

CAMDEN NATIONAL CORP

Form 10-Q

November 06, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2008

OR

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

Commission File No. 0-28190

CAMDEN NATIONAL CORPORATION

(Exact name of registrant as specified in its charter)

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MAINE
(State or other jurisdiction of
incorporation or organization)

01-0413282
(I.R.S. Employer
Identification No.)

2 ELM STREET, CAMDEN, ME
(Address of principal executive offices)

04843
(Zip Code)

Registrant's telephone number, including area code: (207) 236-8821

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 periods 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 is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

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

Outstanding at November 4, 2008: Common stock (no par value) 7,636,441 shares.

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CAMDEN NATIONAL CORPORATION

Form 10-Q for the quarter ended September 30, 2008

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Shareholders and Board of Directors

Camden National Corporation

We have reviewed the accompanying interim consolidated financial information of Camden National Corporation and Subsidiaries as of September 30, 2008, and for the nine-month and three-month periods ended September 30, 2008 and 2007. These financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with standards of the Public Company Accounting Oversight Board (United States), the objective of which is to express an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

Berry, Dunn, McNeil & Parker

Portland, Maine

November 6, 2008

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Table of Contents**Camden National Corporation and Subsidiaries****Consolidated Statements of Condition**

<i>(In thousands, except number of shares)</i>	September 30, 2008 (unaudited)	December 31, 2007 (audited)
Assets		
Cash and due from banks	\$ 38,114	\$ 28,790
Securities available for sale, at market	544,801	423,108
Securities held to maturity (fair value \$41,074 and \$41,013 at September 30, 2008 and December 31, 2007, respectively)	42,066	40,726
Loans, less allowance for loan and lease losses of \$17,212 and \$13,653 at September 30, 2008 and December 31, 2007, respectively	1,502,127	1,131,986
Premises and equipment, net	26,235	19,650
Other real estate owned	2,699	400
Interest receivable	8,789	7,098
Bank-owned life insurance	40,056	21,864
Core deposit intangible	4,644	320
Goodwill	41,965	3,991
Other assets	59,742	38,855
Total assets	\$ 2,311,238	\$ 1,716,788
Liabilities		
Deposits:		
Demand	\$ 205,934	\$ 141,858
NOW	206,933	132,331
Money market	335,611	298,677
Savings	133,095	85,931
Certificates of deposit	627,865	459,254
Total deposits	1,509,438	1,118,051
Borrowings from Federal Home Loan Bank	366,283	271,558
Other borrowed funds	210,084	142,492
Junior subordinated debentures	43,384	36,083
Capital lease obligation	1,257	
Note payable	195	10,000
Accrued interest and other liabilities	21,886	18,401
Total liabilities	2,152,527	1,596,585
Shareholders' Equity		
Common stock, no par value; authorized 20,000,000 shares, issued and outstanding 7,636,441 and 6,513,573 shares on September 30, 2008 and December 31, 2007, respectively	2,814	2,522
Surplus	46,054	2,629
Retained earnings	112,334	114,289
Accumulated other comprehensive (loss) income		
Net unrealized (losses) gains on securities available for sale, net of tax	(2,140)	1,516
Net unrealized losses on post-retirement plans, net of tax	(351)	(753)
Total accumulated other comprehensive (loss) income	(2,491)	763

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Total shareholders' equity	158,711	120,203
Total liabilities and shareholders' equity	\$ 2,311,238	\$ 1,716,788

See Report of Independent Registered Public Accounting Firm.

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Table of Contents**Camden National Corporation and Subsidiaries****Consolidated Statements of Operations***(unaudited)*

	Nine Months Ended September 30,	
	2008	2007
<i>(In thousands, except number of shares and per share data)</i>		
Interest Income		
Interest and fees on loans	\$ 73,803	\$ 64,162
Interest on U.S. government and sponsored enterprise obligations	18,921	14,147
Interest on state and political subdivision obligations	2,026	1,233
Interest on federal funds sold and other investments	1,673	1,455
Total interest income	96,423	80,997
Interest Expense		
Interest on deposits	24,253	27,849
Interest on other borrowings	17,500	14,417
Interest on junior subordinated debentures	2,195	1,781
Total interest expense	43,948	44,047
Net interest income	52,475	36,950
Provision for Loan and Lease Losses	2,120	100
Net interest income after provision for loan and lease losses	50,355	36,850
Non-interest Income (Loss)		
Service charges on deposit accounts	4,069	2,582
Other service charges and fees	2,059	1,380
Income from fiduciary services	5,031	3,668
Brokerage and insurance commissions	1,068	591
Mortgage servicing income (expense), net	(216)	90
Life insurance earnings	883	603
Loss on sale of securities	(624)	
Other income	582	502
Total non-interest income before security Impairment write-down	12,852	9,416
Loss on security impairment write-down	(13,950)	
Total non-interest income (loss)	(1,098)	9,416
Non-interest Expenses		
Salaries and employee benefits	19,130	13,894
Net occupancy	3,008	2,012
Furniture, equipment and data processing	2,707	1,718
Amortization of core deposit intangible	697	642
Other expenses	10,291	7,200
Total non-interest expenses	35,833	25,466

