.16	$	0.21	$	0.37
Cash dividends declared per common share	$	0.09	$	0.09	$	0.27	$	0.27

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(Dollars in thousands)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013	Nine Months Ended March 31, 2014	Nine Months Ended March 31, 2013
Net income	$ 437	$ 1,666	$ 2,150	$ 4,215
Other comprehensive income (loss), before tax:				
Available-for-sale securities:				
Change in net unrealized gain or loss on available-for-sale securities	579	(164)	449	(318)
Reclassification adjustment for net gains included in net income				(792)
Total available-for-sale securities	579	(164)	449	(1,110)
Derivatives and hedging activities:				
Change in accumulated loss on effective cash flow hedges	(528)	62	56	127
Reclassification adjustments for net gains included in net income	(72)	(17)	(108)	(54)
Total derivatives and hedging activities	(600)	45	(52)	73
Total other comprehensive (loss) income, before tax	(21)	(119)	397	(1,037)
Income tax (benefit) expense related to other comprehensive (loss) income	(7)	(40)	135	(353)
Other comprehensive (loss) income, net of tax	(14)	(79)	262	(684)
Comprehensive income	$ 423	$ 1,587	$ 2,412	$ 3,531

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(Unaudited)

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

	Preferred Stock Shares	Preferred Stock Amount	Voting Common Stock Shares	Voting Common Stock Amount	Non-voting Common Stock Shares	Non-voting Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at June 30, 2012	4,227	$ 4	9,307,127	$ 9,307	1,076,314	$ 1,076	$ 96,359	$ 12,235	$ 158	$ 119,139
Net income								4,215		4,215
Other comprehensive loss, net of tax									(684)	(684)
Conversion of non-voting common stock to voting common stock			195,351	195	(195,351)	(195)				
Dividends on preferred stock								(113)		(113)
Dividends on common stock at $0.27 per share								(2,809)		(2,809)
Offering costs							(59)			(59)
Stock-based compensation							374			374
Issuance of restricted common stock			63,202	64			(64)			
Redemption of preferred stock and warrants	(4,227)	(4)					(4,322)			(4,326)
Accretion of preferred stock							268	(268)		
Balance at March 31, 2013		$	9,565,680	$ 9,566	880,963	$ 881	$ 92,556	$ 13,260	$ (526)	$ 115,737
Balance at June 30, 2013		$	9,565,680	$ 9,566	880,963	$ 881	$ 92,745	$ 12,524	$ (1,914)	$ 113,802
Net income								2,150		2,150
Other comprehensive income, net of tax									262	262
Dividends on common stock at $0.27 per share								(2,818)		(2,818)
Stock-based compensation							612			612
Forfeiture of restricted common stock			(14,149)	(14)			14			
Balance at March 31, 2014		$	9,551,531	$ 9,552	880,963	$ 881	$ 93,371	$ 11,856	$ (1,652)	$ 114,008

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

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NORTHEAST BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

	Nine Months Ended March 31, 2014	Nine Months Ended March 31, 2013
Operating activities:		
Net income	$ 2,150	$ 4,215
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Provision for loan losses	407	821
Gain on sale and impairment of real estate owned and other repossessed collateral, net	(50)	(681)
Accretion of fair value adjustments on loans, net	(5,048)	(6,805)
Accretion of fair value adjustments on deposits, net	(489)	(758)
Accretion of fair value adjustments on borrowings, net	(191)	(877)
Originations of loans held for sale	(62,911)	(106,770)
Net proceeds from sales of loans held for sale	62,823	111,179
Gain on sales of loans held for sale	(1,145)	(2,295)
Gain on sales of portfolio loans	(603)	(2,226)
Amortization of intangible assets	582	735
Bank-owned life insurance income, net	(342)	(599)
Depreciation of premises and equipment	1,540	1,283
Loss on disposal of premises and equipment	16	
Net gain on sale of available-for-sale securities		(792)
Stock-based compensation	612	374
Amortization of securities, net	972	1,253
Changes in other assets and liabilities:		
Other assets	(1,978)	1,828
Other liabilities	(460)	737
Net cash (used in) provided by operating activities	(4,115)	622
Investing activities:		
Proceeds from sales of available-for-sale securities		159,579
Purchases of available-for-sale securities	(42,340)	(167,294)
Proceeds from maturities and principal payments on available-for-sale securities	50,682	10,858
Loan purchases	(46,267)	(75,227)
Loan originations and principal collections, net	(33,757)	49,759
Purchases of premises and equipment	(703)	(2,361)
Proceeds from sales of premises and equipment	11	
Proceeds from sales of real estate owned and other repossessed collateral	1,160	2,758
Proceeds from life insurance benefits		628
Proceeds from redemption of regulatory stock		352
Proceeds from sales of portfolio loans	5,575	6,749
Net cash used in investing activities	(65,639)	(14,199)
Financing activities:		
Net increase in deposits	79,176	84,156
Net increase in short-term borrowings	1,960	1,151
Dividends paid on preferred stock		(113)
Dividends paid on common stock	(2,818)	(2,809)