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Income before income taxes	13,424	20,800
Income Taxes	8,143	6,077
Net Income	\$ 5,281	\$ 14,723
Per Share Data		
Basic earnings per share	\$ 0.69	\$ 2.24
Diluted earnings per share	0.69	2.24
Cash dividends per share	\$ 0.74	\$ 0.72
Weighted average number of shares outstanding	7,682,737	6,571,836

See Report of Independent Registered Public Accounting Firm.

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Table of Contents**Camden National Corporation and Subsidiaries****Consolidated Statements of Operations***(unaudited)*

	Three Months Ended September 30,	
	2008	2007
<i>(In thousands, except number of shares and per share data)</i>		
Interest Income		
Interest and fees on loans	\$ 24,079	\$ 21,105
Interest on U.S. government and sponsored enterprise obligations	6,412	4,674
Interest on state and political subdivision obligations	674	411
Interest on federal funds sold and other investments	218	637
Total interest income	31,383	26,827
Interest Expense		
Interest on deposits	7,752	9,197
Interest on other borrowings	5,465	4,854
Interest on junior subordinated debentures	752	600
Total interest expense	13,969	14,651
Net interest income	17,414	12,176
Provision for Loan and Lease Losses	1,170	
Net interest income after provision for loan and lease losses	16,244	12,176
Non-interest Income (Loss)		
Service charges on deposit accounts	1,377	838
Other service charges and fees	724	502
Income from fiduciary services	1,653	1,240
Brokerage and insurance commissions	345	162
Mortgage servicing income (expense), net	(1)	32
Life insurance earnings	305	218
Loss on sale of securities	(804)	
Other income	198	173
Total non-interest income before security impairment write-down	3,797	3,165
Loss on security impairment write-down	(13,950)	
Total non-interest income (loss)	(10,153)	3,165
Non-interest Expenses		
Salaries and employee benefits	6,079	4,609
Net occupancy	927	628
Furniture, equipment and data processing	873	607
Amortization of core deposit intangible	193	214
Other expenses	3,587	2,344
Total non-interest expenses	11,659	8,402

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(Loss) income before income taxes	(5,568)	6,939
Income Taxes	2,452	1,941
Net (Loss) Income	\$ (8,020)	\$ 4,998
Per Share Data		
Basic (loss) earnings per share	\$ (1.05)	\$ 0.77
Diluted (loss) earnings per share	(1.05)	0.77
Cash dividends per share	\$ 0.25	\$ 0.24
Weighted average number of shares outstanding	7,659,811	6,513,000

See Report of Independent Registered Public Accounting Firm.

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents**Camden National Corporation and Subsidiaries****Consolidated Statements of Changes in Shareholders' Equity****Nine Months Ended September 30, 2008 and 2007***(unaudited)*

<i>(In thousands, except number of shares and per share data)</i>	Common Stock	Surplus	Retained Earnings	Net Unrealized Gains (Losses) on Securities Available for Sale	Net Unrealized Losses on Derivative Instruments	Net Unrealized Losses on Plans	Total Shareholders Equity
Balance at December 31, 2006	\$ 2,450	\$ 2,584	\$ 105,959	\$ (2,985)	\$ (198)	\$ (758)	\$ 107,052
Net income			14,723				14,723
Adjustment to record derivatives as economic hedges					198		198
Change in net unrealized losses on securities available for sale, net of taxes of \$(500)				929			929
Change in net unrealized losses on post-retirement plans, net of taxes of \$4						(7)	(7)
Total comprehensive income			14,723	929	198	(7)	15,843
Equity compensation expense		201					201
Exercise of stock options and issuance of restricted stock (total 10,170 shares)	81	(76)	235				240
Purchase of common stock (113,950 shares)		(171)	(4,305)				(4,476)
Cash dividends declared (\$0.72/ share)			(4,751)				(4,751)
Balance at September 30, 2007	\$ 2,531	\$ 2,538	\$ 111,861	\$ (2,056)	\$	\$ (765)	\$ 114,109
Balance at December 31, 2007	\$ 2,522	\$ 2,629	\$ 114,289	\$ 1,516	\$	\$ (753)	\$ 120,203
Net income			5,281				5,281
Change in net unrealized gains on securities available for sale, net of taxes of \$1,969				(3,656)			(3,656)
Change in net unrealized losses on post-retirement plans, net of taxes of \$(216)						402	402
Total comprehensive income			5,281	(3,656)		402	2,027
Shares issued during acquisition of Union Bankshares Company (1,222,497 shares)		43,523					43,523
Equity compensation expense		182					182
Exercise of stock options and issuance of restricted stock (total 9,733 shares)	292	(146)					146
Purchase of common stock (109,362 shares)		(134)	(3,383)				(3,517)
Cash dividends declared (\$0.50/ share)			(3,853)				(3,853)
Balance at September 30, 2008	\$ 2,814	\$ 46,054	\$ 112,334	\$ (2,140)	\$	\$ (351)	\$ 158,711

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See Report of Independent Registered Public Accounting Firm.

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Table of Contents**Camden National Corporation and Subsidiaries****Consolidated Statements of Cash Flows***(unaudited)*

<i>(In thousands)</i>	Nine Months Ended September 30,	
	2008	2007
Operating Activities		
Net Income	\$ 5,281	\$ 14,723
Adjustment to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	2,120	100
Depreciation and amortization	1,643	1,048
Equity compensation costs	182	201
Decrease (increase) in interest receivable	405	(336)
Amortization of core deposit intangible	697	642
Loss on sale of securities	624	
Write-down of other-than-temporarily impaired security	13,950	
Increase in other assets	(1,159)	(685)
(Decrease) increase in other liabilities	(3,703)	985
Net cash provided by operating activities	20,040	16,678
Investing Activities		
Acquisition of Union Bankshares Company	(29,299)	
Proceeds from maturities of securities held to maturity	90	439
Proceeds from sales and maturities of securities available for sale	183,807	99,325
Purchase of securities held to maturity	(39)	(556)
Purchase of securities available for sale	(204,090)	(80,961)
Increase in due from broker	(7,395)	
Change in Federal Home Loan Bank stock		(1,877)
Purchase of bank-owned life insurance	(7,450)	
Premium received on deposit sale	1,400	
Net (increase) decrease in loans	(8,592)	42,710
Change in federal funds sold		(30,965)
Purchase of premises and equipment	(882)	(3,229)
Net cash (used in) provided by investing activities	(72,450)	24,886
Financing Activities		
Net increase (decrease) in deposits	75,525	(8,385)
Proceeds from Federal Home Loan Bank borrowings	199,278	91,585
Repayments on Federal Home Loan Bank borrowings	(218,336)	(80,270)
Net change in short-term Federal Home Loan Bank borrowings	(23,965)	(88,730)
Net increase in other borrowed funds	48,023	79,496
Decrease in note payable	(10,015)	
Decrease in due to broker		(23,798)
Purchase of common stock	(3,517)	(4,476)
Exercise of stock options and stock issuance under option plans	146	240
Cash dividends paid	(5,405)	(4,751)
Net cash provided by (used in) financing activities	61,734	(39,089)

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Net increase in cash and cash equivalents	9,324	2,475
Cash and cash equivalents at beginning of year	28,790	33,358
Cash and cash equivalents at end of period	\$ 38,114	\$ 35,833
Supplemental disclosures of cash flow information:		
Interest paid	\$ 44,322	\$ 44,645
Income taxes paid	8,419	5,317
Non-cash transactions:		
Common stock issued in acquisition	43,523	
Transfer from loans to other real estate owned	2,599	110
<i>See Report of Independent Registered Public Accounting Firm.</i>		

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****NOTE 1 BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and, therefore, do not include all disclosures required by accounting principles generally accepted in the United States of America (US GAAP) for complete presentation of financial statements. In the opinion of management, the consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the consolidated statements of condition of Camden National Corporation (the Company) as of September 30, 2008 and December 31, 2007, the consolidated statements of operations for the nine and three months ended September 30, 2008 and 2007, the consolidated statements of changes in shareholders' equity for the nine months ended September 30, 2008 and 2007, and the consolidated statements of cash flows for the nine months ended September 30, 2008 and 2007. All significant intercompany transactions and balances are eliminated in consolidation. Certain items from the prior year were reclassified to conform to the current year presentation. The income reported for the nine- and three-month periods ended September 30, 2008 are not necessarily indicative of the results that may be expected for the full year. The information in this report should be read in conjunction with the consolidated financial statements and accompanying notes included in the December 31, 2007 Annual Report on Form 10-K.