Proceeds from (repayment of) FHLB advances		15,000		(10,000)
Stock offering costs				(59)
Repayment of wholesale repurchase agreements		(15,000)		(40,000)
Redemption of preferred stock and warrants				(4,326)
Repayment of capital lease obligation		(135)		(128)
Net cash provided by financing activities		78,183		27,872
Net decrease in cash and cash equivalents		8,429		14,295
Cash and cash equivalents, beginning of period		65,934		128,274
Cash and cash equivalents, end of period	$	74,363	$	142,569
Supplemental schedule of noncash investing and financing activities:				
Transfers from loans to real estate owned and other repossessed collateral	$	2,174	$	4,066
Transfers from real estate owned and other repossessed collateral to loans		1,155		1,055
Transfers from premises and equipment to real estate owned and other repossessed collateral				270

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

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NORTHEAST BANCORP AND SUBSIDIARY

Notes to Unaudited Consolidated Financial Statements

March 31, 2014

1. Basis of Presentation

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

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting principally of normal recurring accruals) considered necessary for a fair presentation of the Company s financial position, results of operations, and cash flows for the interim periods presented. These financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2013 (Fiscal 2013) included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission.

2. Recent Accounting Pronouncements

In December 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities* (ASU 2011-11). The update requires entities to disclose information about offsetting and related arrangements of financial instruments and derivative instruments. The amendments require enhanced disclosures by requiring improved information about financial instruments and derivative instruments that are either (i) offset in accordance with current literature or (ii) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with current literature. ASU 2011-11 is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. The adoption of this guidance did not have a material impact on the consolidated financial statements.

In January 2013, the FASB issued ASU No. 2013-01, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities* (ASU 2013-01). The amendments clarify that the scope of Update 2011-11 applies to derivatives accounted for in accordance with Topic 815, *Derivatives and Hedging*, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The new standards are effective for annual periods beginning January 1, 2013 and for interim periods within those annual periods. Retrospective application is required. The adoption of this guidance did not have a material impact on the consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-10, *Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes* (ASU 2013-30). The amendments in ASU 2013-30 permit the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to UST and LIBOR. The amendments also remove the restriction on using different benchmark rates for similar hedges. The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. ASU 2013-30 may impact the accounting for interest rate hedging relationships entered into after July 17, 2013.

In January 2014, the FASB issued ASU No. 2014-04, *Receivables (Topic 310): Troubled Debt Restructurings by Creditors* (ASU 2014-04). The amendments clarify that when an in substance repossession or foreclosure occurs, a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (i) the amount of foreclosed residential real estate property held by the creditor and (ii) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments ASU 2014-04 are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in ASU 2014-04 using either a modified retrospective transition method or a prospective transition method. Under the modified retrospective transition method, an entity should apply the amendments by means of a cumulative-effect adjustment to residential consumer mortgage loans and foreclosed residential real estate properties existing as of the beginning of the annual period for which the amendments are effective. The Company does not expect ASU 2014-04 to have material impact on the consolidated financial statements.

In April 2014, the FASB issued ASU No. 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* (ASU 2014-08). Under

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ASU 2014-08, only disposals that represent a strategic shift that has (or will have) a major effect on the entity s results and operations would qualify as discontinued operations. In addition, ASU 2014-08 (1) expands the disclosure requirements for disposals that meet the definition of a discontinued operation, (2) requires entities to disclose information about disposals of individually significant components, and (3) updates the current definition of discontinued operations. The amendments are effective prospectively within annual periods beginning on or after December 15, 2014. The Company does not expect ASU 2014-08 to have a material impact on the consolidated financial statements.