On January 3, 2008, the Company acquired all of the outstanding common stock of Union Bankshares Company of Ellsworth, Maine, including its principal wholly-owned subsidiary, Union Trust Company, (collectively Union Trust). Immediately after the acquisition, Union Trust Company was merged into Camden National Bank. The financial results of Union Bankshares Company are included in the Company's quarterly results beginning on the January 3, 2008 acquisition date.

NOTE 2 EARNINGS PER SHARE

Basic earnings per share data is computed based on the weighted average number of common shares outstanding during each period. Potential common stock is considered in the calculation of weighted average shares outstanding for diluted earnings per share, and is determined using the treasury stock method. The following table sets forth the computation of basic and diluted earnings per share:

<i>(Dollars in thousands, except number of shares and per share data)</i>		Nine Months Ended September 30,	
		2008	2007
Net income, as reported	\$	5,281	\$ 14,723
Weighted average shares outstanding		7,682,737	6,571,836
Effect of dilutive potential common stock		1,066	14,060
Adjusted weighted average shares and assumed conversion		7,683,803	6,585,896
Basic earnings per share	\$	0.69	\$ 2.24
Diluted earnings per share	\$	0.69	\$ 2.24
		Three Months Ended September 30,	
		2008	2007
Net (loss) income, as reported	\$	(8,020)	\$ 4,998
Weighted average shares outstanding		7,659,811	6,513,000
Effect of dilutive potential common stock			9,694
Adjusted weighted average shares and assumed conversion		7,659,811	6,522,694
Basic (loss) income per share	\$	(1.05)	\$ 0.77
Diluted (loss) income per share	\$	(1.05)	\$ 0.77

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At September 30, 2008, the Company had 60,750 shares of potential common stock, in the form of stock options, which were anti-dilutive as the exercise price was greater than the market price of the common stock. At September 30, 2007, the Company had 72,812 shares of potential common stock that were anti-dilutive, including 71,900 outstanding stock options. At September 30, 2008, the Company had 57,200 non-vested stock option grants, 9,250 of which were in-the-money options. At September 30, 2007, the Company had 83,800 non-vested stock option grants, of which 25,700 were in-the-money options. For the quarter ended September 30, 2008, common stock equivalents are excluded from the computation of diluted net loss per share as the inclusion of such equivalents would be anti-dilutive for a period with a net loss.

NOTE 3 DERIVATIVE FINANCIAL INSTRUMENTS

Through the acquisition of Union Trust, the Company acquired a cap agreement with a cap rate of 5.50%, notional amount of \$20.0 million, and an expiration date of March 15, 2010. The fair value of the cap agreement at September 30, 2008 was \$9,000 and was recorded in other assets. The Company considers this instrument to be an economic hedge, thus, changes in fair value are recorded in the Statement of Operations.

As part of originating mortgage loans, the Company may enter into rate lock agreements with customers, which are considered derivatives under Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*. At September 30, 2008 and December 31, 2007, based upon the pipeline of mortgage loans with rate lock commitments and the change in fair value of those commitments due to changes in market interest rates, the Company determined the balance sheet impact was not material.

NOTE 4 INVESTMENTS

The following tables summarize the amortized costs and fair values of securities available for sale and held to maturity, as of the dates indicated:

	September 30, 2008			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available for sale				
Obligations of U.S. government sponsored enterprises	\$ 9,551	\$ 1	\$	\$ 9,552
Obligations of states and political subdivisions	28,242	78	(537)	27,783
Mortgage-backed securities:				
Issued or guaranteed by U.S. government sponsored enterprises	445,667	3,484	(1,296)	447,855
Other mortgage-backed securities	58,632	28	(4,286)	54,374
Total mortgage-backed securities	504,299	3,512	(5,582)	502,229
Total debt securities	542,092	3,591	(6,119)	539,564
DNP Auction Preferred Stock	5,000		(763)	4,237
Auction Pass-Through Certificates	1,000			1,000
Total equity securities	6,000		(763)	5,237
Total securities available for sale	\$ 548,092	\$ 3,591	\$ (6,882)	\$ 544,801
Held to maturity				
Obligations of states and political subdivisions	\$ 42,066	\$ 59	\$ (1,051)	\$ 41,074
Total securities held to maturity	\$ 42,066	\$ 59	\$ (1,051)	\$ 41,074

Management evaluates investments for other-than-temporary impairment (OTTI) based on the type of investment and the reasons for, and the period of time, the investment has been in an unrealized loss position. In the third quarter of 2008, the Company recorded a \$13.95 million OTTI write-down on Auction Pass-Through

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Certificates with an amortized cost of \$14.95 million, specifically \$10.0 million in Auction Pass-Through Certificates, Series 2007-8 Class A Certificates relating to Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac) 6.02% Non-Cumulative Perpetual Preferred Stock, Series X, and \$4.95 million Auction Pass-Through Certificates Series 2007-1 Class A Certificates relating to FHLMC 5.1% Non-Cumulative Preferred Stock, 5.57% Non-Cumulative Perpetual Preferred Stock and 5.9% Non-Cumulative Perpetual Preferred Stock. On September 6, 2008, the U.S. Treasury Department placed Freddie Mac in conservatorship and, as a result, the payment of dividends ceased on all Freddie Mac issued stock, including the preferred stock supporting the auction pass-through certificates, and the Freddie Mac preferred stock collateralizing the securities severely declined in value.