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3. Securities Available-for-Sale

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

	March 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	$ 45,327	$ 11	$ (47)	$ 45,291
Agency mortgage-backed securities	69,592		(2,151)	67,441
	$ 114,919	$ 11	$ (2,198)	$ 112,732

	June 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	$ 45,289	$ 44	$	$ 45,333
Agency mortgage-backed securities	78,944		(2,680)	76,264
	$ 124,233	$ 44	$ (2,680)	$ 121,597

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on sale. The following table summarizes realized gains and losses on available-for-sale securities.

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
	(Dollars in thousands)			
Gross realized gains	$	$	$	$ 831
Gross realized losses				(39)
Net security gains	$	$	$	$ 792

At March 31, 2014, investment securities with a fair value of approximately $30.0 million were pledged as collateral to secure outstanding borrowings.

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

	March 31, 2014					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
	$ 33,273	$ (47)	$	$	$ 33,273	$ (47)

U.S. Government agency securities												
Agency mortgage-backed securities		32,147		(654)		35,294		(1,497)		67,441		(2,151)
	$	65,420	$	(701)	$	35,294	$	(1,497)	$	100,714	$	(2,198)

	June 30, 2013											
	Less than 12 Months				More than 12 Months				Total			
	Fair Value		Unrealized Losses		Fair Value		Unrealized Losses		Fair Value		Unrealized Losses	
	(Dollars in thousands)											
U.S. Government agency securities	$		$		$		$		$		$	
Agency mortgage-backed securities		76,264		(2,680)						76,264		(2,680)
	$	76,264	$	(2,680)	$		$		$	76,264	$	(2,680)

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

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

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

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

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due within one year	$ 3,004	$ 3,005
Due after one year through five years	42,323	42,286
Due after five years through ten years	35,719	35,045
Due after ten years	33,873	32,396
	$ 114,919	$ 112,732

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4. Loans, Allowance for Loan Losses and Credit Quality

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

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

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

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

The composition of the Company s loan portfolio follows.

		March 31, 2014			June 30, 2013	
	Originated	Purchased	Total	Originated	Purchased	Total
			(Dollars in thousands)			

Residential real estate	$	121,155	$	3,740	$	124,895	$	89,734	$	2,706	$	92,440
Home equity		29,077				29,077		35,389				35,389
Commercial real estate		118,684		181,214		299,898		100,402		164,046		264,448
Construction								42				42
Commercial business		49,549		5		49,554		29,686		34		29,720
Consumer		10,828				10,828		13,337				13,337
Total loans	$	329,293	$	184,959	$	514,252	$	268,590	$	166,786	$	435,376

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Allowance for Loan Losses and Impaired Loans

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

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

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

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

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

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

Purchased: Loans in this segment are typically secured by commercial real estate, multi-family residential real estate, or business assets and have been acquired by the Bank s Loan Acquisition and Servicing Group (LASG). Loans acquired by the LASG are, with limited exceptions, performing loans at the date of purchase. Loans in this segment acquired with specific material credit deterioration since origination are identified as purchased credit-impaired. Repayment of loans in this segment is largely dependent on cash flow from the successful operation of the property, in the case of non-owner occupied property, or operating business, in the case of owner-occupied property. Loan performance may be adversely affected by factors affecting the general economy or conditions specific to the real estate market, such as geographic location or property type.

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

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

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

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

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separately identify individual consumer and residential loans for individual impairment and disclosure. However, all TDRs are individually reviewed for impairment.