At September 30, 2008, the Company held Duff & Phelps (DNP) Select Income Fund Auction Preferred Stock with an amortized cost of \$5.0 million which has failed at auction. Management believes the failed auctions are a temporary liquidity event related to this asset class of securities. We are currently collecting all amounts due according to contractual terms and have the ability and intent to hold the securities until they clear auction, are called, or mature; therefore, the securities are not considered other-than-temporarily impaired.

The \$54.4 million of other mortgage-backed securities are rated either AAA or Aaa by two of the three major rating agencies.

At September 30, 2008, the Company had a greater than 12 months unrealized loss of \$1.5 million, the majority of which was comprised of mortgage-backed securities issued by either the Federal National Mortgage Association (Fannie Mae) or Freddie Mac. Management believes that the unrealized loss positions are primarily due to the changes in the interest rate environment, there is little risk of loss or default from the counterparties, and the Company has the ability and intent to hold the securities for the foreseeable future, therefore, the securities are not considered other-than-temporarily impaired. Investments with unrealized losses at September 30, 2008 and December 31, 2007, and the length of time they have been in a continuous loss position, are as follows:

	Less than 12 months		September 30, 2008 12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<i>(Dollars in thousands)</i>						
Obligations of states and political subdivisions	\$ 44,995	\$ (1,588)	\$	\$	\$ 44,995	\$ (1,588)
Mortgage-backed securities	126,465	(1,199)	6,080	(97)	132,545	(1,296)
Other mortgage-backed securities	54,938	(2,867)	14,360	(1,419)	69,298	(4,286)
Equity securities	4,237	(763)			4,237	(763)
Total	\$ 230,635	\$ (6,417)	\$ 20,440	\$ (1,516)	\$ 251,075	\$ (7,933)

	Less than 12 months		December 31, 2007 12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. government sponsored enterprises	\$	\$	\$ 11,993	\$ (5)	\$ 11,993	\$ (5)
Obligations of states and political subdivisions	6,421	(25)	1,585	(6)	8,006	(31)
Mortgage-backed securities	111	(1)	87,202	(838)	87,313	(839)
Other mortgage-backed securities	13,180	(59)	12,575	(175)	25,755	(234)
Equity securities	1,820	(180)			1,820	(180)
Total	\$ 21,532	\$ (265)	\$ 113,355	\$ (1,024)	\$ 134,887	\$ (1,289)

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The Company has a core deposit intangible asset related to the acquisition of bank branches between 1995 and 1998 and the recent acquisition of Union Trust. The core deposit intangible is amortized on a straight-line basis over 10 years, and reviewed for possible impairment when it is determined that events or changed circumstances may affect the underlying basis of the asset. The carrying amount is as follows:

	September 30, 2008		
	Union Trust Acquisition	1995 1998 Branch Acquisitions	Total
<i>(Dollars in thousands)</i>			
Core deposit intangible, cost	\$ 5,020	\$ 9,424	\$ 14,444
Accumulated amortization	376	9,424	9,800
Core deposit intangible, net	\$ 4,644	\$	\$ 4,644

	December 31, 2007		
	Union Trust Acquisition	1995 1998 Branch Acquisitions	Total
<i>(Dollars in thousands)</i>			
Core deposit intangible, cost	\$	\$ 9,424	\$ 9,424
Accumulated amortization		9,104	9,104
Core deposit intangible, net	\$	\$ 320	\$ 320

Amortization expense related to the core deposit intangible for the nine- and three-month periods ended September 30, 2008 amounted to \$697,000 and \$193,000, respectively. Amortization expense related to the core deposit intangible for the nine- and three-month periods ended September 30, 2007 amounted to \$642,000 and \$214,000, respectively. The expected amortization expense for each year for the next five years is estimated to be \$822,000 in 2008 and \$502,000 for years 2009 through 2012.

NOTE 6 GOODWILL

At September 30, 2008 and December 31, 2007, the value of the Company's goodwill, including the related impairment loss, is as follows:

	September 30, 2008		
	Banking	Financial Services	Total
<i>(Dollars in thousands)</i>			
Goodwill, at cost	\$ 34,905	\$ 7,750	\$ 42,655
Transitional impairment loss		(690)	(690)
Goodwill, net	\$ 34,905	\$ 7,060	\$ 41,965

	December 31, 2007		
	Banking	Financial Services	Total
<i>(Dollars in thousands)</i>			
Goodwill, at cost	\$ 473	\$ 4,208	\$ 4,681
Transitional impairment loss		(690)	(690)
Goodwill, net	\$ 473	\$ 3,518	\$ 3,991

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During the first quarter of 2008, the Company acquired \$37.9 million of goodwill related to the acquisition of Union Trust, which was allocated between the Banking and Financial Services reporting units, with allocations of \$34.4 million and \$3.5 million, respectively. At June 30, 2008, in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, the Company completed its annual review of the Financial Services goodwill and determined that there had been no additional impairment.

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Table of Contents**NOTE 7 COMMON STOCK REPURCHASE**

In June 2008, the Board of Directors of the Company approved the 2008 Common Stock Repurchase Program, which permits the Company to purchase up to 750,000 shares of its authorized and issued common stock for a one-year period, expiring July 1, 2009. The authority may be exercised from time to time and in such amounts as market conditions warrant. Any repurchases are intended to make appropriate adjustments to the Company's capital structure, including meeting share requirements related to employee benefit plans and for general corporate purposes. Through September 30, 2008, the Company has repurchased 50,000 shares at an average price of \$32.00 per share under the 2008 Program and 59,362 shares at an average price of \$32.29 per share under the 2007 Program.

NOTE 8 SHAREHOLDERS' EQUITY**Stock-Based Compensation**

On April 29, 2003, the shareholders of the Company approved the 2003 Stock Option and Incentive Plan (the "current plan"). The maximum number of shares of stock reserved and available for issuance under this Plan is 800,000 shares. Awards may be granted in the form of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, deferred stock, unrestricted stock, performance share and dividend equivalent rights, or any combination of the preceding, and the exercise price shall not be less than 100% of the fair market value on the date of grant in the case of incentive stock options, or 85% of the fair market value on the date of grant in the case of non-qualified stock options. No stock options are exercisable more than ten years after the date the stock option is granted. Prior to April 29, 2003, the Company had three stock option plans. Under all three plans, the options were immediately vested when granted, and expire ten years from the date the option was granted. The exercise price of all options equaled the market price of the Company's stock on the date of grant.

On January 1, 2006, the Company adopted the provisions of SFAS No. 123 (revised 2004) *Share-Based Payment* (SFAS No. 123(R)), using a modified prospective application. The Company had previously adopted the expense provisions of SFAS No. 123, thus adoption of SFAS No. 123(R) did not have a material effect on the statements of condition or results of operations of the Company.

Restricted Stock Awards

In January 2005, under the current plan, the Company granted 4,687 shares of restricted stock, all of which vest over a three-year period. In March 2007, under the current plan, the Company granted 6,873 shares of restricted stock, all of which vest over a three-year period. In April 2008, the Company granted 4,205 shares of restricted stock which vest on June 30, 2009. As of September 30, 2008, 2,724 of the restricted stock awards have been forfeited. The Company recorded approximately \$101,200 of compensation expense and \$35,400 of related tax benefit for the first nine months of 2008, of which \$38,500 of compensation expense and \$13,500 of related tax benefit was recorded in the third quarter. The Company recorded approximately \$74,800 of compensation expense and \$26,200 of related tax benefit for the first nine months of 2007, of which \$28,000 of compensation expense and \$9,800 of related tax benefit was recorded in the third quarter.

A summary of the status of the Company's nonvested restricted stock awards as of September 30, 2008, and changes during the nine-month period ended on that date, is presented below.

	September 30, 2008	
	Number of Shares	Weighted-average Grant Date Fair Value
Nonvested at beginning of period	7,776	\$ 43.28
Granted during the period	4,205	33.30
Vested during the period	3,193	42.04
Forfeited during the period	1,382	44.15
Nonvested at end of period	7,406	\$ 37.99

At the closing price on September 30, 2008 of \$34.95, the total fair value of restricted stock awards vested during the period was \$111,500.