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

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

	Three Months Ended March 31, 2014						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer (Dollars in thousands)	Purchased	Unallocated	Total
Beginning balance	$ 649	$ 321	$ 52	$ 112	$ 207	$ 9	$ 1,350
Provision	151		41	25	(28)	(9)	180
Recoveries	1	1	1	5			8
Charge-offs	(123)		(43)	(27)			(193)
Ending balance	$ 678	$ 322	$ 51	$ 115	$ 179	$	$ 1,345

	Three Months Ended March 31, 2013						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer (Dollars in thousands)	Purchased	Unallocated	Total
Beginning balance	$ 492	$ 102	$ 47	$ 234	$	$	$ 875
Provision	186	117		(4)	47		346
Recoveries	2	5		5			12
Charge-offs	(102)	(43)		(8)	(47)		(200)
Ending balance	$ 578	$ 181	$ 47	$ 227	$	$	1,033

	Nine Months Ended March 31, 2014						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer (Dollars in thousands)	Purchased	Unallocated	Total
Beginning balance	$ 594	$ 173	$ 70	$ 189	$ 76	$ 41	$ 1,143
Provision	233	148	17	(53)	103	(41)	407
Recoveries	7	1	7	36			51
Charge-offs	(156)		(43)	(57)			(256)
Ending balance	$ 678	$ 322	$ 51	$ 115	$ 179	$	$ 1,345

	Nine Months Ended March 31, 2013						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer (Dollars in thousands)	Purchased	Unallocated	Total
Beginning balance	$ 214	$ 93	$ 292	$ 225	$	$	$ 824
Provision	598	126	(42)	92	47		821
Recoveries	3	5		12			20
Charge-offs	(237)	(43)	(203)	(102)	(47)		(632)
Ending balance	$ 578	$ 181	$ 47	$ 227	$	$	1,033

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

	March 31, 2014						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
				(Dollars in thousands)			
Allowance for loan losses:							
Individually evaluated	$ 221	98		6	139		464
Collectively evaluated	457	224	51	109			841
ASC 310-30					40		40
Total	$ 678	$ 322	$ 51	$ 115	$ 179	$	$ 1,345
Loans:							
Individually evaluated	$ 2,379	$ 2,259	$ 65	$ 221	$ 5,657	$	$ 10,581
Collectively evaluated	147,853	116,425	49,484	10,607			324,369
ASC 310-30					179,302		179,302
Total	$ 150,232	$ 118,684	$ 49,549	$ 10,828	$ 184,959	$	$ 514,252

	June 30, 2013						
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total
				(Dollars in thousands)			
Allowance for loan losses:							
Individually evaluated	$ 235	$ 85	$ 63	$ 23	$ 65	$	$ 471
Collectively evaluated	359	88	7	166		41	661
ASC 310-30					11		11
Total	$ 594	$ 173	$ 70	$ 189	$ 76	$ 41	$ 1,143
Loans:							
Individually evaluated	$ 2,626	$ 1,558	$ 110	$ 149	$ 1,129	$	$ 5,572
Collectively evaluated	122,497	98,886	29,576	13,188			264,147
ASC 310-30					165,657		165,657
Total	$ 125,123	$ 100,444	$ 29,686	$ 13,337	$ 166,786	$	$ 435,376

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

	March 31, 2014	June 30, 2013
	Unpaid	Unpaid

	Recorded Investment	Principal Balance	Related Allowance	Recorded Investment	Principal Balance	Related Allowance
			(Dollars in thousands)			
Impaired loans without a valuation allowance:						
Originated:						
Residential real estate	$ 1,227	$ 1,253	$	$ 1,158	$ 1,225	$
Consumer	181	187		88	93	
Commercial real estate	1,280	1,280		434	479	
Commercial business	65	103		47	101	
Purchased:						
Commercial real estate	3,743	5,896		928	1,279	
Total	6,496	8,719		2,655	3,177	
Impaired loans with a valuation allowance:						
Originated:						
Residential real estate	1,152	1,134	221	1,468	1,420	235
Consumer	40	40	6	61	61	23
Commercial real estate	979	1,013	98	1,124	1,131	85
Commercial business				63	98	63
Purchased:						
Commercial real estate	1,914	2,225	139	201	276	65
Total	4,085	4,412	464	2,917	2,986	471
Total impaired loans	$ 10,581	$ 13,131	$ 464	$ 5,572	$ 6,163	$ 471

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

	Three Months Ended March 31, 2014 Average Recorded Investment	2014 Interest Income Recognized	2013 Average Recorded Investment	2013 Interest Income Recognized
	(Dollars in thousands)			
Impaired loans without a valuation allowance:				
Originated:				
Residential real estate	$ 1,032	$ 16	$ 1,097	$ 18
Consumer	146	3	82	1
Commercial real estate	832	13	1,375	22
Commercial business	65	2	68	
Purchased:				
Commercial real estate	3,532	23		
Total	5,607	57	2,622	41
Impaired loans with a valuation allowance:				
Originated:				
Residential real estate	1,262	13	1,459	19
Consumer	77		71	1
Commercial real estate	1,117	14	762	3
Commercial business	22		44	
Purchased:				
Commercial real estate	1,925	10		
Total	4,403	37	2,336	23
Total impaired loans	$ 10,010	$ 94	$ 4,958	$ 64

	Nine Months Ended March 31, 2014 Average Recorded Investment	2014 Interest Income Recognized	2013 Average Recorded Investment	2013 Interest Income Recognized
	(Dollars in thousands)			
Impaired loans without a valuation allowance:				
Originated:				
Residential real estate	$ 1,047	$ 30	$ 825	$ 31
Consumer	115	5	52	3
Commercial real estate	635	27	1,370	61
Commercial business	64	8	169	3
Purchased:				
Commercial real estate	2,584	71	264	
Total	4,445	141	2,680	98
Impaired loans with a valuation allowance:				
Originated:				
Residential real estate	1,327	50	940	45
Consumer	84	3	54	3
Commercial real estate	1,119	59	656	16
Commercial business	38	1	221	
Purchased:				
Commercial real estate	1,062	58		
Total	3,630	171	1,871	64

Total impaired loans	$	8,075	$	312	$	4,551	$	162

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Credit Quality

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

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

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

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

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

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

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

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

	March 31, 2014					
	Originated Portfolio					
	Commercial Real Estate	Construction	Commercial Business	Residential(1)	Purchased Portfolio	Total
	(Dollars in thousands)					
Loans rated 1- 6	$ 107,003	$	$ 49,272	$ 11,859	$ 169,507	$ 337,641

	Commercial Real Estate	Construction	Commercial Business	Residential(1)	Purchased Portfolio	Total
Loans rated 7	8,720		42	763	8,282	17,807
Loans rated 8	2,961		235	657	7,170	11,023
Loans rated 9						
Loans rated 10						
	$ 118,684	$	$ 49,549	$ 13,279	$ 184,959	$ 366,471

	June 30, 2013					
	Originated Portfolio					
	Commercial Real Estate	Construction	Commercial Business	Residential(1)	Purchased Portfolio	Total
Loans rated 1- 6	$ 95,834	$ 42	$ 29,340	$ 13,110	$ 161,965	$ 300,291
Loans rated 7	3,537		82	638	3,226	7,483
Loans rated 8	1,031		264	527	1,595	3,417
Loans rated 9						
Loans rated 10						
	$ 100,402	$ 42	$ 29,686	$ 14,275	$ 166,786	$ 311,191

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

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Past Due and Nonaccrual Loans

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

	March 31, 2014							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More-Nonaccrual	Total Past Due	Total Current	Total Loans	Non-Accrual Loans
	(Dollars in thousands)							
Originated portfolio:								
Residential real estate	$ 788	$ 89	$	$ 1,468	$ 2,345	$ 118,810	$ 121,155	$ 1,678
Home equity	18			194	212	28,865	29,077	214
Commercial real estate	371			657	1,028	117,656	118,684	798
Construction								
Commercial business						49,549	49,549	
Consumer	202	82		90	374	10,454	10,828	152
Total originated portfolio	1,379	171		2,409	3,959	325,334	329,293	2,842
Purchased portfolio:								
Residential real estate						3,740	3,740	
Commercial business						5	5	
Commercial real estate	383	81		2,987	3,451	177,763	181,214	4,582
Total purchased portfolio	383	81		2,987	3,451	181,508	184,959	4,582
Total loans	$ 1,762	$ 252	$	$ 5,396	$ 7,410	$ 506,842	$ 514,252	$ 7,424

	June 30, 2013							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More-Nonaccrual	Total Past Due	Total Current	Total Loans	Non-Accrual Loans
	(Dollars in thousands)							
Originated portfolio:								
Residential real estate	$ 278	$ 408	$	$ 1,965	$ 2,651	$ 87,083	$ 89,734	$ 2,346
Home equity	53	47		253	353	35,036	35,389	334
Commercial real estate	91	326		98	515	99,887	100,402	473
Construction						42	42	
Commercial business				44	44	29,642	29,686	110
Consumer	193	77		117	387	12,950	13,337	136
Total originated portfolio	615	858		2,477	3,950	264,640	268,590	3,399
Purchased portfolio:								
Residential real estate						2,706	2,706	
Commercial business						34	34	
Commercial real estate		2,210		1,135	3,345	160,701	164,046	1,457
Total purchased portfolio		2,210		1,135	3,345	163,441	166,786	1,457

Total loans	$ 615	$ 3,068	$	$ 3,612	$ 7,295	$ 428,081	$ 435,376	$ 4,856

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Troubled Debt Restructurings

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

	Three Months Ended March 31,				Nine Months Ended March 31,			
	2014		2013		2014		2013	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Dollars in thousands)							
Extended maturity	1	$ 305	2	$ 84	5	$ 2,082	3	$ 326
Adjusted interest rate	1	36	3	84	2	118	3	84
Rate and maturity	2	65	1	50	2	65	8	733
Principal deferment			2	73	2	341	2	73
Court ordered concession	1	41	1	80	1	41	2	116
Other	2	171			2	171		
	7	$ 618	9	$ 371	14	$ 2,818	18	$ 1,332

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

[redacted]

Originated portfolio:						
Residential real estate	4	$ 164	$ 164	5	$ 228	$ 228
Home equity	1	8	8	2	84	84
Commercial real estate	1	141	141	1	103	50
Commercial business						
Consumer				1	8	8
Total originated portfolio	6	313	313	9	423	370
Purchased portfolio:						
Residential real estate						
Commercial real estate	1	305	305			
Total purchased portfolio	1	305	305			
Total	7	$ 618	$ 618	9	$ 423	$ 370

[redacted]

Originated portfolio:						
Residential real estate	4	$ 164	$ 164	9	$ 903	$ 903
Home equity	2	22	22	4	362	362
Commercial real estate	2	464	464	1	103	50
Commercial business	1	18	18			
Consumer	2	121	121	4	16	16
Total originated portfolio	11	789	789	18	1,384	1,331
Purchased portfolio:						
Residential real estate						
Commercial real estate	3	1,990	2,029			
Total purchased portfolio	3	1,990	2,029			
Total	14	$ 2,779	$ 2,818	18	$ 1,384	$ 1,331

The following table shows the loans that have been modified during the past twelve months which have subsequently defaulted during the periods indicated. The Company considers a loan to have defaulted when it reaches 90 days past due.

	Three Months Ended March 31,				**Nine Months Ended March 31,**			
	2014		**2013**		**2014**		**2013**	
	Number of Contracts	**Recorded Investment**	**Number of Contracts**	**Recorded Investment**	**Number of Contracts**	**Recorded Investment**	**Number of Contracts**	**Recorded Investment**
				(Dollars in thousands)				
Residential	2	$ 94		$	3	$ 163		$
Home equity			1	36			1	36
Consumer					1	10		
	2	$ 94	1	$ 36	4	$ 173	1	$ 36

As of March 31, 2014, there were no further commitments to lend associated with loans modified in a TDR.

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ASC 310-30 Loans

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

	Three Months Ended March 31, 2014		Nine Months Ended March 31, 2014	
	(Dollars in thousands)			
Contractually required payments receivable	$	27,024	$	70,106
Nonaccretable difference		(376)		(969)
Cash flows expected to be collected		26,648		69,137
Accretable yield		(10,348)		(22,870)
Fair value of loans acquired	$	16,300	$	46,267

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

	Three Months Ended March 31, 2014		Nine Months Ended March 31, 2014	
	(Dollars in thousands)			
Beginning balance	$	104,117	$	108,251
Acquisitions		10,348		22,870
Accretion		(3,816)		(11,452)
Reclassifications to accretable yield		83		846
Disposals and other		(4,079)		(13,862)
End balance	$	106,653	$	106,653

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

	March 31, 2014		June 30, 2013	
	(Dollars in thousands)			
Unpaid principal balance	$	218,328	$	203,755
Carrying amount	$	182,654	$	166,506

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5. Earnings Per Share (EPS)

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

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013	Nine Months Ended March 31, 2014	Nine Months Ended March 31, 2013
	(Dollars in thousands, except share and per share data)			
Net income	$ 437	$ 1,666	$ 2,150	$ 4,215
Preferred stock dividends and accretion				(355)
Net income available to common shareholders	$ 437	$ 1,666	$ 2,150	$ 3,860
Weighted average shares used in calculation of basic EPS	10,432,494	10,425,576	10,435,300	10,397,280
Incremental shares from assumed exercise of dilutive securities				
Weighted average shares used in calculation of diluted EPS	10,432,494	10,425,576	10,435,300	10,397,280
Earnings per common share:				
Income from continuing operations	$ 0.04	$ 0.16	$ 0.21	$ 0.35
Income from discontinued operations	0.00	0.00	0.00	0.02
Earnings per common share	$ 0.04	$ 0.16	$ 0.21	$ 0.37
Diluted earnings per common share:				
Income from continuing operations	$ 0.04	$ 0.16	$ 0.21	$ 0.35
Income from discontinued operations	0.00	0.00	0.00	0.02
Diluted earnings per common share	$ 0.04	$ 0.16	$ 0.21	$ 0.37

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

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013	Nine Months Ended March 31, 2014	Nine Months Ended March 31, 2013
Stock options	1,143,329	1,074,687	1,148,777	900,514
Warrants				40,775
	1,143,329	1,074,687	1,148,777	941,289

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6. Fair Value Measurements

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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Fair Value of other Financial Instruments:

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

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

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

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

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

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

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

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

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

	March 31, 2014			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Assets				
Securities available-for-sale:				
U.S. Government agency securities	$ 45,291	$	$ 45,291	$
Agency mortgage-backed securities	67,441		67,441	
Other assets interest rate caps				
Liabilities				
Other liabilities interest rate swaps	$ 333	$	$ 333	$

	June 30, 2013			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Assets				
Securities available-for-sale:				
U.S. Government agency securities	$ 45,333	$	$ 45,333	$
Agency mortgage-backed securities	76,264		76,264	
Other assets interest rate caps				
Liabilities				
Other liabilities interest rate swaps	$ 389	$	$ 389	$

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

	March 31, 2014			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Collateral dependent impaired loans	$ 1,361	$	$	$ 1,361
Real estate owned and other repossessed collateral	2,000			2,000

	June 30, 2013			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Collateral dependent impaired loans	$ 894	$	$	$ 894
Real estate owned and other repossessed collateral	2,134			2,134

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

	Carrying Amount	Fair Value Measurements at March 31, 2014 Total	Level 1	Level 2	Level 3
		(Dollars in thousands)			
Financial assets:					
Cash and cash equivalents	$ 74,363	$ 74,363	$ 74,363	$	$
Available-for-sale securities	112,732	112,732		112,732	
Regulatory stock	5,721	5,721		5,721	
Loans held for sale	9,827	9,838		9,838	
Loans, net	512,907	518,901			518,901
Accrued interest receivable	1,302	1,302		1,302	
Interest rate caps					
Financial liabilities:					
Deposits	563,310	527,447		527,447	
FHLB advances	42,878	43,981		43,981	
Wholesale repurchase agreements	10,240	10,581		10,581	
Short-term borrowings	2,585	2,585		2,585	
Capital lease obligation	1,604	1,751		1,751	
Subordinated debentures	8,396	7,583			7,583
Interest rate swaps	333	333		333	

[redacted]

Financial assets:					
Cash and cash equivalents	$ 65,934	$ 65,934	$ 65,934	$	$
Available-for-sale securities	121,597	121,597		121,597	
Regulatory stock	5,721	5,721		5,721	
Loans held for sale	8,594	8,602		8,602	
Loans, net	434,233	444,988			444,988
Accrued interest receivable	1,396	1,396		1,396	
Interest rate caps					
Financial liabilities:					
Deposits	484,623	449,857		449,857	
FHLB advances	28,040	29,404		29,404	
Wholesale repurchase agreements	25,397	26,092		26,092	
Short-term borrowings	625	625		625	
Capital lease obligation	1,739	1,926		1,926	
Subordinated debentures	8,268	7,594			7,594
Interest rate swaps	389	389		389	

7. Derivatives and Hedging Activities

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

The Company currently holds derivative instruments that contain credit-risk related features that are in a net liability position, which may require that collateral be assigned to dealer banks. At March 31, 2014, the Company had posted cash collateral totaling $1.0 million with dealer banks related to derivative instruments in a net liability position.

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

Risk Management Policies Derivative Instruments

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

Interest Rate Risk Management Cash Flow Hedging Instruments

The Company uses variable rate debt as a source of funds for use in the Company s lending and investment activities and other general business purposes. These debt obligations expose the Company to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases. Management believes

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it is prudent to limit the variability of a portion of its interest payments and, therefore, generally hedges a portion of its variable-rate interest payments.

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

March 31, 2014									
Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location
(Dollars in thousands)									
Interest rate swaps:									
$ 10,000	February 2010	February 2015	3 Mo. LIBOR	2.13%	4.69%	n/a	$ (192)	$ (226)	Other Liabilities
5,000	July 2013	July 2033	3 Mo. LIBOR	0.24%	3.38%	n/a	(30)	(30)	Other Liabilities
5,000	July 2013	July 2028	3 Mo. LIBOR	0.24%	3.23%	n/a	(46)	(46)	Other Liabilities
5,000	July 2013	July 2023	3 Mo. LIBOR	0.24%	2.77%	n/a	(31)	(31)	Other Liabilities
Interest rate caps:									
6,000	September 2009	September 2014	3 Mo. LIBOR	n/a	n/a	2.51%	(20)		Other Assets
$ 31,000							$ (319)	$ (333)	

June 30, 2013									
Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location
(Dollars in thousands)									
Interest rate swaps:									
$ 10,000	February 2010	February 2015	3 Mo. LIBOR	2.16%	4.69%	n/a	$ (223)	$ (389)	Other Liabilities
Interest rate caps:									
6,000	September 2009	September 2014	3 Mo. LIBOR	n/a	n/a	2.51%	(40)		Other Assets
$ 16,000							$ (263)	$ (389)	

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

During the periods presented, amounts recognized in income related to hedge ineffectiveness resulted from amortization of the non-zero fair value associated with the Company s single interest rate swap held at the time of the merger with FHB Formation LLC in December 2010. During the periods presented, amounts recognized in income related to amounts excluded from effectiveness testing resulted from amortization of the acquisition price of interest rate caps. The table below presents amounts recognized in income related to both hedge ineffectiveness and amounts excluded from effectiveness testing.

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013	Nine Months Ended March 31, 2014	Nine Months Ended March 31, 2013
	(Dollars in thousands)			
Interest income (expense):				
Interest rate caps	$ (8)	$ (8)	$ (22)	$ (22)
Interest rate swap	80	25	130	76
Total	$ 72	$ 17	$ 108	$ 54

The Company expects to record interest income of $90 thousand related to interest rate swap ineffectiveness in the next twelve months. The Company expects to record interest expense of $18 thousand related to its purchased interest rate caps in the next twelve months.

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8. Other Comprehensive Income

The components of other comprehensive income (loss) follow.

	Three Months Ended March 31,					
	2014			2013		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Change in net unrealized gain or loss on available-for-sale securities	$ 579	$ 196	$ 383	$ (164)	$ (55)	$ (109)
Reclassification adjustment for net gains included in net income						
Total available-for-sale securities	579	196	383	(164)	(55)	(109)
Change in accumulated loss on effective cash flow hedges	(528)	(178)	(350)	62	21	41
Reclassification adjustment for net gains included in net income	(72)	(25)	(47)	(17)	(6)	(11)
Total derivatives and hedging activities	(600)	(203)	(397)	45	15	30
Total other comprehensive loss	$ (21)	$ (7)	$ (14)	$ (119)	$ (40)	$ (79)

	Nine Months Ended March 31,					
	2014			2013		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Change in net unrealized gain or loss on available-for-sale securities	$ 449	$ 152	$ 297	$ (318)	$ (108)	$ (210)
Reclassification adjustment for net gains included in net income				(792)	(270)	(522)