Table of Contents*Management Stock Purchase Plan*

The Management Stock Purchase Plan (MSPP), which is a component of the current plan, provides equity incentive compensation to selected management employees of the Company. Participants in the Plan who are senior executives of the Company are required to receive restricted shares in lieu of a portion of their annual incentive bonus, if any, while certain other officers may elect to receive restricted shares in lieu of a portion of their annual incentive bonus. Restricted shares are granted at a discount of one-third of the fair market value of the stock on the date of grant. Restricted shares will vest two years after the date of grant if the participant remains employed by the Company for such period, unless the participant reaches age 60 with at least 10 years of service, at which time there is immediate vesting of existing and new purchases under the MSPP. During the first quarter of 2008, under the MSPP, the Company granted 3,398 shares of restricted stock at a discounted price of \$21.05, of which 570 have been forfeited. During the first quarter of 2007, under the MSPP, the Company granted 934 shares of restricted stock at a discounted price of \$29.67, of which 119 shares have been forfeited. Related to the discount on the restricted stock, the Company recorded approximately \$15,100 of compensation expense and \$5,300 of related tax benefit for the first nine months of 2008, of which \$2,300 of compensation expense and \$800 of related tax benefit was recorded in the third quarter. The Company recorded approximately \$17,400 of compensation expense and \$6,100 of related tax benefit for the first nine months of 2007, of which \$4,700 of compensation expense and \$1,600 of related tax benefit was recorded in the third quarter.

A summary of the status of the Company's nonvested restricted stock under the MSPP as of September 30, 2008, and changes during the nine-month period ended on that date, is presented below.

	September 30, 2008	
	Number of Shares	Weighted-average Grant Date Fair Value
Nonvested at beginning of period	5,047	\$ 12.18
Granted during the period	3,398	10.40
Vested during the period	4,345	11.70
Forfeited during the period	599	10.76
Nonvested at end of period	3,501	\$ 11.32

Long-term Performance Share Plan

The Long-term Performance Share Plan, which is a component of the current plan, is intended to create incentives for certain executive officers of the Company and to thus allow the Company to attract and retain in its employ persons who will contribute to the future success of the Company. It is further the intent of the Company that awards made under this plan will be used to achieve the twin goals of aligning executive incentive compensation with increases in shareholder value and using equity compensation as a tool to retain key employees. The long-term performance period is a period of three consecutive fiscal years beginning on January 1 of the first year and ending on December 31 of the third year. Awards for the three year performance period January 1, 2006 - December 31, 2008 are based upon the attainment of certain thresholds of tangible book value and return on average equity over the three-year period. Awards for the three year performance periods January 1, 2007 - December 31, 2009 and January 1, 2008 - December 31, 2010 are based upon the attainment of certain thresholds of revenue growth and the efficiency ratio over the three-year periods. The current aggregate amount of awards based on actual and projected results for the three-year performance period January 1, 2007 - December 31, 2009 is \$334,000 and, as of September 30, 2008, \$195,000 has been recorded as compensation expense. The current aggregate amount of awards, based on actual and projected results for the three-year performance periods January 1, 2006 - December 31, 2008 and January 1, 2008 - December 31, 2010, is not considered material and no related expense has been recognized.

Defined Contribution Retirement Plan

Approved during the first quarter of 2008, the Defined Contribution Retirement Plan (DCRP), which is a component of the current plan, is an unfunded deferred compensation plan for the benefit of a group of senior management employees of the Company. Participation in the DCRP by an employee must be approved by the Company's Compensation Committee. Annually, on March 1st or the closest business day, the Compensation Committee will credit to an account administered by the Company 10% of each participant's annual base salary and bonus for the prior performance period. Annual credits to a participant's account will be denominated in

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Deferred Stock Awards based on the fair market value of the common stock of the Company on the date of grant. Deferred Stock Awards are the right to receive a share of common stock of the Company upon the satisfaction of certain restrictions. Vesting occurs ratably from the date of participation until the participant reaches the age of 65, at which time the participant is 100% vested. Upon retirement or termination of employment, the participant will receive shares of common stock equal to the Deferred Stock Awards in the account multiplied by the vested percentage, reduced by the amount to be withheld for income taxes. During the first quarter of 2008, the Company granted 1,469 deferred stock awards under the DCRP, all of which have been forfeited.

Stock Option Awards

During the first three quarters of 2008, the Company issued, under the current plan, 8,250 incentive stock options to employees, all of which vest over a five-year period. During the first three quarters of 2007, the Company issued, under the current plan, 38,750 incentive stock options to employees, all of which vest over a five-year period. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants: in 2008, dividend yield of 3.3%, expected volatility of 28.28%, risk-free interest rate of 3.44%, and expected lives of 5.8 years; in 2007, dividend yield of 2.1%, expected volatility of 26.66%, risk-free interest rate of 4.77%, and expected lives of 5.0 years. Expected volatilities are based on the historical volatility of the Company's stock, and other factors. The risk-free rate for periods within the contractual life of the option is based on the US Treasury yield curve in effect at the time of the grant. The Company uses historical data, such as option exercise and employee termination rates, to calculate the expected option life.

Related to the incentive stock option grants and in accordance with the provisions of SFAS No. 123(R), the Company recorded approximately \$65,400 of compensation expense during the first nine months of 2008, of which \$23,100 was in the third quarter. The Company recorded approximately \$108,000 of compensation expense during the first nine months of 2007, of which \$23,900 was in the third quarter.

A summary of the status of the Company's stock option plans as of September 30, 2008, and changes during the nine-month period ended on that date is presented below.

		September 30, 2008		
	Number of Shares	Weighted-average Exercise Price	Weighted-average Remaining Contractual Term	Aggregate Intrinsic Value (\$000)
Outstanding at beginning of year	112,897	\$ 36.75		
Granted during the period	8,250	29.14		
Exercised during the period	2,175	20.14		
Forfeited during the period	14,050	37.66		
Outstanding at end of period	104,922	\$ 36.38	7.2	\$ 161
Exercisable at end of period	47,722	\$ 34.49	6.3	\$ 109

The weighted-average grant date fair value of options granted during the nine-month period ended September 30, 2008 was \$6.47. The total intrinsic value of options exercised during the nine-month period ended September 30, 2008 was \$27,750.

A summary of the status of the Company's nonvested stock options as of September 30, 2008, and changes during the nine-month period ended on that date, is presented below.

	September 30, 2008	
	Number of Shares	Weighted-average Grant Date Fair Value
Nonvested at beginning of year	81,700	\$ 9.26
Granted during the period	8,250	6.47
Vested during the period	20,900	8.95
Forfeited during the period	11,850	8.77

Nonvested at end of period	57,200	\$	9.11
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At the closing price on September 30, 2008 of \$34.95, the total fair value of stock options vested during the period was \$730,500.

The following table summarizes information related to options at September 30, 2008:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Remaining Contractual Life	Weighted-average Exercise Price	Number Exercisable	Weighted-average Exercise Price
\$10.00 - \$19.99	2,272	0.3	\$ 16.29	2,272	\$ 16.29
\$20.00 - \$29.99	12,000	7.8	26.72	4,500	23.08
\$30.00 - \$39.99	63,350	6.8	35.42	35,050	35.45
\$40.00 - \$49.99	27,300	8.4	44.51	5,900	44.51
	104,922	7.2	\$ 36.38	47,722	\$ 34.49

As of September 30, 2008, there was \$508,100 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the current plan, which is expected to be recognized over a weighted-average period of 1.9 years.

NOTE 9 MORTGAGE SERVICING RIGHTS

Residential real estate mortgages are originated by the Company both for portfolio and for sale into the secondary market. The Company may sell its loans to institutional investors such as Freddie Mac. Under loan sale and servicing agreements with the investor, the Company generally continues to service the residential real estate mortgages. The Company pays the investor an agreed-upon rate on the loan, which is less than the interest rate the Company receives from the borrower. The Company retains the difference as a fee for servicing the residential real estate mortgages. As required by SFAS No. 156, *Accounting for Servicing of Financial Assets - an amendment of SFAS No. 140*, the Company capitalizes mortgage servicing rights at their fair value upon sale of the related loans, amortizes the asset over the estimated life of the serviced loan, and periodically assesses the asset for impairment. The balance of capitalized mortgage servicing rights, net of a valuation allowance, included in other assets at September 30, 2008 and 2007 and December 31, 2007 was \$712,000, \$180,450, and \$142,000, respectively, which equaled the net book value of these rights. The fair market value of the mortgage servicing rights approximated \$733,500, \$846,000 and \$775,000, respectively, at September 30, 2008 and 2007 and December 31, 2007. In evaluating the reasonableness of the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. The model utilizes a variety of assumptions, the most significant of which are loan prepayment assumptions and the discount rate used to discount future cash flows. Prepayment assumptions, which are impacted by loan rates and terms, are calculated using a three-month moving average of weekly prepayment data published by the Public Securities Association and modeled against the serviced loan portfolio by the third party valuation specialist. The discount rate is the quarterly average 10-year US Treasury rate plus 5.0%. Other assumptions include delinquency rates, foreclosure rates, servicing cost inflation, and annual unit loan cost. All assumptions are adjusted periodically to reflect current circumstances. Amortization of the mortgage servicing rights, as well as write-offs of capitalized rights due to prepayments of the related mortgage loans, are recorded as a charge against mortgage servicing income.

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The following summarizes mortgage servicing rights capitalized and amortized, along with the activity in the related valuation allowance: