

CAMDEN NATIONAL CORP  
Form 10-Q  
November 08, 2013

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

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

For the quarterly period ended September 30, 2013

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)

|                                                                            |                                                       |
|----------------------------------------------------------------------------|-------------------------------------------------------|
| MAINE<br>(State or other jurisdiction of<br>incorporation or organization) | 01-0413282<br>(I.R.S. Employer<br>Identification No.) |
|----------------------------------------------------------------------------|-------------------------------------------------------|

|                                                                      |                     |
|----------------------------------------------------------------------|---------------------|
| 2 ELM STREET, CAMDEN, ME<br>(Address of principal executive offices) | 04843<br>(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer 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 <input type="checkbox"/> | Accelerated filer <input checked="" type="checkbox"/> |
| Non-accelerated filer <input type="checkbox"/>   | Smaller reporting company <input type="checkbox"/>    |

(Do not check if a 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, 2013: Common stock (no par value) 7,646,964 shares.

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CAMDEN NATIONAL CORPORATION

FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2013  
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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 (the “Company”) and Subsidiaries as of September 30, 2013, and for the three and nine-month periods ended September 30, 2013 and 2012. 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.

/s/ Berry Dunn McNeil & Parker, LLC  
Berry Dunn McNeil & Parker, LLC

Bangor, Maine  
November 8, 2013

CAMDEN NATIONAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CONDITION

|                                                                                                                                                                           | September 30,<br>2013<br>(unaudited) | December 31,<br>2012 |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------|----------------------|
| (In Thousands, Except Number of Shares)                                                                                                                                   |                                      |                      |
| <b>ASSETS</b>                                                                                                                                                             |                                      |                      |
| Cash and due from banks                                                                                                                                                   | \$57,086                             | \$58,290             |
| Securities                                                                                                                                                                |                                      |                      |
| Securities available-for-sale, at fair value                                                                                                                              | 783,243                              | 781,050              |
| Federal Home Loan Bank and Federal Reserve Bank stock, at cost                                                                                                            | 19,724                               | 21,034               |
| Total securities                                                                                                                                                          | 802,967                              | 802,084              |
| Trading account assets                                                                                                                                                    | 2,309                                | 2,300                |
| Loans held for sale                                                                                                                                                       | 1,313                                | —                    |
| Loans                                                                                                                                                                     | 1,589,946                            | 1,563,866            |
| Less allowance for loan losses                                                                                                                                            | (22,661)                             | (23,044)             |
| Net loans                                                                                                                                                                 | 1,567,285                            | 1,540,822            |
| Goodwill and other intangible assets                                                                                                                                      | 52,436                               | 53,299               |
| Bank-owned life insurance                                                                                                                                                 | 46,039                               | 45,053               |
| Premises and equipment, net                                                                                                                                               | 26,751                               | 28,059               |
| Deferred tax asset                                                                                                                                                        | 16,035                               | 7,663                |
| Interest receivable                                                                                                                                                       | 5,678                                | 6,215                |
| Other real estate owned                                                                                                                                                   | 1,802                                | 1,313                |
| Other assets                                                                                                                                                              | 17,554                               | 19,659               |
| Total assets                                                                                                                                                              | \$2,597,255                          | \$2,564,757          |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                                                                                                               |                                      |                      |
| <b>Liabilities</b>                                                                                                                                                        |                                      |                      |
| <b>Deposits</b>                                                                                                                                                           |                                      |                      |
| Demand                                                                                                                                                                    | \$282,023                            | \$240,749            |
| Interest checking, savings and money market                                                                                                                               | 1,208,691                            | 1,169,148            |
| Retail certificates of deposit                                                                                                                                            | 379,281                              | 418,442              |
| Brokered deposits                                                                                                                                                         | 103,369                              | 101,130              |
| Total deposits                                                                                                                                                            | 1,973,364                            | 1,929,469            |
| Federal Home Loan Bank advances                                                                                                                                           | 96,130                               | 56,404               |
| Other borrowed funds                                                                                                                                                      | 207,326                              | 259,940              |
| Junior subordinated debentures                                                                                                                                            | 43,896                               | 43,819               |
| Accrued interest and other liabilities                                                                                                                                    | 44,257                               | 41,310               |
| Total liabilities                                                                                                                                                         | 2,364,973                            | 2,330,942            |
| <b>Shareholders' Equity</b>                                                                                                                                               |                                      |                      |
| Common stock, no par value; authorized 20,000,000 shares, issued and outstanding 7,646,664 and 7,622,750 shares on September 30, 2013 and December 31, 2012, respectively | 50,265                               | 49,667               |
| Retained earnings                                                                                                                                                         | 193,304                              | 181,151              |
| Accumulated other comprehensive income (loss)                                                                                                                             |                                      |                      |
| Net unrealized (losses) gains on securities available-for-sale, net of tax                                                                                                | (5,073)                              | 12,943               |
| Net unrealized losses on derivative instruments, at fair value, net of tax                                                                                                | (3,614)                              | (7,205)              |
| Net unrecognized losses on postretirement plans, net of tax                                                                                                               | (2,600)                              | (2,741)              |
| Total accumulated other comprehensive income (loss)                                                                                                                       | (11,287)                             | 2,997                |
| Total shareholders' equity                                                                                                                                                | 232,282                              | 233,815              |
| Total liabilities and shareholders' equity                                                                                                                                | \$2,597,255                          | \$2,564,757          |

See Report of Independent Registered Public Accounting Firm.  
The accompanying notes are an integral part of these consolidated financial statements.

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CAMDEN NATIONAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME  
(unaudited)

| (In Thousands, Except Number of Shares and Per Share Data)                       | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|----------------------------------------------------------------------------------|-------------------------------------|----------|------------------------------------|----------|
|                                                                                  | 2013                                | 2012     | 2013                               | 2012     |
| Interest Income                                                                  |                                     |          |                                    |          |
| Interest and fees on loans                                                       | \$17,470                            | \$18,084 | \$53,324                           | \$54,787 |
| Interest on U.S. government and sponsored enterprise obligations                 | 4,091                               | 4,153    | 12,441                             | 12,387   |
| Interest on state and political subdivision obligations                          | 292                                 | 344      | 889                                | 1,064    |
| Interest on federal funds sold and other investments                             | 38                                  | 55       | 144                                | 160      |
| Total interest income                                                            | 21,891                              | 22,636   | 66,798                             | 68,398   |
| Interest Expense                                                                 |                                     |          |                                    |          |
| Interest on deposits                                                             | 1,780                               | 2,218    | 5,427                              | 7,146    |
| Interest on borrowings                                                           | 767                                 | 1,337    | 2,352                              | 4,164    |
| Interest on junior subordinated debentures                                       | 637                                 | 634      | 1,894                              | 1,904    |
| Total interest expense                                                           | 3,184                               | 4,189    | 9,673                              | 13,214   |
| Net interest income                                                              | 18,707                              | 18,447   | 57,125                             | 55,184   |
| Provision for credit losses                                                      | 665                                 | 868      | 2,034                              | 2,708    |
| Net interest income after provision for credit losses                            | 18,042                              | 17,579   | 55,091                             | 52,476   |
| Non-Interest Income                                                              |                                     |          |                                    |          |
| Service charges on deposit accounts                                              | 1,750                               | 1,386    | 5,189                              | 3,857    |
| Other service charges and fees                                                   | 1,568                               | 1,003    | 4,510                              | 2,804    |
| Income from fiduciary services                                                   | 1,149                               | 1,155    | 3,567                              | 3,883    |
| Mortgage banking income, net                                                     | 93                                  | 8        | 1,251                              | 476      |
| Brokerage and insurance commissions                                              | 354                                 | 360      | 1,175                              | 1,109    |
| Bank-owned life insurance                                                        | 334                                 | 353      | 986                                | 1,034    |
| Net gain on sale of securities and other-than-temporary impairment of securities | 647                                 | 187      | 785                                | 1,059    |
| Other income                                                                     | 580                                 | 586      | 1,724                              | 1,798    |
| Total non-interest income                                                        | 6,475                               | 5,038    | 19,187                             | 16,020   |
| Non-Interest Expenses                                                            |                                     |          |                                    |          |
| Salaries and employee benefits                                                   | 8,115                               | 7,270    | 24,437                             | 21,150   |
| Furniture, equipment and data processing                                         | 1,668                               | 1,131    | 5,203                              | 3,555    |
| Net occupancy                                                                    | 1,242                               | 930      | 4,201                              | 3,061    |
| Other real estate owned and collection costs, net                                | 489                                 | 571      | 1,355                              | 1,694    |
| Consulting and professional fees                                                 | 504                                 | 408      | 1,636                              | 1,351    |
| Regulatory assessments                                                           | 496                                 | 450      | 1,495                              | 1,317    |
| Amortization of intangible assets                                                | 289                                 | 144      | 863                                | 433      |
| Branch acquisition/divestiture costs                                             | 47                                  | 396      | 279                                | 704      |
| Other expenses                                                                   | 2,349                               | 2,070    | 7,878                              | 7,003    |
| Total non-interest expenses                                                      | 15,199                              | 13,370   | 47,347                             | 40,268   |
| Income before income taxes                                                       | 9,318                               | 9,247    | 26,931                             | 28,228   |
| Income Taxes                                                                     | 2,952                               | 2,992    | 8,572                              | 8,978    |
| Net Income                                                                       | \$6,366                             | \$6,255  | \$18,359                           | \$19,250 |
| Per Share Data                                                                   |                                     |          |                                    |          |
| Basic earnings per share                                                         | \$0.83                              | \$0.82   | \$2.40                             | \$2.51   |
| Diluted earnings per share                                                       | \$0.83                              | \$0.82   | \$2.39                             | \$2.50   |



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|                                                              |           |           |           |           |
|--------------------------------------------------------------|-----------|-----------|-----------|-----------|
| Weighted average number of common shares outstanding         | 7,643,720 | 7,619,411 | 7,636,352 | 7,655,619 |
| Diluted weighted average number of common shares outstanding | 7,666,305 | 7,639,434 | 7,651,870 | 7,669,763 |

See Report of Independent Registered Public Accounting Firm.

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

CAMDEN NATIONAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(unaudited)

| (In Thousands)                                                                                                                                                                  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|----------|------------------------------------|----------|
|                                                                                                                                                                                 | 2013                                | 2012     | 2013                               | 2012     |
| Net income                                                                                                                                                                      | \$6,366                             | \$6,255  | \$18,359                           | \$19,250 |
| Other comprehensive income (loss), net of related tax effects:                                                                                                                  |                                     |          |                                    |          |
| Unrealized gains (losses) on securities available-for-sale:                                                                                                                     |                                     |          |                                    |          |
| Unrealized holding gains (losses) on securities available-for-sale arising during period, net of related tax effects of \$1,111, (\$2,343), \$9,426 and (\$3,162), respectively | (2,063                              | ) 4,350  | (17,506                            | ) 5,871  |
| Less: reclassification adjustment for gains included in net income, net of related tax effects of \$227, \$66, \$275 and \$371, respectively <sup>(1)</sup>                     | (420                                | ) (121   | ) (510                             | ) (688   |
| Net unrealized gains (losses) on securities available-for-sale                                                                                                                  | (2,483                              | ) 4,229  | (18,016                            | ) 5,183  |
| Unrealized gain (loss) on cash flow hedging derivatives, net of related tax effects of (\$239), (\$59), (\$1,933) and \$347, respectively                                       | 445                                 | 109      | 3,591                              | (645     |
| Postretirement plans:                                                                                                                                                           |                                     |          |                                    |          |
| Net actuarial gain arising during period, net of related tax effects of (\$22), (\$14), (\$64) and (\$40), respectively                                                         | 39                                  | 23       | 118                                | 71       |
| Plus: amortization of prior service cost included in net periodic cost, net of related tax effects of (\$4), (\$3) (\$12) and (\$6), respectively <sup>(2)</sup>                | 8                                   | 3        | 23                                 | 9        |
| Net gain on postretirement plans                                                                                                                                                | 47                                  | 26       | 141                                | 80       |
| Other comprehensive income (loss)                                                                                                                                               | (1,991                              | ) 4,364  | (14,284                            | ) 4,618  |
| Comprehensive income                                                                                                                                                            | \$4,375                             | \$10,619 | \$4,075                            | \$23,868 |

(1) Reclassified into the consolidated statements of income in net gain on sale of securities and other-than-temporary impairment of securities.

(2) Reclassified into the consolidated statements of income in salaries and employee benefits.

See Report of Independent Registered Public Accounting Firm.

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

CAMDEN NATIONAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
(unaudited)

| (In Thousands, Except Number of Shares and Per Share Data)                                                         | Common Stock       |          | Retained Earnings | Accumulated Other Comprehensive Income (Loss) |          | Total Shareholders' Equity |
|--------------------------------------------------------------------------------------------------------------------|--------------------|----------|-------------------|-----------------------------------------------|----------|----------------------------|
|                                                                                                                    | Shares Outstanding | Amount   |                   | Income                                        | Loss     |                            |
| Balance at December 31, 2011                                                                                       | 7,664,975          | \$51,438 | \$165,377         | \$2,061                                       |          | \$218,876                  |
| Net income                                                                                                         | —                  | —        | 19,250            | —                                             |          | 19,250                     |
| Other comprehensive income (loss), net of tax:                                                                     |                    |          |                   |                                               |          |                            |
| Change in fair value of securities available-for-sale                                                              | —                  | —        | —                 | 5,183                                         |          | 5,183                      |
| Change in fair value of cash flow hedges                                                                           | —                  | —        | —                 | (645)                                         | (645)    |                            |
| Change in net unrecognized gains on postretirement plans                                                           | —                  | —        | —                 | 80                                            | 80       |                            |
| Total comprehensive income                                                                                         | —                  | —        | 19,250            | 4,618                                         |          | 23,868                     |
| Stock-based compensation expense                                                                                   | —                  | 355      | —                 | —                                             |          | 355                        |
| Exercise of stock options and issuance of restricted stock, net of repurchase for tax withholdings and tax benefit | 20,677             | (241)    | —                 | —                                             |          | (241)                      |
| Common stock repurchased                                                                                           | (65,580)           | (2,097)  | —                 | —                                             |          | (2,097)                    |
| Cash dividends declared (\$0.75 per share)                                                                         | —                  | —        | (5,783)           | —                                             |          | (5,783)                    |
| Balance at September 30, 2012                                                                                      | 7,620,072          | \$49,455 | \$178,844         | \$6,679                                       |          | \$234,978                  |
| Balance at December 31, 2012                                                                                       | 7,622,750          | \$49,667 | \$181,151         | \$2,997                                       |          | \$233,815                  |
| Net income                                                                                                         | —                  | —        | 18,359            | —                                             |          | 18,359                     |
| Other comprehensive income (loss), net of tax:                                                                     |                    |          |                   |                                               |          |                            |
| Change in fair value of securities available-for-sale                                                              | —                  | —        | —                 | (18,016)                                      | (18,016) |                            |
| Change in fair value of cash flow hedges                                                                           | —                  | —        | —                 | 3,591                                         | 3,591    |                            |
| Change in net unrecognized gains on postretirement plans                                                           | —                  | —        | —                 | 141                                           | 141      |                            |
| Total comprehensive income                                                                                         | —                  | —        | 18,359            | (14,284)                                      |          | 4,075                      |
| Stock-based compensation expense                                                                                   | —                  | 340      | —                 | —                                             |          | 340                        |
| Exercise of stock options and issuance of restricted stock, net of repurchase for tax withholdings and tax benefit | 23,914             | 258      | —                 | —                                             |          | 258                        |
| Cash dividends declared (\$0.81 per share)                                                                         | —                  | —        | (6,206)           | —                                             |          | (6,206)                    |
| Balance at September 30, 2013                                                                                      | 7,646,664          | \$50,265 | \$193,304         | \$(11,287)                                    |          | \$232,282                  |

See Report of Independent Registered Public Accounting Firm.

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

CAMDEN NATIONAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(unaudited)

| (In Thousands)                                                                                                     | Nine Months Ended September 30, |           |
|--------------------------------------------------------------------------------------------------------------------|---------------------------------|-----------|
|                                                                                                                    | 2013                            | 2012      |
| Operating Activities                                                                                               |                                 |           |
| Net income                                                                                                         | \$ 18,359                       | \$ 19,250 |
| Adjustments to reconcile net income to net cash provided by operating activities:                                  |                                 |           |
| Provision for credit losses                                                                                        | 2,034                           | 2,708     |
| Depreciation and amortization                                                                                      | 2,300                           | 1,849     |
| Securities amortization and accretion                                                                              | 1,745                           | 1,494     |
| Stock-based compensation expense                                                                                   | 340                             | 355       |
| Decrease in interest receivable                                                                                    | 537                             | 58        |
| Amortization of intangible assets                                                                                  | 863                             | 433       |
| Net investment securities gains and other-than-temporary impairment of securities                                  | (785)                           | (1,059)   |
| Increase in other real estate owned valuation allowance and loss on disposition                                    | 97                              | 465       |
| Originations of mortgage loans held for sale                                                                       | (29,515)                        | (12,775)  |
| Proceeds from the sale of mortgage loans                                                                           | 28,886                          | 19,104    |
| Gain on sale of mortgage loans                                                                                     | (684)                           | (268)     |
| (Increase) decrease in other assets                                                                                | (633)                           | 720       |
| (Decrease) increase in other liabilities                                                                           | (2,539)                         | 474       |
| Net cash provided by operating activities                                                                          | 21,005                          | 32,808    |
| Investing Activities                                                                                               |                                 |           |
| Proceeds from sales and maturities of securities available-for-sale                                                | 121,793                         | 154,708   |
| Purchase of securities available-for-sale                                                                          | (138,300)                       | (267,533) |
| Net increase in loans                                                                                              | (29,168)                        | (30,544)  |
| Proceeds from sale of Federal Home Loan Bank stock                                                                 | 1,310                           | 928       |
| Proceeds from the sale of other real estate owned                                                                  | 530                             | 1,665     |
| Proceeds from previously charged-off loans                                                                         | 436                             | 530       |
| Cash settlement in branch acquisition                                                                              | (3,278)                         | —         |
| Purchase of premises and equipment                                                                                 | (1,203)                         | (2,662)   |
| Net cash used by investing activities                                                                              | (47,880)                        | (142,908) |
| Financing Activities                                                                                               |                                 |           |
| Net increase in deposits                                                                                           | 44,210                          | 97,952    |
| Repayments on Federal Home Loan Bank long-term advances                                                            | (271)                           | (10,335)  |
| Net change in short-term Federal Home Loan Bank borrowings                                                         | 40,000                          | 45,000    |
| Net decrease in other borrowed funds                                                                               | (52,479)                        | (4,815)   |
| Common stock repurchase                                                                                            | —                               | (2,097)   |
| Exercise of stock options and issuance of restricted stock, net of repurchase for tax withholdings and tax benefit | 258                             | (241)     |
| Cash dividends paid on common stock                                                                                | (6,047)                         | (5,756)   |
| Net cash provided by financing activities                                                                          | 25,671                          | 119,708   |
| Net (decrease) increase in cash and cash equivalents                                                               | (1,204)                         | 9,608     |
| Cash and cash equivalents at beginning of year                                                                     | 58,290                          | 39,325    |
| Cash and cash equivalents at end of period                                                                         | \$ 57,086                       | \$ 48,933 |

Supplemental information

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|                                                                           |         |          |
|---------------------------------------------------------------------------|---------|----------|
| Interest paid                                                             | \$9,952 | \$13,402 |
| Income taxes paid                                                         | 8,750   | 4,560    |
| Securities purchased but unsettled                                        | 14,363  | 20,231   |
| Transfer from loans and premises and equipment to other real estate owned | 1,116   | 1,044    |

See Report of Independent Registered Public Accounting Firm.

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

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## CAMDEN NATIONAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in Tables Expressed in Thousands, Except Number of Shares and per Share Data)

## 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 ("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, 2013 and December 31, 2012, the consolidated statements of income for the three and nine months ended September 30, 2013 and 2012, the consolidated statements of comprehensive income for the three and nine months ended September 30, 2013 and 2012, the consolidated statements of changes in shareholders' equity for the nine months ended September 30, 2013 and 2012, and the consolidated statements of cash flows for the nine months ended September 30, 2013 and 2012. 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 three and nine months period ended September 30, 2013 is 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 Annual Report for the year ended December 31, 2012, Form 10-K.

## NOTE 2 – EARNINGS PER SHARE

The following is an analysis of basic and diluted earnings per share ("EPS"), reflecting the application of the two-class method, as described below:

|                                                                                           | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|-------------------------------------------------------------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                                                                           | 2013                                | 2012      | 2013                               | 2012      |
| Net income                                                                                | \$6,366                             | \$6,255   | \$18,359                           | \$19,250  |
| Dividends and undistributed earnings allocated to participating securities <sup>(1)</sup> | (20                                 | ) (18     | ) (50                              | ) (48     |
| Net income available to common shareholders                                               | \$6,346                             | \$6,237   | \$18,309                           | \$19,202  |
| Weighted-average common shares outstanding for basic EPS                                  | 7,643,720                           | 7,619,411 | 7,636,352                          | 7,655,619 |
| Dilutive effect of stock-based awards <sup>(2)</sup>                                      | 22,585                              | 20,023    | 15,518                             | 14,144    |
| Weighted-average common and potential common shares for diluted EPS                       | 7,666,305                           | 7,639,434 | 7,651,870                          | 7,669,763 |
| Earnings per common share:                                                                |                                     |           |                                    |           |
| Basic EPS                                                                                 | \$0.83                              | \$0.82    | \$2.40                             | \$2.51    |
| Diluted EPS                                                                               | \$0.83                              | \$0.82    | \$2.39                             | \$2.50    |

(1) Represents dividends paid and undistributed earnings allocated to nonvested restricted stock awards.

(2) Represents the effect of the assumed exercise of stock options, vesting of restricted shares, and vesting of restricted stock units, based on the treasury stock method.

Nonvested stock-based payment awards that contain non-forfeitable rights to dividends are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Certain of the Company's nonvested restricted stock awards qualify as participating securities.

Net income is allocated between the common stock and participating securities pursuant to the two-class method. Basic EPS is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period, excluding participating nonvested restricted shares.

Diluted EPS is computed in a similar manner, except that first the denominator is increased to include the number of additional common shares that would have been outstanding if potentially dilutive common shares were issued using the treasury stock method.

For the three and nine months ended September 30, 2013, options to purchase 14,250 and 31,000 shares, respectively, of common stock were not considered in the computation of potential common shares for purposes of diluted EPS, since the exercise prices of the options were greater than the average market price of the common stock for the respective periods. For the three and nine months ended September 30, 2012, options to purchase 18,250 and 49,500 shares, respectively, of common stock were not considered in the computation of potential common shares for purposes of diluted EPS, since the exercise prices of the options were greater than the average market price of the common stock for the respective periods.

### NOTE 3 – SECURITIES

The following tables summarize the amortized costs and estimated fair values of securities available-for-sale (“AFS”), as of September 30, 2013 and December 31, 2012:

|                                                                                                   | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
|---------------------------------------------------------------------------------------------------|-------------------|---------------------|----------------------|---------------|
| September 30, 2013                                                                                |                   |                     |                      |               |
| Obligations of states and political subdivisions                                                  | \$27,848          | \$1,352             | \$—                  | \$29,200      |
| Mortgage-backed securities issued or guaranteed by U.S. government sponsored enterprises          | 358,436           | 6,384               | (4,612)              | 360,208       |
| Collateralized mortgage obligations issued or guaranteed by U.S. government sponsored enterprises | 397,064           | 1,045               | (11,763)             | 386,346       |
| Private issue collateralized mortgage obligations                                                 | 7,700             | 31                  | (242)                | 7,489         |
| Total securities available-for-sale                                                               | \$791,048         | \$8,812             | \$(16,617)           | \$783,243     |
| December 31, 2012                                                                                 |                   |                     |                      |               |
| Obligations of states and political subdivisions                                                  | \$31,112          | \$1,928             | \$—                  | \$33,040      |
| Mortgage-backed securities issued or guaranteed by U.S. government sponsored enterprises          | 345,528           | 12,699              | (79)                 | 358,148       |
| Collateralized mortgage obligations issued or guaranteed by U.S. government sponsored enterprises | 375,627           | 6,181               | (120)                | 381,688       |
| Private issue collateralized mortgage obligations                                                 | 8,871             | —                   | (697)                | 8,174         |
| Total securities available-for-sale                                                               | \$761,138         | \$20,808            | \$(896)              | \$781,050     |

Net unrealized gains (losses) on securities AFS at September 30, 2013 and December 31, 2012 and included in accumulated other comprehensive income (loss) amounted to \$(5.1) million and \$12.9 million, net of a deferred tax benefit of \$2.7 million and liability of \$7.0 million, respectively.

#### Impaired Securities

Management periodically reviews the Company’s investment portfolio to determine the cause, magnitude and duration of declines in the fair value of each security. Thorough evaluations of the causes of the unrealized losses are performed to determine whether the impairment is temporary or other-than-temporary in nature. Considerations such as the ability of the securities to meet cash flow requirements, levels of credit enhancements, risk of curtailment,



recoverability of invested amount over a reasonable period of time and the length of time the security is in a loss position, for example, are applied in determining other-than-temporary impairment (“OTTI”). Once a decline in value is determined to be other-than-temporary, the value of the security is reduced to fair value and a corresponding charge to earnings is recognized.

The following table presents the estimated fair values and gross unrealized losses of investment securities that were in a continuous loss position at September 30, 2013 and December 31, 2012, by length of time that individual securities in each category have been in a continuous loss position:

|                                                   | Less Than 12 Months |                   | 12 Months or More |                   | Total      |                   |
|---------------------------------------------------|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
|                                                   | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| September 30, 2013                                |                     |                   |                   |                   |            |                   |
| Mortgage-backed securities                        | \$ 149,819          | \$(4,612 )        | \$ 13             | \$—               | \$ 149,832 | \$(4,612 )        |
| Collateralized mortgage obligations               | 307,640             | (11,763 )         | —                 | —                 | 307,640    | (11,763 )         |
| Private issue collateralized mortgage obligations | 131                 | (2 )              | 5,357             | (240 )            | 5,488      | (242 )            |
| Total                                             | \$457,590           | \$(16,377 )       | \$5,370           | \$(240 )          | \$462,960  | \$(16,617 )       |
| December 31, 2012                                 |                     |                   |                   |                   |            |                   |
| Mortgage-backed securities                        | \$42,782            | \$(79 )           | \$—               | \$—               | \$42,782   | \$(79 )           |
| Collateralized mortgage obligations               | 73,098              | (120 )            | —                 | —                 | 73,098     | (120 )            |
| Private issue collateralized mortgage obligations | —                   | —                 | 8,174             | (697 )            | 8,174      | (697 )            |
| Total                                             | \$ 115,880          | \$(199 )          | \$ 8,174          | \$(697 )          | \$ 124,054 | \$(896 )          |

At September 30, 2013, the Company held \$463.0 million in investment securities with unrealized losses that are considered temporary. Included in the unrealized losses were non-agency private issue collateralized mortgage obligations (“non-agency”). At September 30, 2013, the Company held \$7.5 million in non-agencies of which \$5.4 million had unrealized losses for twelve months or longer. Management believes the unrealized losses for the non-agencies are the result of current market conditions and the underestimation of their value in the market. Management currently has the intent and ability to retain these investment securities with unrealized losses until the decline in value has been recovered. Stress tests are performed monthly on the non-agencies, which are higher risk bonds, within the investment portfolio using current statistical data to determine expected cash flows and forecast potential losses. The results of the stress tests during the first nine months of 2013 indicated expected future cash flows in excess of cost, and, as such the non-agencies are not considered to be OTTI.

#### Security Gains and Losses and Other-Than-Temporary Impairment of Securities

The following table details the Company’s sales of investment securities, the gross realized gains and losses, and impairment of securities:

|                                               | Three Months Ended |                    | Nine Months Ended  |                    |
|-----------------------------------------------|--------------------|--------------------|--------------------|--------------------|
|                                               | September 30, 2013 | September 30, 2012 | September 30, 2013 | September 30, 2012 |
| Available-for-sale                            |                    |                    |                    |                    |
| Proceeds from sales of securities             | \$12,738           | \$7,337            | \$17,613           | \$38,701           |
| Gross realized gains                          | 647                | 198                | 785                | 1,302              |
| Gross realized (losses)                       | —                  | (1 )               | —                  | (204 )             |
| Other-than-temporary impairment of securities | —                  | (10 )              | —                  | (39 )              |

For the three and nine months ended September 30, 2013, the Company sold certain securities AFS with a total carrying value of \$12.7 million and \$17.6 million, respectively. For the three and nine months ended September 30, 2013, the Company recorded net gains of \$647,000 and \$785,000, respectively, in the consolidated statements of income in net gain on sale of securities and other-than-temporary impairment of securities.

For the three and nine months ended September 30, 2012, the Company sold certain securities AFS with a total carrying value of \$7.3 million and \$38.7 million, respectively. For the three and nine months ended September 30, 2012, the Company recorded net gains of \$187,000 and \$1.1 million, respectively, in the consolidated statements of

income in net gain on sale of securities and other-than-temporary impairment of securities.

The cost basis of securities sold is measured on a specific identification basis.

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### Securities Pledged

At September 30, 2013 and December 31, 2012, securities with an amortized cost of \$487.0 million and \$465.0 million and a fair value of \$484.9 million and \$482.4 million, respectively, were pledged to secure Federal Home Loan Bank (“FHLB”) advances, public deposits, and securities sold under agreements to repurchase and for other purposes required or permitted by law.

### Contractual Maturities

The amortized cost and estimated fair values of debt securities by contractual maturity at September 30, 2013, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| Available-for-sale                     | Amortized<br>Cost | Fair<br>Value |
|----------------------------------------|-------------------|---------------|
| Due in one year or less                | \$1,739           | \$1,765       |
| Due after one year through five years  | 24,679            | 25,403        |
| Due after five years through ten years | 150,623           | 152,200       |
| Due after ten years                    | 614,007           | 603,875       |
|                                        | \$791,048         | \$783,243     |

### NOTE 4 – LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of the Company’s loan portfolio, excluding residential loans held for sale, at September 30, 2013 and December 31, 2012 was as follows:

|                                 | September 30,<br>2013 | December 31,<br>2012 |
|---------------------------------|-----------------------|----------------------|
| Residential real estate loans   | \$564,933             | \$572,768            |
| Commercial real estate loans    | 522,610               | 506,231              |
| Commercial loans                | 177,855               | 190,454              |
| Home equity loans               | 306,303               | 278,375              |
| Consumer loans                  | 18,626                | 16,633               |
| Deferred loan fees net of costs | (381)                 | (595)                |
| Total loans                     | \$1,589,946           | \$1,563,866          |

The Company’s lending activities are primarily conducted in Maine. The Company originates single family and multi-family residential loans, commercial real estate loans, business loans, municipal loans and a variety of consumer loans. In addition, the Company makes loans for the construction of residential homes, multi-family properties and commercial real estate properties. The ability and willingness of borrowers to honor their repayment commitments is generally dependent on the level of overall economic activity within the geographic area and the general economy. During the first nine months of 2013 and 2012, the Company sold \$28.2 million and \$18.8 million, respectively, of fixed-rate residential mortgage loans on the secondary market that resulted in net gains on the sale of loans of \$684,000 and \$268,000, respectively.

In connection with a branch acquisition in 2012, the Company acquired \$6.0 million in performing commercial loans. The loans were recorded at fair value, which was determined by estimating the amount and timing of principal and interest cash flows expected to be collected on the loans and discounting those cash flows at a market rate of interest. As a result of this analysis, the Company recorded a fair value mark of \$317,000, which will amortize over the estimated lives of the loans. Additionally, the acquired loans did not have any related allowance for loan losses (“ALL”)

as they were recorded at fair value; however, an ALL will be established should the credit quality of these loans deteriorate subsequent to the acquisition. Based on the immateriality of the acquired loans and fair value mark, additional disclosures related to the acquired loans are not required.

The ALL is management's best estimate of the inherent risk of loss in the Company's loan portfolio as of the consolidated statement of condition date. Management makes various assumptions and judgments about the collectability of the loan portfolio and provides an allowance for potential losses based on a number of factors including historical losses. If those assumptions are incorrect, the ALL may not be sufficient to cover losses and may cause an increase in the allowance in the future. Among the factors that could affect the Company's ability to collect loans and require an increase to the ALL in the future are: (i) general real estate and economic conditions; (ii) regional credit concentration; (iii) industry concentration, for example in the hospitality, tourism and recreation industries; and (iv) a requirement by federal and state regulators to increase the provision for loan losses or recognize additional charge-offs.

The board of directors monitors credit risk management through the Directors' Loan Committee and the Corporate Risk Management group. The Directors' Loan Committee reviews large exposure credit requests, monitors asset quality on a regular basis and has approval authority for credit granting policies. The Corporate Risk Management group oversees management's systems and procedures to monitor the credit quality of the loan portfolio, conduct a loan review program, maintain the integrity of the loan rating system and determine the adequacy of the ALL. The Company's practice is to identify credit problems early and take charge-offs as promptly as practicable. In addition, management continuously reassesses its underwriting standards in response to credit risk posed by changes in economic conditions. For purposes of determining the ALL, the Company disaggregates its portfolio loans into portfolio segments, which include residential real estate, commercial real estate, commercial, home equity, and consumer.

The following table presents activity in the ALL for the three months ended September 30, 2013:

|                       | Residential<br>Real Estate | Commercial<br>Real Estate | Commercial | Home<br>Equity | Consumer | Unallocated | Total    |
|-----------------------|----------------------------|---------------------------|------------|----------------|----------|-------------|----------|
| ALL:                  |                            |                           |            |                |          |             |          |
| Beginning balance     | \$6,232                    | \$ 3,590                  | \$ 5,788   | \$3,428        | \$221    | \$4,062     | \$23,321 |
| Loans charged off     | (340 )                     | (591 )                    | (379 )     | (86 )          | (42 )    | —           | (1,438 ) |
| Recoveries            | —                          | 14                        | 77         | 8              | 12       | —           | 111      |
| Provision (reduction) | 709                        | 547                       | 465        | 137            | 40       | (1,231 )    | 667      |
| Ending balance        | \$6,601                    | \$ 3,560                  | \$ 5,951   | \$3,487        | \$231    | \$2,831     | \$22,661 |

The following table presents activity in the ALL for the nine months ended September 30, 2013:

|                                       | Residential<br>Real Estate | Commercial<br>Real Estate | Commercial | Home<br>Equity | Consumer | Unallocated | Total    |
|---------------------------------------|----------------------------|---------------------------|------------|----------------|----------|-------------|----------|
| ALL:                                  |                            |                           |            |                |          |             |          |
| Beginning balance                     | \$6,996                    | \$ 4,549                  | \$ 5,933   | \$2,520        | \$184    | \$2,862     | \$23,044 |
| Loans charged off                     | (687 )                     | (762 )                    | (823 )     | (423 )         | (175 )   | —           | (2,870 ) |
| Recoveries                            | 5                          | 106                       | 275        | 10             | 40       | —           | 436      |
| Provision (reduction)                 | 287                        | (333 )                    | 566        | 1,380          | 182      | (31 )       | 2,051    |
| Ending balance                        | \$6,601                    | \$ 3,560                  | \$ 5,951   | \$3,487        | \$231    | \$2,831     | \$22,661 |
| ALL balance attributable to loans:    |                            |                           |            |                |          |             |          |
| Individually evaluated for impairment | \$1,655                    | \$ 686                    | \$ 177     | \$449          | \$81     | \$—         | \$3,048  |
| Collectively evaluated for impairment | 4,946                      | 2,874                     | 5,774      | 3,038          | 150      | 2,831       | 19,613   |
| Total ending ALL                      | \$6,601                    | \$ 3,560                  | \$ 5,951   | \$3,487        | \$231    | \$2,831     | \$22,661 |

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Loans:

|                                       |           |            |            |           |           |     |              |
|---------------------------------------|-----------|------------|------------|-----------|-----------|-----|--------------|
| Individually evaluated for impairment | \$ 14,059 | \$ 11,016  | \$ 3,369   | \$ 1,521  | \$ 498    | \$— | \$30,463     |
| Collectively evaluated for impairment | 550,493   | 511,594    | 174,486    | 304,782   | 18,128    | —   | 1,559,483    |
| Total ending loans balance            | \$564,552 | \$ 522,610 | \$ 177,855 | \$306,303 | \$ 18,626 | \$— | \$ 1,589,946 |

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The following table presents activity in the ALL for the three months ended September 30, 2012:

|                       | Residential<br>Real Estate | Commercial<br>Real Estate | Commercial | Home<br>Equity | Consumer | Unallocated | Total    |
|-----------------------|----------------------------|---------------------------|------------|----------------|----------|-------------|----------|
| ALL:                  |                            |                           |            |                |          |             |          |
| Beginning balance     | \$6,352                    | \$4,837                   | \$6,368    | \$2,319        | \$164    | \$3,222     | \$23,262 |
| Loans charged off     | (578 )                     | —                         | (730 )     | (70 )          | (38 )    | —           | (1,416 ) |
| Recoveries            | 5                          | 53                        | 85         | 1              | 2        | —           | 146      |
| Provision (reduction) | 860                        | (215 )                    | 73         | 108            | 34       | (1 )        | 859      |
| Ending balance        | \$6,639                    | \$4,675                   | \$5,796    | \$2,358        | \$162    | \$3,221     | \$22,851 |

The following table presents activity in the ALL for the nine months ended September 30, 2012:

|                                       | Residential<br>Real Estate | Commercial<br>Real Estate | Commercial | Home<br>Equity | Consumer | Unallocated | Total       |
|---------------------------------------|----------------------------|---------------------------|------------|----------------|----------|-------------|-------------|
| ALL:                                  |                            |                           |            |                |          |             |             |
| Beginning balance                     | \$6,398                    | \$5,702                   | \$4,846    | \$2,704        | \$420    | \$2,941     | \$23,011    |
| Loans charged off                     | (1,024 )                   | (209 )                    | (1,146 )   | (921 )         | (66 )    | —           | (3,366 )    |
| Recoveries                            | 73                         | 219                       | 205        | 21             | 12       | —           | 530         |
| Provision (reduction)                 | 1,192                      | (1,037 )                  | 1,891      | 554            | (204 )   | 280         | 2,676       |
| Ending balance                        | \$6,639                    | \$4,675                   | \$5,796    | \$2,358        | \$162    | \$3,221     | \$22,851    |
| ALL balance attributable to loans:    |                            |                           |            |                |          |             |             |
| Individually evaluated for impairment | \$2,071                    | \$343                     | \$376      | \$265          | \$39     | \$—         | \$3,094     |
| Collectively evaluated for impairment | 4,568                      | 4,332                     | 5,420      | 2,093          | 123      | 3,221       | 19,757      |
| Total ending ALL                      | \$6,639                    | \$4,675                   | \$5,796    | \$2,358        | \$162    | \$3,221     | \$22,851    |
| Loans:                                |                            |                           |            |                |          |             |             |
| Individually evaluated for impairment | \$12,554                   | \$7,121                   | \$3,829    | \$1,668        | \$263    | \$—         | \$25,435    |
| Collectively evaluated for impairment | 558,739                    | 494,162                   | 174,454    | 272,508        | 15,302   | —           | 1,515,165   |
| Total ending loans balance            | \$571,293                  | \$501,283                 | \$178,283  | \$274,176      | \$15,565 | \$—         | \$1,540,600 |

The following table presents the activity in the ALL for the year ended December 31, 2012:

|                                       | Residential<br>Real Estate | Commercial<br>Real Estate | Commercial | Home<br>Equity | Consumer | Unallocated | Total    |
|---------------------------------------|----------------------------|---------------------------|------------|----------------|----------|-------------|----------|
| ALL:                                  |                            |                           |            |                |          |             |          |
| Beginning balance                     | \$6,398                    | \$5,702                   | \$4,846    | \$2,704        | \$420    | \$2,941     | \$23,011 |
| Loans charged off                     | (1,197 )                   | (593 )                    | (1,393 )   | (1,234 )       | (85 )    | —           | (4,502 ) |
| Recoveries                            | 73                         | 222                       | 406        | 23             | 20       | —           | 744      |
| Provision (reduction)                 | 1,722                      | (782 )                    | 2,074      | 1,027          | (171 )   | (79 )       | 3,791    |
| Ending balance                        | \$6,996                    | \$4,549                   | \$5,933    | \$2,520        | \$184    | \$2,862     | \$23,044 |
| ALL balance attributable to loans:    |                            |                           |            |                |          |             |          |
| Individually evaluated for impairment | \$2,255                    | \$265                     | \$286      | \$261          | \$39     | \$—         | \$3,106  |
| Collectively evaluated for impairment | 4,741                      | 4,284                     | 5,647      | 2,259          | 145      | 2,862       | 19,938   |
| Total ending ALL                      | \$6,996                    | \$4,549                   | \$5,933    | \$2,520        | \$184    | \$2,862     | \$23,044 |



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Loans:

|                                       |           |           |           |           |          |     |             |
|---------------------------------------|-----------|-----------|-----------|-----------|----------|-----|-------------|
| Individually evaluated for impairment | \$13,805  | \$7,968   | \$3,610   | \$1,515   | \$259    | \$— | \$27,157    |
| Collectively evaluated for impairment | 558,368   | 498,263   | 186,844   | 276,860   | 16,374   | —   | 1,536,709   |
| Total ending loans balance            | \$572,173 | \$506,231 | \$190,454 | \$278,375 | \$16,633 | \$— | \$1,563,866 |

The ALL for the Company's portfolio segments is determined based on loan balances and the historical performance factor of each portfolio segment. The significant changes in the ALL at September 30, 2013 compared to December 31, 2012 were within the home equity and commercial real estate portfolio segments. The increase in the allocation of ALL for home equity was primarily due to the 10.0% increase in loan balances and its historical performance, while the decrease in commercial real estate allocation was due to the improvement in that segment's performance factor.

The Company focuses on maintaining a well-balanced and diversified loan portfolio. Despite such efforts, it is recognized that credit concentrations may occasionally emerge as a result of economic conditions, changes in local demand, natural loan growth and runoff. To ensure that credit concentrations can be effectively identified, all commercial and commercial real estate loans are assigned Standard Industrial Classification codes, North American Industry Classification System codes, and state and county codes. Shifts in portfolio concentrations are monitored by the Credit Risk Policy Committee. As of September 30, 2013, the two most significant industry exposures within the commercial real estate loan portfolio were non-residential building operators (operators of commercial and industrial buildings, retail establishments, theaters, banks and insurance buildings) and lodging (inns, bed & breakfasts, ski lodges, tourist cabins, hotels and motels). At September 30, 2013, exposure to these two industries as a percentage of total commercial real estate loans was 29% and 27%, respectively.

To further identify loans with similar risk profiles, the Company categorizes each portfolio segment into classes by credit risk characteristic and applies a credit quality indicator to each portfolio segment. The indicators for commercial, commercial real estate and residential real estate loans are represented by Grades 1 through 10 as outlined below. In general, risk ratings are adjusted periodically throughout the year as updated analysis and review warrants. This process may include, but is not limited to, annual credit and loan reviews, periodic reviews of loan performance metrics, such as delinquency rates, and quarterly reviews of adversely risk rated loans. The Company uses the following definitions when assessing grades for the purpose of evaluating the risk and adequacy of the ALL:

Grade 1 through 6 — Grades 1 through 6 represent groups of loans that are not subject to adverse criticism as defined in regulatory guidance. Loans in these groups exhibit characteristics that represent low to moderate risks, which is measured using a variety of credit risk criteria, such as cash flow coverage, debt service coverage, balance sheet leverage, liquidity, management experience, industry position, prevailing economic conditions, support from secondary sources of repayment and other credit factors that may be relevant to a specific loan. In general, these loans are supported by properly margined collateral and guarantees of principal parties.

Grade 7 — Loans with potential weakness (Special Mention). Loans in this category are currently protected based on collateral and repayment capacity and do not constitute undesirable credit risk, but have potential weakness that may result in deterioration of the repayment process at some future date. This classification is used if a negative trend is evident in the obligor's financial situation. Special mention loans do not sufficiently expose the Company such that they warrant adverse classification.

Grade 8 — Loans with definite weakness (Substandard). Loans classified as substandard are inadequately protected by the current sound worth and paying capacity of the obligor or by collateral pledged. This classification is used if borrowers experience difficulty in meeting debt repayment requirements. Deterioration is sufficient to cause the Company to look to the sale of collateral.

Grade 9 — Loans with potential loss (Doubtful). Loans classified as doubtful have all the weaknesses inherent in the substandard grade with the added characteristic that the weaknesses make collection or liquidation of the loan in full highly questionable and improbable. The possibility of some loss is extremely high, but because of specific pending factors that may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined.

Grade 10 — Loans with definite loss (Loss). Loans classified as loss are considered uncollectible. The loss classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off the asset because recovery and collection time may be protracted.

Asset quality indicators are periodically reassessed to appropriately reflect the risk composition of the Company's loan portfolio. Home equity and consumer loans are not individually risk rated, but rather analyzed as groups taking into account delinquency rates and other economic conditions which may affect the ability of borrowers to meet debt service requirements, including interest rates and energy costs. Performing loans include loans that are current and loans that are past due less than 90 days. Loans that are past due over 90 days and non-accrual loans are considered non-performing.

The following table summarizes credit risk exposure indicators by portfolio segment as of the following dates:

|                           | Residential<br>Real Estate | Commercial<br>Real Estate | Commercial | Home<br>Equity | Consumer |
|---------------------------|----------------------------|---------------------------|------------|----------------|----------|
| September 30, 2013        |                            |                           |            |                |          |
| Pass (Grades 1-6)         | \$545,922                  | \$475,515                 | \$153,688  | \$—            | \$—      |
| Performing                | —                          | —                         | —          | 304,781        | 18,130   |
| Special Mention (Grade 7) | 3,073                      | 8,050                     | 10,511     | —              | —        |
| Substandard (Grade 8)     | 15,557                     | 39,045                    | 13,656     | —              | —        |
| Non-performing            | —                          | —                         | —          | 1,522          | 496      |
| Total                     | \$564,552                  | \$522,610                 | \$177,855  | \$306,303      | \$18,626 |
| December 31, 2012         |                            |                           |            |                |          |
| Pass (Grades 1-6)         | \$555,444                  | \$440,610                 | \$165,460  | \$—            | \$—      |
| Performing                | —                          | —                         | —          | 276,742        | 16,376   |
| Special Mention (Grade 7) | 1,291                      | 17,069                    | 7,449      | —              | —        |
| Substandard (Grade 8)     | 15,438                     | 48,552                    | 17,545     | —              | —        |
| Non-performing            | —                          | —                         | —          | 1,633          | 257      |
| Total                     | \$572,173                  | \$506,231                 | \$190,454  | \$278,375      | \$16,633 |

The Company closely monitors the performance of its loan portfolio. Loans past due 30 days or more are considered delinquent. In general, consumer loans will be charged off if the loan is delinquent for 90 consecutive days. Commercial and real estate loans are charged off in part or in full if they appear uncollectible. A loan is placed on non-accrual status when the financial condition of the borrower is deteriorating, payment in full of both principal and interest is not expected as scheduled or principal or interest has been in default for 90 days or more. Exceptions may be made if the asset is well-secured by collateral sufficient to satisfy both the principal and accrued interest in full and collection is assured by a specific event, such as the closing of a pending sale contract. When one loan to a borrower is placed on non-accrual status, generally all other loans to the borrower are re-evaluated to determine if they should also be placed on non-accrual status. All previously accrued and unpaid interest is reversed at this time. Interest payments received on non-accrual loans (including impaired loans) are applied as a reduction of principal. A loan remains on non-accrual status until all principal and interest amounts contractually due are brought current and future payments are reasonably assured. A loan may be returned to accrual status when collection of principal and interest is assured and the borrower has demonstrated timely payments of principal and interest for a reasonable period. Unsecured loans, however, are not normally placed on non-accrual status because they are charged-off once their collectability is in doubt.

The following is a loan aging analysis by portfolio segment (including loans past due over 90 days and non-accrual loans) and a summary of non-accrual loans, which include troubled debt restructured loans (“TDRs”), and loans past due over 90 days and accruing as of the following dates:

|                            | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater<br>than<br>90 Days | Total<br>Past Due | Current            | Total Loans<br>Outstanding | Loans > 90<br>Days Past<br>Due and<br>Accruing | Non-Accrual<br>Loans |
|----------------------------|------------------------|------------------------|----------------------------|-------------------|--------------------|----------------------------|------------------------------------------------|----------------------|
| September 30,<br>2013      |                        |                        |                            |                   |                    |                            |                                                |                      |
| Residential<br>real estate | \$774                  | \$855                  | \$6,876                    | \$8,505           | \$556,047          | \$564,552                  | \$—                                            | \$ 10,224            |
| Commercial<br>real estate  | 1,971                  | 122                    | 4,483                      | 6,576             | 516,034            | 522,610                    | —                                              | 9,847                |
| Commercial<br>Home equity  | 443                    | 230                    | 2,568                      | 3,241             | 174,614            | 177,855                    | 24                                             | 2,994                |
| Consumer                   | 1,136                  | 171                    | 962                        | 2,269             | 304,034            | 306,303                    | —                                              | 1,522                |
|                            | 52                     | 19                     | 472                        | 543               | 18,083             | 18,626                     | —                                              | 496                  |
| <b>Total</b>               | <b>\$4,376</b>         | <b>\$1,397</b>         | <b>\$15,361</b>            | <b>\$21,134</b>   | <b>\$1,568,812</b> | <b>\$1,589,946</b>         | <b>\$24</b>                                    | <b>\$ 25,083</b>     |
| December 31,<br>2012       |                        |                        |                            |                   |                    |                            |                                                |                      |
| Residential<br>real estate | \$1,459                | \$850                  | \$8,410                    | \$10,719          | \$561,454          | \$572,173                  | \$193                                          | \$ 10,584            |
| Commercial<br>real estate  | 896                    | 2,227                  | 5,380                      | 8,503             | 497,728            | 506,231                    | 138                                            | 6,719                |
| Commercial<br>Home equity  | 1,079                  | 68                     | 2,969                      | 4,116             | 186,338            | 190,454                    | 160                                            | 3,409                |
| Consumer                   | 2,230                  | 355                    | 1,105                      | 3,690             | 274,685            | 278,375                    | 118                                            | 1,514                |
|                            | 342                    | 199                    | 259                        | 800               | 15,833             | 16,633                     | 2                                              | 257                  |
| <b>Total</b>               | <b>\$6,006</b>         | <b>\$3,699</b>         | <b>\$18,123</b>            | <b>\$27,828</b>   | <b>\$1,536,038</b> | <b>\$1,563,866</b>         | <b>\$611</b>                                   | <b>\$ 22,483</b>     |

The Company takes a conservative approach in credit risk management and remains focused on community lending and reinvesting. The Company’s Credit Administration group works closely with borrowers experiencing credit problems to assist in loan repayment or term modifications. TDRs consist of loans where the Company, for economic or legal reasons related to the borrower’s financial difficulties, granted a concession to the borrower that it would not otherwise consider. TDRs involve term modifications or a reduction of either interest or principal. Once such an obligation has been restructured, it will continue to remain in a restructured status until paid in full.

At September 30, 2013 and December 31, 2012, the allowance related to TDRs was \$604,000 and \$494,000, respectively. The specific reserve component was determined by discounting the total expected future cash flows from the borrower, or if the loan is currently collateral-dependent, using the fair value of the underlying collateral, which was obtained through independent appraisals and internal evaluations. At September 30, 2013, the Company did not have any commitments to lend additional funds to borrowers with loans classified as TDRs.

During the first nine months of 2013, the Company modified nine loans as TDRs, which had current balances of \$1.2 million at September 30, 2013. During the first nine months of 2012, the Company modified seven loans with current balances of \$1.7 million at September 30, 2012. The modification of these loans as TDRs did not have a material financial effect on the Company. Loans restructured due to credit difficulties that are now performing were \$5.4 million at September 30, 2013 and \$4.7 million at December 31, 2012. The Company had one TDR that subsequently defaulted during the first nine months of 2013, which had a current balance of \$550,000 at September 30, 2013. The Company had no TDRs that subsequently defaulted during the first nine months of 2012.



The following is a summary of accruing and non-accruing TDRs by portfolio segment as of the following dates:

|                         | Number of<br>Contracts | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment | Current<br>Balance |
|-------------------------|------------------------|-----------------------------------------------------------|------------------------------------------------------------|--------------------|
| September 30, 2013      |                        |                                                           |                                                            |                    |
| Residential real estate | 24                     | \$3,940                                                   | \$4,099                                                    | \$3,900            |
| Commercial real estate  | 9                      | 2,844                                                     | 2,897                                                      | 2,574              |
| Commercial              | 5                      | 386                                                       | 386                                                        | 375                |
| Consumer                | 1                      | 3                                                         | 3                                                          | 1                  |
| Total                   | 39                     | \$7,173                                                   | \$7,385                                                    | \$6,850            |
| December 31, 2012       |                        |                                                           |                                                            |                    |
| Residential real estate | 20                     | \$3,305                                                   | \$3,434                                                    | \$3,286            |
| Commercial real estate  | 6                      | 2,602                                                     | 2,649                                                      | 2,344              |
| Commercial              | 3                      | 303                                                       | 303                                                        | 236                |
| Consumer                | 1                      | 3                                                         | 3                                                          | 2                  |
| Total                   | 30                     | \$6,213                                                   | \$6,389                                                    | \$5,868            |

Impaired loans consist of non-accrual loans and TDRs. The following is a summary of impaired loan balances and associated allowance by portfolio segment as of the following dates and for the periods then ended:

|                             | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Three Months Ended<br>Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Nine Months Ended<br>Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|-----------------------------|------------------------|--------------------------------|----------------------|---------------------------------------------------------|----------------------------------|--------------------------------------------------------|----------------------------------|
| September 30, 2013          |                        |                                |                      |                                                         |                                  |                                                        |                                  |
| With an allowance recorded: |                        |                                |                      |                                                         |                                  |                                                        |                                  |
| Residential real estate     | \$10,746               | \$10,746                       | \$1,655              | \$10,457                                                | \$32                             | \$10,130                                               | \$91                             |
| Commercial real estate      | 8,497                  | 8,497                          | 686                  | 6,503                                                   | 9                                | 4,976                                                  | 18                               |
| Commercial                  | 2,347                  | 2,347                          | 177                  | 2,606                                                   | 3                                | 2,721                                                  | 6                                |
| Home equity                 | 1,263                  | 1,263                          | 449                  | 1,245                                                   | —                                | 1,307                                                  | —                                |
| Consumer                    | 480                    | 480                            | 81                   | 481                                                     | —                                | 466                                                    | —                                |
| Ending Balance              | \$23,333               | \$23,333                       | \$3,048              | \$21,292                                                | \$44                             | \$19,600                                               | \$115                            |
| Without allowance recorded: |                        |                                |                      |                                                         |                                  |                                                        |                                  |
| Residential real estate     | \$3,313                | \$4,439                        | \$—                  | \$2,816                                                 | \$9                              | \$2,908                                                | \$22                             |
| Commercial real estate      | 2,519                  | 3,167                          | —                    | 3,663                                                   | 10                               | 3,750                                                  | 56                               |
| Commercial                  | 1,022                  | 1,213                          | —                    | 907                                                     | 2                                | 699                                                    | 8                                |
| Home equity                 | 258                    | 450                            | —                    | 291                                                     | —                                | 356                                                    | —                                |
| Consumer                    | 18                     | 38                             | —                    | 7                                                       | —                                | 3                                                      | —                                |
| Ending Balance              | \$7,130                | \$9,307                        | \$—                  | \$7,684                                                 | \$21                             | \$7,716                                                | \$86                             |
| Total impaired loans        | \$30,463               | \$32,640                       | \$3,048              | \$28,976                                                | \$65                             | \$27,316                                               | \$201                            |

|                                     | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Year Ended<br>Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|-------------------------------------|------------------------|--------------------------------|----------------------|-------------------------------------------------|----------------------------------|
| December 31, 2012                   |                        |                                |                      |                                                 |                                  |
| With related allowance recorded:    |                        |                                |                      |                                                 |                                  |
| Residential real estate             | \$11,021               | \$11,021                       | \$2,255              | \$10,585                                        | \$114                            |
| Commercial real estate              | 4,296                  | 4,296                          | 265                  | 5,551                                           | —                                |
| Commercial                          | 2,971                  | 2,971                          | 286                  | 3,927                                           | —                                |
| Home equity                         | 1,236                  | 1,236                          | 261                  | 1,289                                           | —                                |
| Consumer                            | 257                    | 257                            | 39                   | 239                                             | —                                |
| Ending Balance                      | \$19,781               | \$19,781                       | \$3,106              | \$21,591                                        | \$114                            |
| Without related allowance recorded: |                        |                                |                      |                                                 |                                  |
| Residential real estate             | \$2,784                | \$3,841                        | \$—                  | \$2,548                                         | \$26                             |
| Commercial real estate              | 3,672                  | 4,127                          | —                    | 2,056                                           | 33                               |
| Commercial                          | 639                    | 956                            | —                    | 389                                             | 13                               |
| Home equity                         | 279                    | 550                            | —                    | 617                                             | —                                |
| Consumer                            | 2                      | 2                              | —                    | 6                                               | —                                |
| Ending Balance                      | \$7,376                | \$9,476                        | \$—                  | \$5,616                                         | \$72                             |
| Total impaired loans                | \$27,157               | \$29,257                       | \$3,106              | \$27,207                                        | \$186                            |

## NOTE 5 – GOODWILL, CORE DEPOSIT AND TRUST RELATIONSHIP INTANGIBLES

The Company has recognized goodwill and certain identifiable intangible assets in connection with certain acquisitions of other businesses in prior years. The changes in goodwill, core deposit intangible and trust relationship intangible for the nine months ended September 30, 2013 are shown in the table below:

|                               | Goodwill |                       |          |
|-------------------------------|----------|-----------------------|----------|
|                               | Banking  | Financial<br>Services | Total    |
| Balance at December 31, 2012  | \$40,902 | \$6,734               | \$47,636 |
| 2013 activity                 | —        | —                     | —        |
| Balance at September 30, 2013 | \$40,902 | \$6,734               | \$47,636 |

|                               | Core Deposit Intangible |                             |         | Trust Relationship Intangible |                             |       |
|-------------------------------|-------------------------|-----------------------------|---------|-------------------------------|-----------------------------|-------|
|                               | Total                   | Accumulated<br>Amortization | Net     | Total                         | Accumulated<br>Amortization | Net   |
| Balance at December 31, 2012  | \$17,300                | \$(12,014)                  | \$5,286 | \$753                         | \$(376)                     | \$377 |
| 2013 amortization             | —                       | (806)                       | (806)   | —                             | (57)                        | (57)  |
| Balance at September 30, 2013 | \$17,300                | \$(12,820)                  | \$4,480 | \$753                         | \$(433)                     | \$320 |



The following table reflects the expected amortization of intangible assets over the remaining estimated useful life (assuming no acquisitions, divestitures, or impairment) as of September 30, 2013:

|                                     | Core Deposit<br>Intangible | Trust<br>Relationship<br>Intangible |
|-------------------------------------|----------------------------|-------------------------------------|
| 2013                                | \$268                      | \$19                                |
| 2014                                | 1,073                      | 75                                  |
| 2015                                | 1,073                      | 75                                  |
| 2016                                | 1,073                      | 75                                  |
| 2017                                | 993                        | 76                                  |
| Total unamortized intangible assets | \$4,480                    | \$320                               |

#### NOTE 6 – EMPLOYEE BENEFIT PLANS

The Company maintains an unfunded, non-qualified supplemental executive retirement plan for certain officers and provides medical and life insurance to certain eligible retired employees. The components of net period benefit cost for the periods ended September 30, 2013 and 2012 were as follows:

##### Supplemental Executive Retirement Plan

|                                        | Three Months Ended<br>September 30, |       | Nine Months Ended<br>September 30, |       |
|----------------------------------------|-------------------------------------|-------|------------------------------------|-------|
|                                        | 2013                                | 2012  | 2013                               | 2012  |
| Net period benefit cost                |                                     |       |                                    |       |
| Service cost                           | \$82                                | \$67  | \$246                              | \$201 |
| Interest cost                          | 94                                  | 102   | 282                                | 306   |
| Recognized net actuarial loss          | 56                                  | 29    | 168                                | 87    |
| Recognized prior service cost          | 5                                   | 5     | 15                                 | 15    |
| Net period benefit cost <sup>(1)</sup> | \$237                               | \$203 | \$711                              | \$609 |

##### Other Postretirement Benefit Plan

|                                        | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |       |
|----------------------------------------|-------------------------------------|------|------------------------------------|-------|
|                                        | 2013                                | 2012 | 2013                               | 2012  |
| Net period benefit cost                |                                     |      |                                    |       |
| Service cost                           | \$19                                | \$17 | \$57                               | \$51  |
| Interest cost                          | 35                                  | 37   | 105                                | 111   |
| Recognized net actuarial loss          | 11                                  | 8    | 33                                 | 24    |
| Net period benefit cost <sup>(1)</sup> | \$65                                | \$62 | \$195                              | \$186 |

(1) Presented within the consolidated statements of income in salaries and employee benefits.

#### NOTE 7 – STOCK-BASED COMPENSATION PLANS

On February 26, 2013, the Company granted 6,325 restricted stock awards to certain officers of the Company and its subsidiaries under the 2012 Equity and Incentive Plan. The holders of these awards participate fully in the rewards of stock ownership of the Company, including voting and dividend rights. The restricted stock awards have been determined to have a fair value of \$33.72 per unit, based on the market price of the Company's common stock on the date of grant. The restricted stock awards vest over a three-year period.



Under the Long-term Performance Share Plan, 6,797 shares vested upon the achievement of certain revenue and expense goals under the 2010-2012 Long-term Performance Share Plan metrics and 4,352 shares, net of taxes, were issued to participants. Under the Management Stock Purchase Plan, 7,801 shares were purchased by employees at a discount in lieu of the management employees' annual incentive bonus during the first three months of 2013. During the first quarter of 2013, the Company granted 2,304 deferred stock awards under the Defined Contribution Retirement Plan.

On March 26, 2013, the Company approved the Amended and Restated Long-Term Performance Share Plan for the 2013 – 2015 performance period (the “2013 – 2015 LTIP”). Pursuant to the 2013 – 2015 LTIP, certain executive officers of the Company are eligible to receive equity compensation based on the attainment of certain performance goals set forth in the 2013 – 2015 LTIP. Performance goals under the 2013-2015 LTIP include specific revenue growth and efficiency ratio goals for threshold, target and superior levels of performance, and a minimum level of performance for the Company's non-performing asset to total asset ratio at December 31, 2015 and a minimum level of net income growth for the three-year period ending December 31, 2015.

#### NOTE 8 – FAIR VALUE MEASUREMENT AND DISCLOSURE

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined using quoted market prices. However, in many instances, quoted market prices are not available. In such instances, fair values are determined using various valuation techniques. Various assumptions and observable inputs must be relied upon in applying these techniques. GAAP establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

GAAP permits an entity to choose to measure eligible financial instruments and other items at fair value. The Company has elected the fair value option for its loans held for sale. Electing the fair value option for loans held for sale enables the Company's financial position to more clearly align with the economic value of the actively traded asset.

The fair value hierarchy for valuation of an asset or liability is as follows:

Level 1: Valuation is based upon unadjusted quoted prices in active markets for identical assets and liabilities that the entity has the ability to access as of the measurement date.

Level 2: Valuation is determined from quoted prices for similar assets or liabilities in active markets, from quoted prices for identical or similar instruments in markets that are not active or by model-based techniques in which all significant inputs are observable in the market.

Level 3: Valuation is derived from model-based and other techniques in which at least one significant input is unobservable and which may be based on the Company's own estimates about the assumptions that market participants would use to value the asset or liability.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon model-based techniques incorporating various assumptions including interest rates, prepayment speeds and credit losses. Assets and liabilities valued using model-based techniques are classified as either Level 2 or Level 3, depending on the lowest level classification of an input that is considered significant to the overall valuation. A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.



Financial Instruments Recorded at Fair Value on a Recurring Basis

Securities Available-for-sale: The fair value of debt securities available-for-sale is reported utilizing prices provided by an independent pricing service based on recent trading activity and other observable information including, but not limited to, dealer quotes, market spreads, cash flows, market interest rate curves, market consensus prepayment speeds, credit information, and the bond's terms and conditions. The fair value of debt securities is classified as Level 2.

Trading Account Assets: Trading account assets are invested in mutual funds and classified as Level 1 based upon quoted prices.

Loans Held for Sale: The fair value of loans held for sale is determined using quoted secondary market prices or executed sales agreements and classified as Level 2.

Derivatives: The fair value of interest rate swaps is determined using inputs that are observable in the market place obtained from third parties including yield curves, publicly available volatilities, and floating indexes and, accordingly, are classified as Level 2 inputs. The credit value adjustments associated with derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by the Company and its counterparties. As of September 30, 2013 and December 31, 2012, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives due to collateral postings.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

|                                                                                                   | Readily<br>Available<br>Market<br>Prices<br>(Level 1) | Observable<br>Market<br>Data<br>(Level 2) | Company<br>Determined<br>Fair Value<br>(Level 3) | Total    |
|---------------------------------------------------------------------------------------------------|-------------------------------------------------------|-------------------------------------------|--------------------------------------------------|----------|
| September 30, 2013                                                                                |                                                       |                                           |                                                  |          |
| Financial Assets:                                                                                 |                                                       |                                           |                                                  |          |
| Available-for-sale debt securities:                                                               |                                                       |                                           |                                                  |          |
| Obligations of states and political subdivisions                                                  | \$—                                                   | \$29,200                                  | \$—                                              | \$29,200 |
| Mortgage-backed securities issued or guaranteed by U.S. government sponsored enterprises          | —                                                     | 360,208                                   | —                                                | 360,208  |
| Collateralized mortgage obligations issued or guaranteed by U.S. government sponsored enterprises | —                                                     | 386,346                                   | —                                                | 386,346  |
| Private issue collateralized mortgage obligations                                                 | —                                                     | 7,489                                     | —                                                | 7,489    |
| Trading account assets                                                                            | 2,309                                                 | —                                         | —                                                | 2,309    |
| Loans held for sale                                                                               | —                                                     | 1,313                                     | —                                                | 1,313    |
| Customer interest rate swap agreements                                                            | —                                                     | 192                                       | —                                                | 192      |
| Financial Liabilities:                                                                            |                                                       |                                           |                                                  |          |
| Interest rate swap agreements                                                                     | —                                                     | 5,560                                     | —                                                | 5,560    |
| Customer interest rate swap agreements                                                            | —                                                     | 192                                       | —                                                | 192      |
| December 31, 2012                                                                                 |                                                       |                                           |                                                  |          |
| Financial Assets:                                                                                 |                                                       |                                           |                                                  |          |
| Available-for-sale debt securities:                                                               |                                                       |                                           |                                                  |          |
| Obligations of states and political subdivisions                                                  | \$—                                                   | \$33,040                                  | \$—                                              | \$33,040 |
| Mortgage-backed securities issued or guaranteed by U.S. government sponsored enterprises          | —                                                     | 358,148                                   | —                                                | 358,148  |
| Collateralized mortgage obligations issued or guaranteed by U.S. government sponsored enterprises | —                                                     | 381,688                                   | —                                                | 381,688  |
| Private issue collateralized mortgage obligations                                                 | —                                                     | 8,174                                     | —                                                | 8,174    |
| Trading account assets                                                                            | 2,300                                                 | —                                         | —                                                | 2,300    |
| Customer interest rate swap agreements                                                            | —                                                     | 496                                       | —                                                | 496      |
| Financial Liabilities:                                                                            |                                                       |                                           |                                                  |          |
| Interest rate swap agreements                                                                     | —                                                     | 11,084                                    | —                                                | 11,084   |
| Customer interest rate swap agreements                                                            | —                                                     | 496                                       | —                                                | 496      |

The Company did not have any transfers between Level 1 and Level 2 of the fair value hierarchy during the nine months ended September 30, 2013. The Company's procedure for determining transfers between levels occurs at the end of the reporting period when circumstances in the underlying valuation criteria change and result in transfer between levels.

#### Financial Instruments Recorded at Fair Value on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain financial assets and financial liabilities at fair value on a nonrecurring basis in accordance with GAAP. These include assets that are measured at the lower of cost or market value that were recognized at fair value below cost at the end of the period.

Collateral-Dependent Impaired Loans: Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as

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individually impaired, the Company measures impairment in accordance with GAAP. Impaired loans are measured using one of three methods: (i) the present value of expected future cash flows discounted at the loan's effective interest rate; (ii) the loan's observable market price; (iii) or the fair value of the collateral. If the measure is less than an impaired loan's recorded investment, an impairment loss is recognized as part of the ALL. Accordingly, certain impaired loans may be subject to measurement at fair value on a non-recurring basis. Management has estimated the fair values of these assets using Level 2 inputs, such as the fair value of collateral based on independent third-party market approach appraisals for collateral-dependent loans, and Level 3 inputs where circumstances warrant an adjustment to the appraised value based on the age of the appraisal and/or comparable sales, condition of the collateral, and market conditions.

**Mortgage Servicing Rights:** The Company accounts for mortgage servicing assets at cost, subject to impairment testing. When the carrying value exceeds fair value, a valuation allowance is established to reduce the carrying cost to fair value. Fair value is based on a valuation model that calculates the present value of estimated net servicing income. The Company obtains a third-party valuation based upon loan level data including note rate, type and term of the underlying loans. The model utilizes a variety of observable inputs for its assumptions, the most significant of which are loan prepayment assumptions and the discount rate used to discount future cash flows. Other assumptions include delinquency rates, servicing cost inflation and annual unit loan cost. Mortgage servicing rights are classified within Level 2 of the fair value hierarchy.

#### Non-Financial Assets and Non-Financial Liabilities Recorded at Fair Value

The Company has no non-financial assets or non-financial liabilities measured at fair value on a recurring basis. Non-financial assets measured at fair value on a non-recurring basis consist of other real estate owned ("OREO").

OREO properties acquired through foreclosure or deed in lieu of foreclosure are recorded at the fair value of the real estate, less costs to sell. Any write-down of the recorded investment in the related loan is charged to the allowance for loan losses upon transfer to OREO. Upon acquisition of a property, a current appraisal or a broker's opinion is used to substantiate fair value for the property. After foreclosure, management periodically obtains updated valuations of the OREO assets and, if additional impairments are deemed necessary, the subsequent write-downs for declines in value are recorded through a valuation allowance and a provision for losses charged to other non-interest expense on the consolidated statements of income. Certain assets require assumptions, such as expected future cash flows, that are not observable in an active market in determination of fair value and are classified as Level 3.



Assets measured at fair value on a non-recurring basis as of September 30, 2013 and December 31, 2012 are included below:

|                                         | Readily Available Market Prices (Level 1) | Observable Market Data (Level 2) | Company Determined Fair Value (Level 3) | Total    |
|-----------------------------------------|-------------------------------------------|----------------------------------|-----------------------------------------|----------|
| September 30, 2013                      |                                           |                                  |                                         |          |
| Assets:                                 |                                           |                                  |                                         |          |
| Collateral-dependent impaired loans (1) | \$—                                       | \$—                              | \$13,006                                | \$13,006 |
| Other real estate owned                 | —                                         | —                                | 1,802                                   | 1,802    |
| Mortgage servicing rights               | —                                         | 1,463                            | —                                       | 1,463    |
| December 31, 2012                       |                                           |                                  |                                         |          |
| Assets:                                 |                                           |                                  |                                         |          |
| Collateral-dependent impaired loans (1) | \$—                                       | \$—                              | \$9,183                                 | \$9,183  |
| Other real estate owned                 | —                                         | —                                | 1,313                                   | 1,313    |
| Mortgage servicing rights               | —                                         | 879                              | —                                       | 879      |

The following table presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a non-recurring basis at September 30, 2013:

|                                          | Fair Value | Valuation Methodology                   | Unobservable input                 | Discount Range |
|------------------------------------------|------------|-----------------------------------------|------------------------------------|----------------|
| September 30, 2013                       |            |                                         |                                    |                |
| Collateral-dependent impaired loans: (1) |            |                                         |                                    |                |
| Partially charged-off                    | \$4,246    | Market approach appraisal of collateral | Management adjustment of appraisal | 10 – 30 %      |
| Specifically reserved                    | 8,760      | Market approach appraisal of collateral | Management adjustment of appraisal | — (2)          |
| Other real estate owned                  | 1,802      | Market approach appraisal of collateral | Management adjustment of appraisal | 10 – 30 %      |
|                                          |            |                                         | Estimated selling cost             | 6 – 10 %       |
| December 31, 2012                        |            |                                         |                                    |                |
| Collateral-dependent impaired loans:(1)  |            |                                         |                                    |                |
| Partially charged-off                    | \$3,524    | Market approach appraisal of collateral | Management adjustment of appraisal | 10 – 30 %      |
| Specifically reserved                    | 5,659      | Market approach appraisal of collateral | Management adjustment of appraisal | — (2)          |
| Other real estate owned                  | 1,313      | Market approach appraisal of collateral | Management adjustment of appraisal | 10 – 30 %      |
|                                          |            |                                         | Estimated selling cost             | 6 – 10 %       |

(1) Does not include impaired loans that are measured by the present value of expected future cash flows discounted at the loan's effective interest rate.

(2) The specific reserve for collateral-dependent impaired loans is determined by any deficit of 75% of collateral value over the recorded investment.



GAAP requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or non-recurring basis are discussed above. The following methods and assumptions were used by the Company in estimating the fair values of its other financial instruments.

**Cash and Due from Banks:** The carrying amounts reported in the consolidated statement of condition approximate fair value.

**FHLB and Federal Reserve Bank Stock and Investments in Trust Preferred Securities Affiliates:** The carrying amounts reported in the consolidated statements of condition approximate fair value.

**Loans:** For variable rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. The fair value of other loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

**Interest Receivable and Payable:** The carrying amounts reported in the consolidated statements of condition approximate fair value.

**Deposits:** The fair value of deposits with no stated maturity is equal to the carrying amount. The fair value of certificates of deposit is estimated using a discounted cash flow calculation that applies interest rates and remaining maturities for currently offered certificates of deposit.

**Borrowings:** The carrying amounts of short-term borrowings from the FHLB, securities sold under repurchase agreements, notes payable and other short-term borrowings approximate fair value. The fair values of long-term borrowings and commercial repurchase agreements are based on the discounted cash flows using current rates for advances of similar remaining maturities.

**Junior Subordinated Debentures:** The carrying amounts reported in the consolidated statements of condition approximate fair value.

The following table presents the carrying amounts and estimated fair value for financial instrument assets and liabilities measured at September 30, 2013:

|                                                     | Carrying<br>Amount | Fair Value | Readily<br>Available<br>Market<br>Prices<br>(Level 1) | Observable<br>Market<br>Prices<br>(Level 2) | Company<br>Determined<br>Market<br>Prices<br>(Level 3) |
|-----------------------------------------------------|--------------------|------------|-------------------------------------------------------|---------------------------------------------|--------------------------------------------------------|
| Financial assets:                                   |                    |            |                                                       |                                             |                                                        |
| Cash and due from banks                             | \$57,086           | \$57,086   | \$57,086                                              | \$—                                         | \$—                                                    |
| Securities available-for-sale                       | 783,243            | 783,243    | —                                                     | 783,243                                     | —                                                      |
| FHLB and Federal Reserve Bank stock                 | 19,724             | 19,724     | 19,724                                                | —                                           | —                                                      |
| Trading account assets                              | 2,309              | 2,309      | 2,309                                                 | —                                           | —                                                      |
| Loans held for sale                                 | 1,313              | 1,313      | —                                                     | 1,313                                       | —                                                      |
| Residential real estate loans                       | 557,009            | 572,253    | —                                                     | —                                           | 572,253                                                |
| Commercial real estate loans                        | 518,542            | 519,587    | —                                                     | —                                           | 519,587                                                |
| Commercial loans                                    | 171,054            | 170,846    | —                                                     | —                                           | 170,846                                                |
| Home equity loans                                   | 302,318            | 303,794    | —                                                     | —                                           | 303,794                                                |
| Consumer loans                                      | 18,362             | 18,743     | —                                                     | —                                           | 18,743                                                 |
| Mortgage servicing rights                           | 730                | 1,463      | —                                                     | 1,463                                       | —                                                      |
| Interest receivable                                 | 5,678              | 5,678      | —                                                     | 5,678                                       | —                                                      |
| Investment in trust preferred securities affiliates | 1,331              | 1,331      | —                                                     | —                                           | 1,331                                                  |
| Customer interest rate swap agreements              | 192                | 192        | —                                                     | 192                                         | —                                                      |
| Financial liabilities:                              |                    |            |                                                       |                                             |                                                        |
| Deposits                                            | 1,973,364          | 1,977,585  | 1,439,307                                             | 538,278                                     | —                                                      |
| FHLB advances                                       | 96,130             | 99,374     | —                                                     | 99,374                                      | —                                                      |
| Commercial repurchase agreements                    | 30,154             | 32,311     | —                                                     | 32,311                                      | —                                                      |
| Other borrowed funds                                | 177,172            | 177,172    | 177,172                                               | —                                           | —                                                      |
| Junior subordinated debentures                      | 43,896             | 43,896     | —                                                     | 43,896                                      | —                                                      |
| Interest payable                                    | 560                | 560        | 560                                                   | —                                           | —                                                      |
| Interest rate swap agreements                       | 5,560              | 5,560      | —                                                     | 5,560                                       | —                                                      |
| Customer interest rate swap agreements              | 192                | 192        | —                                                     | 192                                         | —                                                      |

The following table presents the carrying amounts and estimated fair value for financial instrument assets and liabilities measured at December 31, 2012:

|                                                     | Carrying<br>Amount | Fair Value | Readily<br>Available<br>Market<br>Prices<br>(Level 1) | Observable<br>Market<br>Prices<br>(Level 2) | Company<br>Determined<br>Market<br>Prices<br>(Level 3) |
|-----------------------------------------------------|--------------------|------------|-------------------------------------------------------|---------------------------------------------|--------------------------------------------------------|
| Financial assets:                                   |                    |            |                                                       |                                             |                                                        |
| Cash and due from banks                             | \$58,290           | \$58,290   | \$58,290                                              | \$—                                         | \$—                                                    |
| Securities available-for-sale                       | 781,050            | 781,050    | —                                                     | 781,050                                     | —                                                      |
| FHLB and Federal Reserve Bank stock                 | 21,034             | 21,034     | 21,034                                                | —                                           | —                                                      |
| Trading account assets                              | 2,300              | 2,300      | 2,300                                                 | —                                           | —                                                      |
| Residential real estate loans                       | 564,184            | 591,139    | —                                                     | —                                           | 591,139                                                |
| Commercial real estate loans                        | 501,037            | 492,602    | —                                                     | —                                           | 492,602                                                |
| Commercial loans                                    | 183,680            | 179,519    | —                                                     | —                                           | 179,519                                                |
| Home equity loans                                   | 275,498            | 277,194    | —                                                     | —                                           | 277,194                                                |
| Consumer loans                                      | 16,423             | 16,866     | —                                                     | —                                           | 16,866                                                 |
| Mortgage servicing rights                           | 542                | 879        | —                                                     | 879                                         | —                                                      |
| Interest receivable                                 | 6,215              | 6,215      | —                                                     | 6,215                                       | —                                                      |
| Investment in trust preferred securities affiliates | 1,331              | 1,331      | —                                                     | —                                           | 1,331                                                  |
| Customer interest rate swap agreements              | 496                | 496        | —                                                     | 496                                         | —                                                      |
| Financial liabilities:                              |                    |            |                                                       |                                             |                                                        |
| Deposits                                            | 1,929,469          | 1,936,446  | 1,339,290                                             | 597,156                                     | —                                                      |
| FHLB advances                                       | 56,404             | 60,813     | —                                                     | 60,813                                      | —                                                      |
| Commercial repurchase agreements                    | 66,187             | 69,067     | —                                                     | 69,067                                      | —                                                      |
| Other borrowed funds                                | 193,753            | 193,753    | 193,753                                               | —                                           | —                                                      |
| Junior subordinated debentures                      | 43,819             | 43,819     | —                                                     | 43,819                                      | —                                                      |
| Interest payable                                    | 905                | 905        | 905                                                   | —                                           | —                                                      |
| Interest rate swap agreements                       | 11,084             | 11,084     | —                                                     | 11,084                                      | —                                                      |
| Customer interest rate swap agreements              | 496                | 496        | —                                                     | 496                                         | —                                                      |

#### NOTE 9 – COMMITMENTS AND CONTINGENCIES

##### Legal Contingencies

In the normal course of business, the Company and its subsidiaries are subject to pending and threatened legal actions. Although the Company is not able to predict the outcome of such actions, after reviewing pending and threatened actions with counsel, management believes that based on the information currently available the outcome of such actions, individually or in the aggregate, will not have a material adverse effect on the Company's consolidated financial position as a whole.

Reserves are established for legal claims only when losses associated with the claims are judged to be probable and the loss can be reasonably estimated. In many lawsuits and arbitrations, it is not possible to determine whether a liability has been incurred or to estimate the ultimate or minimum amount of that liability until the case is close to resolution, in which case a reserve will not be recognized until that time.

As of September 30, 2013, the Company did not have any loss contingencies that were both probable and reasonably estimable and, therefore, has not accrued for any legal contingencies on the consolidated statements of condition.



### Financial Instruments

In the normal course of business, the Company is a party to both on-balance sheet and off-balance sheet financial instruments involving, to varying degrees, elements of credit risk and interest rate risk in addition to the amounts recognized in the consolidated statements of condition.

A summary of the contractual and notional amounts of the Company's financial instruments follows:

|                                                              | September 30,<br>2013 | December 31,<br>2012 |
|--------------------------------------------------------------|-----------------------|----------------------|
| Lending-Related Instruments:                                 |                       |                      |
| Loan origination commitments and unadvanced lines of credit: |                       |                      |
| Home equity                                                  | \$320,993             | \$277,373            |
| Commercial and commercial real estate                        | 15,072                | 20,016               |
| Residential                                                  | 12,600                | 9,497                |
| Letters of credit                                            | 2,106                 | 1,836                |
| Other commitments                                            | 2,228                 | 16,845               |
| Derivative Financial Instruments:                            |                       |                      |
| Forward mortgage loan sale commitments                       | 3,259                 | —                    |
| Derivative mortgage loan commitments                         | 2,000                 | —                    |
| Customer loan swaps                                          | 15,802                | 16,093               |
| Interest rate swaps                                          | 43,000                | 43,000               |

### Lending-Related Instruments

The contractual amounts of the Company's lending-related financial instruments do not necessarily represent future cash requirements since certain of these instruments may expire without being funded and others may not be fully drawn upon. These instruments are subject to the Company's credit approval process, including an evaluation of the customer's creditworthiness and related collateral requirements. Commitments generally have fixed expiration dates or other termination clauses.

### Derivative Financial Instruments

The Company uses derivative financial instruments for risk management purposes (primarily interest rate risk) and not for trading or speculative purposes. The Company controls the credit risk of these instruments through collateral, credit approvals and monitoring procedures.

### Interest Rate Swaps

The Company's interest rate swap arrangements contain provisions that require the Company to post cash collateral with the counterparty for contracts that are in a net liability position based on their fair values and the Company's credit rating. The Company had a notional amount of \$43.0 million in variable- for fixed- interest rate swap agreements on its junior subordinated debentures and \$6.0 million in cash held as collateral. The terms of the interest rate swap agreements are as follows:

| Notional Amount | Fixed-Rate | Maturity Date  |
|-----------------|------------|----------------|
| \$10,000        | 5.09%      | June 30, 2021  |
| 10,000          | 5.84%      | June 30, 2029  |
| 10,000          | 5.71%      | June 30, 2030  |
| 5,000           | 4.35%      | March 30, 2031 |
| 8,000           | 4.14%      | July 7, 2031   |

The fair value of the swap agreements on the junior subordinated debentures at September 30, 2013 was a liability of \$5.6 million. As this instrument qualifies as a highly effective cash flow hedge, the change in the fair value of the interest rate swaps for the nine months ended September 30, 2013 of \$3.6 million, net of tax, was recorded in other

comprehensive income on the consolidated statements of comprehensive income. Net payments under the swap transactions were \$1.3 million in the first nine months of 2013, and have been classified as cash flows from operating activities in the consolidated statements of cash flows.



#### Customer Derivatives

The Company has a notional amount of \$7.9 million in interest rate swap agreements with commercial customers and interest rate swap agreements of equal notional amounts with a dealer bank related to the Company's commercial loan level derivative program. As the swap agreements have substantially equivalent and offsetting terms, they do not materially change the Company's interest rate risk.

#### Forward Commitments to Sell Residential Mortgage Loans

The Company enters into forward commitments to sell residential mortgages in order to reduce the market risk associated with originating loans for sale in the secondary market. At September 30, 2013, the Company had \$3.3 million of forward commitments to sell residential mortgages. At September 30, 2013, these forward commitments were in an unrealized loss position of \$38,000 and recognized within the consolidated statements of income. At December 31, 2012, the Company had no outstanding commitments to sell mortgages.

As part of originating residential mortgage and commercial loans, the Company may enter into rate lock agreements with customers, and may issue commitment letters to customers, which are considered interest rate locks or forward commitments. At September 30, 2013, the Company had \$2.0 million of mortgage loans with rate lock commitments. At September 30, 2013, these interest rate locks were in an unrealized gain position of \$38,000 and were recognized within the consolidated statements of income as the Company intends to sell the related loans.

#### NOTE 10 – RECENT ACCOUNTING PRONOUNCEMENTS

In January 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-01, Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. This ASU clarifies 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. This guidance is effective for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. The clarifications provided in ASU No. 2013-01 did not have a material effect on the Company's consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income. This ASU improves the reporting of reclassifications out of accumulated other comprehensive income. The amendments in the ASU seek to attain that objective by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about those amounts. This guidance is effective for reporting periods beginning after December 15, 2012, with early adoption permitted. Other than matters of presentation, the adoption of this new guidance did not have a material effect on the Company's 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. This ASU amends Topic 815 to permit the Fed Funds Effective Swap Rate to be used as a United States benchmark interest rate for hedge accounting purposes. The ASU seeks to provide another acceptable United States benchmark interest rate to provide risk managers with a more comprehensive spectrum of interest rate resets to utilize as the designated benchmark interest rate when applying the guidance of Topic 815. The amendments are effectively prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The

amendments provided in ASU No. 2013-10 did not have a material effect on the Company's consolidated financial statements.

NOTE 11 – SUBSEQUENT BRANCH DIVESTITURE

On October 4, 2013, Camden National Bank (the "Bank"), a subsidiary of Camden National Corporation, completed its divestiture of its Farmington, Kingfield, Phillips, Rangeley and Stratton branches. Included in the transaction are branch deposits of \$85.9 million, business loans and certain consumer loans of \$46.0 million and real estate and equipment of \$602,000. The purchase price represents a 3.5% premium on deposits, par value on the loan portfolio and book value for the real estate. The Company will recognize approximately \$3.0 million of additional pre-tax income in the fourth quarter of 2013.

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

### FORWARD-LOOKING STATEMENTS

The discussions set forth below and in the documents we incorporate by reference herein contain certain statements that may be considered forward-looking statements under the Private Securities Litigation Reform Act of 1995, including certain plans, exceptions, goals, projections, and statements, which are subject to numerous risks, assumptions, and uncertainties. Forward-looking statements can be identified by the use of the words "believe," "expect," "anticipate," "intend," "estimate," "assume," "plan," "target," or "goal" or future or conditional verbs such as "will," "may," "should," "could" and other expressions which predict or indicate future events or trends and which do not relate to historical matters. Forward-looking statements should not be relied on, because they involve known and unknown risks, uncertainties and other factors, some of which are beyond the control of the Company. These risks, uncertainties and other factors may cause the actual results, performance or achievements of the Company to be materially different from the anticipated future results, performance or achievements expressed or implied by the forward-looking statements.

Although the Company believes that the expectations reflected in the Company's forward-looking statements are reasonable, these statements involve risks and uncertainties that are subject to change based on various important factors (some of which are beyond the Company's control). The following factors, among others, could cause the Company's financial performance to differ materially from the Company's goals, plans, objectives, intentions, expectations and other forward-looking statements:

- continued weakness in the United States economy in general and the regional and local economies within the New England region and Maine, which could result in a deterioration of credit quality, an increase in the allowance for loan losses or a reduced demand for the Company's credit or fee-based products and services;
- adverse changes in the local real estate market could result in a deterioration of credit quality and an increase in the allowance for loan loss, as most of the Company's loans are concentrated in Maine, and a substantial portion of these loans have real estate as collateral;
- changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System;
- inflation, interest rate, market and monetary fluctuations;
- competitive pressures, including continued industry consolidation, the increased financial services provided by non-banks and banking reform;
- volatility in the securities markets that could adversely affect the value or credit quality of the Company's assets;
- impairment of goodwill, the availability and terms of funding necessary to meet the Company's liquidity needs and the Company's ability to originate loans;
  - changes in information technology that require increased capital spending;
- changes in consumer spending and savings habits;
- changes in laws and regulations, including new laws and regulations concerning taxes, banking, securities and insurance; and
- changes in accounting policies, practices and standards, as may be adopted by the regulatory agencies as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board ("FASB"), and other accounting standard setters.

You should carefully review all of these factors, and be aware that there may be other factors that could cause differences, including the risk factors listed in Part II, Item 1A, "Risk Factors," and in our Annual Report on Form 10-K for the year ended December 31, 2012. Readers should carefully review the risk factors described therein and should

not place undue reliance on our forward-looking statements.

These forward-looking statements were based on information, plans and estimates at the date of this report, and we do not promise to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.

## CRITICAL ACCOUNTING POLICIES

In preparing the Company's consolidated financial statements, management is required to make significant estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from our current estimates, as a result of changing conditions and future events. Several estimates are particularly critical and are susceptible to significant near-term change, including the allowance for credit losses, accounting for acquisitions and our review of goodwill and other identifiable intangible assets for impairment, valuation of other real estate owned, other-than-temporary impairment ("OTTI") of investments, accounting for postretirement plans and income taxes. Our significant accounting policies and critical estimates are summarized in Note 1 to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2012.

**Loans and Allowance for Credit Losses.** Loans past due 30 days or more are considered delinquent. In general, consumer loans will be charged off if the loan is delinquent for 90 consecutive days. Commercial and real estate loans may be charged off in part or in full if they appear uncollectible. A loan is classified as non-accrual generally when it becomes 90 days past due as to interest or principal payments. All previously accrued but unpaid interest on non-accrual loans is reversed from interest income in the current period. Interest payments received on non-accrual loans (including impaired loans) are applied as a reduction of principal. A loan remains on non-accrual status until all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Management is committed to maintaining an allowance for loan losses ("ALL") that is appropriate to absorb likely loss exposure in the loan portfolio. Evaluating the appropriateness of the ALL is a key management function, one that requires the most significant amount of management estimates and assumptions. The ALL, which is established through a charge to the provision for credit losses, consists of two components: (1) a contra to total gross loans in the asset section of the balance sheet, and (2) the reserve for unfunded commitments included in other liabilities on the balance sheet. We regularly evaluate the ALL for adequacy by taking into consideration, among other factors, historical trends in charge-offs and delinquencies, overall risk characteristics and size of the portfolios, ongoing review of significant individual loans, trends in levels of watched or criticized assets, business and economic conditions, local industry trends, evaluation of results of examinations by regulatory authorities and other third parties, and other relevant factors.

In determining the appropriate level of the ALL, we use a methodology to systematically measure the amount of estimated loan loss exposure inherent in the loan portfolio. The methodology focuses on four key elements: (1) identification of loss allocations for specific loans, (2) loss allocation factors for certain loan types based on credit grade and loss experience, (3) general loss allocations for other environmental factors, and (4) the unallocated portion of the allowance. The specific loan component relates to loans that are impaired. For such impaired loans, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. This methodology is in accordance with accounting principles generally accepted in the United States of America ("GAAP").

We use a risk rating system to determine the credit quality of our loans and apply the related loss allocation factors. In assessing the risk rating of a particular loan, we consider, among other factors, the obligor's debt capacity, financial condition, the level of the obligor's earnings, the amount and sources of repayment, the performance with respect to loan terms, the adequacy of collateral, the level and nature of contingent liabilities, management strength, and the industry in which the obligor operates. These factors are based on an evaluation of historical information, as well as a subjective assessment and interpretation of current conditions. Emphasizing one factor over another, or considering additional factors that may be relevant in determining the risk rating of a particular loan but which are not currently an explicit part of our methodology, could impact the risk rating assigned to that loan.

Three times annually, management conducts a thorough review of adversely risk rated commercial and commercial real estate exposures exceeding certain thresholds to re-evaluate the risk rating and identify impaired loans. This extensive review takes into account the obligor's repayment history and financial condition, collateral value, guarantor support, local economic and industry trends, and other factors relevant to the particular loan relationship. Allocations for impaired loans are based upon discounted cash flows or collateral values and are made in accordance with GAAP.

We periodically reassess and revise the loss allocation factors used in the assignment of loss exposure to appropriately reflect our analysis of loss experience. Portfolios of more homogeneous populations of loans including home equity and consumer loans are analyzed as groups, taking into account delinquency rates and other economic conditions which may affect the ability of borrowers to meet debt service requirements, including interest rates and energy costs. An additional allocation is determined based on a judgmental process whereby management considers qualitative and quantitative assessments of other environmental factors. Finally, an unallocated portion of the total allowance is maintained to allow for measurement imprecision attributable to uncertainty in the economic environment.

Because the methodology is based upon historical experience and trends as well as management's judgment, factors may arise that result in different estimations. Significant factors that could give rise to changes in these estimates may include, but are not limited to, changes in economic conditions in our market area, concentration of risk, declines in local property values, and the results of regulatory examinations. While management's evaluation of the ALL as of September 30, 2013 determined the allowance to be appropriate, under adversely different conditions or assumptions, we may need to increase the allowance. The Corporate Risk Management group reviews the ALL on a monthly basis with the board of directors of Camden National Bank (the "Bank"), a subsidiary of Camden National Corporation. A more comprehensive review of the ALL is reviewed with the Company's board of directors, as well as the Bank's board of directors, on a quarterly basis.

The adequacy of the reserve for unfunded commitments is determined in a similar manner as the ALL, with the exception that management must also estimate the likelihood of these commitments being funded and becoming loans. This is accomplished by evaluating the historical utilization of each type of unfunded commitment and estimating the likelihood that the historical utilization rates could change in the future.

**Goodwill and Identifiable Intangible Assets for Impairment.** We record all assets and liabilities acquired in purchase acquisitions at fair value, which is an estimate determined by the use of internal or other valuation techniques. These valuation estimates result in goodwill and other intangible assets and are subject to ongoing periodic impairment tests and are evaluated using various fair value techniques. Goodwill impairment evaluations are required to be performed annually and may be required more frequently if certain conditions indicating potential impairment exist. Identifiable intangible assets are amortized over their estimated useful lives and are subject to impairment tests if events or circumstances indicate a possible inability to realize the carrying amount. If we were to determine that our goodwill was impaired, the recognition of an impairment charge could have an adverse impact on our results of operations in the period that the impairment occurred or on our financial position. Goodwill is evaluated for impairment using several standard valuation techniques including discounted cash flow analysis, as well as an estimation of the impact of business conditions. The use of different estimates or assumptions could produce different estimates of carrying value.

**Valuation of Other Real Estate Owned ("OREO").** Periodically, we acquire property in connection with foreclosures or in satisfaction of debt previously contracted. The valuation of this property is accounted for individually based on its fair value on the date of acquisition. At the acquisition date, if the fair value of the property less the costs to sell is less than the book value of the loan, a charge or reduction in the ALL is recorded. If the value of the property becomes permanently impaired, as determined by an appraisal or an evaluation in accordance with our appraisal policy, we will record the decrease in value by charging against current earnings. Upon acquisition of a property, we use a current appraisal or broker's opinion to substantiate fair value for the property.

**Other-Than-Temporary Impairment ("OTTI") of Investments.** We record an investment impairment charge at the point we believe an investment has experienced a decrease in value that is other-than-temporary. In determining whether an OTTI has occurred, we review information about the underlying investment that is publicly available, analysts' reports, applicable industry data and other pertinent information, and assess our ability to hold the securities for the foreseeable future. The investment is written down to its current market value at the time the impairment is deemed to have occurred. Future adverse changes in market conditions, continued poor operating results of underlying investments or other factors could result in further losses that may not be reflected in an investment's current carrying value, possibly requiring an additional impairment charge in the future.

**Effectiveness of Hedging Derivatives.** The Company maintains an overall interest rate risk management strategy that incorporates the use of interest rate contracts, which are generally non-leveraged generic interest rate and basis swaps, to minimize significant fluctuations in earnings that are caused by interest rate volatility. Interest rate contracts are

used by the Company in the management of its interest rate risk position. The Company's goal is to manage interest rate sensitivity so that movements in interest rates do not significantly adversely affect earnings. When interest rates fluctuate, hedged assets and liabilities appreciate or depreciate in fair value or cash flows. Gains or losses on the derivative instruments that are linked to the hedged assets and liabilities are expected to substantially offset this unrealized appreciation or depreciation or changes in cash flows. The Company utilizes a third-party service to evaluate the effectiveness of its cash flow hedges on a quarterly basis. The effective portion of a gain or loss on a cash flow hedge is recorded in other comprehensive income, net of tax, and other assets or other liabilities on the consolidated statements of condition. The ineffective portions of cash flow hedging transactions are included in "other income" in the consolidated statements of income, if material.

Accounting for Postretirement Plans. We use a December 31<sup>st</sup> measurement date to determine postretirement expenses for the upcoming calendar year and related financial disclosure information. Once determined, the related expenses are accrued evenly over the plan year. Postretirement plan expense is sensitive to changes in the number of eligible employees (and their related



demographics) and to changes in the discount rate and other expected rates, such as medical cost trends rates. As with the computations on plan expense, cash contribution requirements are also sensitive to such changes.

**Stock-Based Compensation.** The fair value of restricted stock and stock options is determined on the date of grant and amortized to compensation expense, with a corresponding increase in common stock, over the longer of the service period or performance period, but in no event beyond an employee's retirement date. For performance-based restricted stock, we estimate the degree to which performance conditions will be met to determine the number of shares that will vest and the related compensation expense. Compensation expense is adjusted in the period such estimates change. Non-forfeitable dividends, if any, paid on shares of restricted stock are recorded to retained earnings for shares that are expected to vest and to compensation expense for shares that are not expected to vest.

**Income Taxes.** We account for income taxes by deferring income taxes based on the estimated future tax effects of differences between the tax and book bases of assets and liabilities considering the provisions of enacted tax laws. These differences result in deferred tax assets and liabilities, which are included in the consolidated statements of condition. We must also assess the likelihood that any deferred tax assets will be recovered from future taxable income and establish a valuation allowance for those assets determined not likely to be recoverable. Judgment is required in determining the amount and timing of recognition of the resulting deferred tax assets and liabilities, including projections of future taxable income. Although we have determined a valuation allowance is not required for all deferred tax assets, there is no guarantee that these assets will be realized. Although not currently under review, income tax returns for the years ended December 31, 2010 through 2012 are open to audit by federal and Maine authorities. If we, as a result of an audit, were assessed interest and penalties, the amounts would be recorded through other non-interest expense on the consolidated statements of income.

**Non-Generally Accepted Accounting Principles ("non-GAAP") Financial Measures and Reconciliation to GAAP**  
In addition to evaluating the Company's results of operations in accordance with GAAP, management supplements this evaluation with an analysis of certain non-GAAP financial measures, such as the efficiency and tangible equity ratios, and tax equivalent net interest income. We believe these non-GAAP financial measures help investors in understanding the Company's operating performance and trends and allow for better performance comparisons to other banks. In addition, these non-GAAP financial measures remove the impact of unusual items that may obscure trends in the Company's underlying performance. These disclosures should not be viewed as a substitute for GAAP operating results, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other financial institutions.

**Efficiency Ratio.** The efficiency ratio, which represents an approximate measure of the cost required for the Company to generate a dollar of revenue, is the ratio of (i) total non-interest expense excluding prepayment penalties and branch acquisition and divestiture costs (the numerator) to (ii) net interest income on a fully taxable equivalent basis plus total non-interest income excluding net gains or losses on sale of securities and OTTI (the denominator).

| (Dollars in Thousands)                    | Three Months Ended |          | Nine Months Ended |          |
|-------------------------------------------|--------------------|----------|-------------------|----------|
|                                           | September 30,      |          | September 30,     |          |
|                                           | 2013               | 2012     | 2013              | 2012     |
| Non-interest expense, as presented        | \$15,199           | \$13,370 | \$47,347          | \$40,268 |
| Less branch acquisition/divestiture costs | 47                 | 396      | 279               | 704      |
| Less prepayment fees on borrowings        | —                  | —        | —                 | 728      |
| Adjusted non-interest expense             | \$15,152           | \$12,974 | \$47,068          | \$38,836 |
| Net interest income, as presented         | \$18,707           | \$18,447 | \$57,125          | \$55,184 |
| Effect of tax-exempt income               | 203                | 250      | 618               | 760      |
| Non-interest income                       | 6,475              | 5,038    | 19,187            | 16,020   |
|                                           | 647                | 187      | 785               | 1,059    |

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Less gains on sale of securities, net of other-than-temporary  
impairments

|                                                       |          |          |          |          |
|-------------------------------------------------------|----------|----------|----------|----------|
| Adjusted net interest income plus non-interest income | \$24,738 | \$23,548 | \$76,145 | \$70,905 |
|-------------------------------------------------------|----------|----------|----------|----------|

|                           |       |         |         |         |   |
|---------------------------|-------|---------|---------|---------|---|
| Non-GAAP efficiency ratio | 61.25 | % 55.10 | % 61.81 | % 54.77 | % |
| GAAP efficiency ratio     | 60.36 | % 56.93 | % 62.04 | % 56.55 | % |

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Tax Equivalent Net Interest Income. Tax-equivalent net interest income is net interest income plus the taxes that would have been paid had tax-exempt securities been taxable. This number attempts to enhance the comparability of the performance of assets that have different tax liabilities. The following table provides a reconciliation of tax equivalent net interest income to GAAP net interest income using a 35% tax rate.

| (Dollars in Thousands)              | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|-------------------------------------|-------------------------------------|----------|------------------------------------|----------|
|                                     | 2013                                | 2012     | 2013                               | 2012     |
| Net interest income, as presented   | \$18,707                            | \$18,447 | \$57,125                           | \$55,184 |
| Effect of tax-exempt income         | 203                                 | 250      | 618                                | 760      |
| Net interest income, tax equivalent | \$18,910                            | \$18,697 | \$57,743                           | \$55,944 |

Return on Average Tangible Shareholders' Equity. Return on tangible shareholders' equity is the ratio of (i) net income, adjusted for tax-effected amortization of intangible assets to (ii) average shareholders' equity less average goodwill and other intangibles. The following table reconciles return on average tangible shareholders' equity to return on average shareholders' equity.

| (Dollars in Thousands)                                       | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |   |   |
|--------------------------------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|---|---|
|                                                              | 2013                                | 2012      | 2013                               | 2012      |   |   |
| Net income                                                   | \$6,366                             | \$6,255   | \$18,359                           | \$19,250  |   |   |
| Tax-effected amortization of intangible assets               | 188                                 | 94        | 561                                | 281       |   |   |
| Net income, adjusted                                         | 6,554                               | 6,349     | 18,920                             | 19,531    |   |   |
| Average shareholders' equity                                 | 228,909                             | 228,370   | 233,398                            | 224,479   |   |   |
| Less average goodwill and other intangibles                  | 52,572                              | 44,552    | 52,861                             | 44,764    |   |   |
| Average tangible shareholders' equity                        | \$176,337                           | \$183,818 | \$180,537                          | \$179,715 |   |   |
| Return on average tangible shareholders' equity (annualized) | 14.74                               | % 13.74   | % 14.01                            | % 14.52   | % | % |
| Return on average shareholders' equity (annualized)          | 11.03                               | % 10.90   | % 10.52                            | % 11.45   | % | % |

## EXECUTIVE OVERVIEW

During the third quarter of 2013, we earned net income of \$6.4 million, an increase of 2% from \$6.3 million earned the same period a year ago. Net income for the nine months ended September 30, 2013 was \$18.4 million, representing a 5% decrease compared to net income of \$19.3 million for the nine months ended September 30, 2012. Earnings for the three and nine months ended September 30, 2013 reflect the operating costs associated with the addition of 14 branches acquired during the fourth quarter of 2012.

On May 29, 2013, the Bank entered into a definitive agreement with Skowhegan Savings Bank to sell the Bank's Farmington, Kingfield, Phillips, Rangeley and Stratton branches. On October 4, 2013, the divestiture of the five branches was successfully completed with the sale of branch deposits of approximately \$85.9 million, business loans and certain consumer loans of \$46.0 million and real estate and equipment of \$602,000. The purchase price represents a 3.5% premium on deposits, par value on the loan portfolio and book value for the real estate. We will recognize approximately \$3.0 million of additional pre-tax income in the fourth quarter of 2013.

Nine months ended September 30, 2013 compared to nine months ended September 30, 2012:

Net income of \$18.4 million for the nine months ended September 30, 2013 decreased \$891,000, or 5%, compared to the same period of 2012. Diluted earnings per share decreased \$0.11 to \$2.39, compared to the first nine months of 2012. For the first nine months of 2013, the Company achieved a return on average assets of 0.95%, a return on average tangible shareholders' equity of 13.60%, a net interest margin of 3.21%, and a non-GAAP efficiency ratio of 61.81%. The following were major factors contributing to the results of the first nine months of 2013 compared to the same period in 2012:

Net interest income on a fully-taxable equivalent basis of \$57.7 million for the first nine months ended September 30, 2013, increased \$1.8 million, or 3%, primarily due to a decrease in the average cost of funds of 28 basis points. The decrease in our cost of funds reflects the benefit of the branch acquisition as we shifted our funding base from higher cost borrowings to lower cost deposits.

The provision for credit losses decreased \$674,000 to \$2.0 million due to lower charge-offs and improved credit quality factors.

Non-interest income increased \$3.2 million, or 20%, primarily due to the growth in deposit-related and other service fees associated with the acquired deposit accounts. In addition, mortgage banking income increased \$775,000, primarily as a result of an increase in sales of 30-year fixed-rate mortgages to the secondary market and associated gains recognized of \$684,000, which is an increase of \$416,000 compared to the same period last year.

Non-interest expense increased \$7.1 million, or 18%, primarily due to the incremental operating costs associated with the 14 branches acquired in the fourth quarter of 2012. These incremental costs largely consists of salaries and benefits, data processing costs, facilities expenses, amortization of intangible assets, and other expenses. The increase was partially offset by a reduction in non-recurring transaction related costs associated with the branch acquisition and other real estate owned and collection costs of \$425,000 and \$339,000, respectively.

Three months ended September 30, 2013 compared to three months ended September 30, 2012:

Net income of \$6.4 million for the three months ended September 30, 2013 increased \$111,000, or 2%, compared to the three months ended September 30, 2012. Diluted earnings per share increased one cent to \$0.83, compared to the third quarter of 2012. The following were major factors contributing to the results of the three months ended September 30, 2013 compared to the same period a year ago:

Net interest income on a fully-taxable equivalent basis of \$18.9 million increased \$213,000, or 1%, compared to the same period for 2012 primarily due to a decrease in the average cost of funds of 24 basis points. The decrease in our cost of funds reflects the benefit of the branch acquisition as we shifted our funding base from higher cost borrowings to lower cost deposits.

The provision for credit losses decreased \$203,000 to \$665,000 due to improved asset quality measures.

Non-interest income increased \$1.4 million, or 29%, compared to the same period of 2012 primarily due to the growth in deposit-related and other service fees of \$929,000 related to the new customer accounts from the branch acquisition in the fourth quarter of 2012 and an increase in net gains from the sale of securities of \$460,000.

Non-interest expense increased \$1.8 million, or 14%, compared to the same period of 2012. The increase reflects the incremental associated costs inherent with the addition of new branch locations in the fourth quarter of 2012. These costs include salaries and benefits for new employees and general operating costs, including facility-related costs. The increase was partially offset by a decrease in non-recurring transaction-related costs of \$349,000 as compared to the third quarter of 2012.

Financial condition at September 30, 2013 compared to December 31, 2012:

Total assets at September 30, 2013 were \$2.6 billion, representing a \$32.5 million increase, or 1%, since December 31, 2012. The growth in total assets was primarily driven by an increase in loans (excluding loans held for sale) of \$26.1 million. Our loan growth is centered in the consumer and commercial real estate portfolios, which experienced increases of \$29.9 million and \$16.4 million, respectively. The growth in the consumer portfolio was led by our promotions on home equity lines and a short-term fixed-rate home equity product. Since year end, we experienced declines in our residential real estate and commercial portfolios of \$7.8 million and \$12.6 million, respectively. The residential real estate portfolio decreased primarily due to the sale of \$28.2 million in 30-year fixed-rate production to manage our interest rate risk profile.

Total deposits at September 30, 2013 of \$2.0 billion increased \$43.9 million, or 2%, since December 31, 2012. The increase is primarily driven by an increase in core deposits (demand, interest checking, savings, and money market) of \$80.8 million, offset by a decrease in retail certificates of deposit of \$39.2 million. The increase in core deposits was the result of normal business with customers and large deposits received from our municipal relationships in the third quarter of 2013.

The following are other key highlights of the Company's financial condition at September 30, 2013 compared to December 31, 2012:

Available-for-sale securities increased \$2.2 million as a result of purchases of securities of \$152.7 million, of which \$14.4 million had not settled as of September 30, 2013, proceeds from the sale and maturities of securities of \$121.8 million and realized gains of \$785,000, net amortization of securities of \$1.7 million, and a decline in market value of \$27.7 million related to the increase in long-term U.S. Treasury rates.

Shareholders' equity decreased \$1.5 million, or 1%, primarily due to other comprehensive loss of \$18.0 million on available-for-sale securities, net of tax, and dividends of \$6.2 million, offset by other comprehensive income of \$3.6 million on cash flow hedging derivatives, net of tax, and net income for the nine months ended September 30, 2013 of \$18.4 million.

## RESULTS OF OPERATIONS

### Net Interest Income

Net interest income is the interest earned on loans, securities, and other earning assets, plus loan fees, less the interest paid on interest-bearing deposits and borrowings. Net interest income, which is our largest source of revenue and accounts for approximately 75% of total revenues (net interest income and non-interest income), is affected by factors including, but not limited to, changes in interest rates, loan and deposit pricing strategies and competitive conditions, the volume and mix of interest-earning assets and interest-bearing liabilities, and the level of non-performing assets.

Nine Months Ended September 30, 2013 compared to September 30, 2012:

Net interest income was \$57.7 million on a fully-taxable equivalent basis for the nine months ended September 30, 2013, compared to \$55.9 million for the first nine months of 2012, an increase of \$1.8 million, or 3%. The increase in net interest income was primarily due to the 28 basis point reduction in the average cost of funds. The cost of funds averaged 0.56% for the first nine months of 2013, compared to 0.84% for the same period in 2012. The decrease in the average cost of funds is a result of decreasing interest rates on deposits and other borrowings, while benefiting from a shift in our funding base from higher cost borrowings to lower cost deposits that is attributable to the branch acquisition in the fourth quarter of 2012. While we have benefited from a decrease in our average cost of funds, our yield on interest-earning assets has also decreased over the same time period due to the low interest rate environment. Our yield on interest-earning assets for the nine months ended September 30, 2013 decreased 45 basis points to 3.75%. As a result, our net interest margin on a fully-taxable equivalent basis has decreased 18 basis points to 3.21% as compared to the same period last year.

The following table presents average balances, interest income, interest expense, and the corresponding average yields earned and rates paid, as well as net interest income, net interest rate spread and net interest margin for the nine months ended September 30, 2013 and 2012:



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Year-to-Date Average Balance, Interest and Yield/Rate Analysis (unaudited)

| (Dollars in thousands)                                     | Nine Months Ended<br>September 30, 2013 |          |            | Nine Months Ended<br>September 30, 2012 |             |            |      |   |
|------------------------------------------------------------|-----------------------------------------|----------|------------|-----------------------------------------|-------------|------------|------|---|
|                                                            | Average<br>Balance                      | Interest | Yield/Rate | Average<br>Balance                      | Interest    | Yield/Rate |      |   |
| <b>Assets</b>                                              |                                         |          |            |                                         |             |            |      |   |
| <b>Interest-earning assets:</b>                            |                                         |          |            |                                         |             |            |      |   |
| Securities - taxable                                       | \$770,166                               | \$12,571 | 2.18       | %                                       | \$615,233   | \$12,528   | 2.72 | % |
| Securities - nontaxable (1)                                | 30,983                                  | 1,367    | 5.88       | %                                       | 38,106      | 1,637      | 5.73 | % |
| Trading account assets                                     | 2,258                                   | 14       | 0.83       | %                                       | 2,194       | 19         | 1.16 | % |
| <b>Loans: (2)</b>                                          |                                         |          |            |                                         |             |            |      |   |
| Residential real estate                                    | 572,032                                 | 19,214   | 4.48       | %                                       | 574,134     | 20,695     | 4.81 | % |
| Commercial real estate                                     | 512,686                                 | 18,558   | 4.77       | %                                       | 488,142     | 18,263     | 4.92 | % |
| Commercial                                                 | 175,572                                 | 5,805    | 4.36       | %                                       | 167,681     | 5,985      | 4.69 | % |
| Municipal (1)                                              | 12,464                                  | 400      | 4.29       | %                                       | 14,527      | 534        | 4.91 | % |
| Consumer                                                   | 313,489                                 | 9,487    | 4.05       | %                                       | 285,522     | 9,497      | 4.44 | % |
| Total loans                                                | 1,586,243                               | 53,464   | 4.47       | %                                       | 1,530,006   | 54,974     | 4.76 | % |
| Total interest-earning assets                              | 2,389,650                               | 67,416   | 3.75       | %                                       | 2,185,539   | 69,158     | 4.20 | % |
| Cash and due from banks                                    | 44,268                                  |          |            |                                         | 37,723      |            |      |   |
| Other assets                                               | 167,284                                 |          |            |                                         | 153,818     |            |      |   |
| Less allowance for loan losses                             | (23,233 )                               |          |            |                                         | (23,146 )   |            |      |   |
| Total assets                                               | \$2,577,969                             |          |            |                                         | \$2,353,934 |            |      |   |
| <b>Liabilities &amp; Shareholders' Equity</b>              |                                         |          |            |                                         |             |            |      |   |
| <b>Retail deposits:</b>                                    |                                         |          |            |                                         |             |            |      |   |
| Non-interest bearing demand deposits                       | \$239,996                               | \$—      | —          |                                         | \$242,855   | \$—        | —    |   |
| Interest checking accounts                                 | 475,343                                 | 244      | 0.07       | %                                       | 319,463     | 251        | 0.10 | % |
| Savings accounts                                           | 236,712                                 | 99       | 0.06       | %                                       | 188,797     | 242        | 0.17 | % |
| Money market accounts                                      | 446,852                                 | 1,037    | 0.31       | %                                       | 357,938     | 1,568      | 0.59 | % |
| Certificates of deposit                                    | 400,211                                 | 2,981    | 1.00       | %                                       | 379,216     | 3,786      | 1.33 | % |
| Total retail deposits                                      | 1,799,114                               | 4,361    | 0.32       | %                                       | 1,488,269   | 5,847      | 0.52 | % |
| <b>Borrowings:</b>                                         |                                         |          |            |                                         |             |            |      |   |
| Brokered deposits                                          | 118,210                                 | 1,066    | 1.21       | %                                       | 123,959     | 1,299      | 1.40 | % |
| Junior subordinated debentures                             | 43,858                                  | 1,894    | 5.77       | %                                       | 43,756      | 1,904      | 5.81 | % |
| Other borrowings                                           | 351,387                                 | 2,352    | 0.89       | %                                       | 438,954     | 4,164      | 1.27 | % |
| Total borrowings                                           | 513,455                                 | 5,312    | 1.38       | %                                       | 606,669     | 7,367      | 1.62 | % |
| Total funding liabilities                                  | 2,312,569                               | 9,673    | 0.56       | %                                       | 2,094,938   | 13,214     | 0.84 | % |
| Other liabilities                                          | 32,002                                  |          |            |                                         | 34,517      |            |      |   |
| Shareholders' equity                                       | 233,398                                 |          |            |                                         | 224,479     |            |      |   |
| Total liabilities & shareholders' equity                   | \$2,577,969                             |          |            |                                         | \$2,353,934 |            |      |   |
| <b>Net interest income (fully-taxable equivalent)</b>      |                                         |          |            |                                         |             |            |      |   |
|                                                            |                                         | 57,743   |            |                                         |             | 55,944     |      |   |
| Less: fully-taxable equivalent adjustment                  |                                         | (618 )   |            |                                         |             | (760 )     |      |   |
| Net interest income                                        |                                         | \$57,125 |            |                                         |             | \$55,184   |      |   |
| <b>Net interest rate spread (fully-taxable equivalent)</b> |                                         |          |            |                                         |             |            |      |   |
|                                                            |                                         |          | 3.19       | %                                       |             |            | 3.36 | % |
| Net interest margin (fully-taxable equivalent)             |                                         |          | 3.21       | %                                       |             |            | 3.39 | % |



- (1) Reported on tax-equivalent basis calculated using a tax rate of 35%.
- (2) Non-accrual loans and loans held for sale are included in total average loans.

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Three Months Ended September 30, 2013 compared to September 30, 2012:

Net interest income was \$18.9 million on a fully-taxable equivalent basis for the three months ended September 30, 2013, compared to \$18.7 million for same period last year, an increase of \$213,000, or 1%. The increase in net interest income was primarily due to the 24 basis point reduction in the average cost of funds. The cost of funds averaged 0.54% for the third quarter of 2013, compared to 0.78% for the same period in 2012. The decrease in the average cost of funds is a result of decreasing interest rates on deposits and other borrowings, while benefiting from a shift in our funding base from higher cost borrowings to lower cost deposits that is attributable to the branch acquisition in the fourth quarter of 2012. While we have benefited from a decrease in our average cost of funds, our yield on interest-earning assets has also decreased over the same time period due to the low interest rate environment. Our yield on interest-earning assets for the three months ended September 30, 2013 decreased 40 basis points to 3.65%. As a result, our net interest margin on a fully-taxable equivalent basis has decreased 17 basis points to 3.13% as compared to the same period last year.

The following table presents average balances, interest income, interest expense, and the corresponding average yields earned and rates paid, as well as net interest income, net interest rate spread and net interest margin for the three months ended September 30, 2013 and 2012:

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Quarterly Average Balance, Interest and Yield/Rate Analysis (unaudited)

| (Dollars In Thousands)                                     | At or for the Three Months Ended<br>September 30, 2013 |          |            | At or for the Three Months Ended<br>September 30, 2012 |          |            |  |  |
|------------------------------------------------------------|--------------------------------------------------------|----------|------------|--------------------------------------------------------|----------|------------|--|--|
|                                                            | Average<br>Balance                                     | Interest | Yield/Rate | Average<br>Balance                                     | Interest | Yield/Rate |  |  |
| <b>Assets</b>                                              |                                                        |          |            |                                                        |          |            |  |  |
| <b>Interest-earning assets:</b>                            |                                                        |          |            |                                                        |          |            |  |  |
| Securities - taxable                                       | \$765,635                                              | \$4,126  | 2.16 %     | \$667,341                                              | \$4,199  | 2.52 %     |  |  |
| Securities - nontaxable (1)                                | 30,481                                                 | 450      | 5.91 %     | 36,608                                                 | 529      | 5.78 %     |  |  |
| Trading account assets                                     | 2,291                                                  | 2        | 0.43 %     | 2,205                                                  | 9        | 1.62 %     |  |  |
| <b>Loans: (2)</b>                                          |                                                        |          |            |                                                        |          |            |  |  |
| Residential real estate                                    | 568,099                                                | 6,043    | 4.25 %     | 569,569                                                | 6,685    | 4.69 %     |  |  |
| Commercial real estate                                     | 522,932                                                | 6,256    | 4.68 %     | 497,051                                                | 6,139    | 4.83 %     |  |  |
| Commercial                                                 | 171,350                                                | 1,870    | 4.27 %     | 165,263                                                | 1,957    | 4.63 %     |  |  |
| Municipal (1)                                              | 12,850                                                 | 132      | 4.08 %     | 16,478                                                 | 187      | 4.51 %     |  |  |
| Consumer                                                   | 322,912                                                | 3,215    | 3.95 %     | 288,384                                                | 3,181    | 4.39 %     |  |  |
| Total loans                                                | 1,598,143                                              | 17,516   | 4.33 %     | 1,536,745                                              | 18,149   | 4.67 %     |  |  |
| Total interest-earning assets                              | 2,396,550                                              | 22,094   | 3.65 %     | 2,242,899                                              | 22,886   | 4.05 %     |  |  |
| Cash and due from banks                                    | 44,307                                                 |          |            | 40,944                                                 |          |            |  |  |
| Other assets                                               | 168,792                                                |          |            | 152,713                                                |          |            |  |  |
| Less: allowance for loan losses                            | (23,041 )                                              |          |            | (23,059 )                                              |          |            |  |  |
| Total assets                                               | \$2,586,608                                            |          |            | \$2,413,497                                            |          |            |  |  |
| <b>Liabilities &amp; Shareholders' Equity</b>              |                                                        |          |            |                                                        |          |            |  |  |
| <b>Retail deposits:</b>                                    |                                                        |          |            |                                                        |          |            |  |  |
| Non-interest bearing demand deposits                       | \$264,147                                              | \$—      | \$—        | \$210,203                                              | \$—      | \$—        |  |  |
| Interest checking accounts                                 | 480,674                                                | 86       | 0.07 %     | 401,204                                                | 95       | 0.09 %     |  |  |
| Savings accounts                                           | 243,583                                                | 35       | 0.06 %     | 196,507                                                | 61       | 0.12 %     |  |  |
| Money market accounts                                      | 438,831                                                | 326      | 0.29 %     | 367,532                                                | 512      | 0.55 %     |  |  |
| Certificates of deposit                                    | 386,052                                                | 982      | 1.01 %     | 368,505                                                | 1,188    | 1.28 %     |  |  |
| Total retail deposits                                      | 1,813,287                                              | 1,429    | 0.31 %     | 1,543,951                                              | 1,856    | 0.48 %     |  |  |
| <b>Borrowings:</b>                                         |                                                        |          |            |                                                        |          |            |  |  |
| Brokered deposits                                          | 105,625                                                | 351      | 1.32 %     | 111,518                                                | 362      | 1.29 %     |  |  |
| Junior subordinated debentures                             | 43,884                                                 | 637      | 5.76 %     | 43,781                                                 | 634      | 5.76 %     |  |  |
| Other borrowings                                           | 367,240                                                | 767      | 0.83 %     | 449,622                                                | 1,337    | 1.18 %     |  |  |
| Total borrowings                                           | 516,749                                                | 1,755    | 1.35 %     | 604,921                                                | 2,333    | 1.53 %     |  |  |
| Total funding liabilities                                  | 2,330,036                                              | 3,184    | 0.54 %     | 2,148,872                                              | 4,189    | 0.78 %     |  |  |
| Other liabilities                                          | 27,663                                                 |          |            | 36,255                                                 |          |            |  |  |
| Shareholders' equity                                       | 228,909                                                |          |            | 228,370                                                |          |            |  |  |
| Total liabilities & shareholders' equity                   | \$2,586,608                                            |          |            | \$2,413,497                                            |          |            |  |  |
| <b>Net interest income (fully-taxable equivalent)</b>      |                                                        |          |            |                                                        |          |            |  |  |
|                                                            |                                                        | 18,910   |            |                                                        | 18,697   |            |  |  |
| Less: fully-taxable equivalent adjustment                  |                                                        | (203 )   |            |                                                        | (250 )   |            |  |  |
| Net interest income                                        |                                                        | \$18,707 |            |                                                        | \$18,447 |            |  |  |
| <b>Net interest rate spread (fully-taxable equivalent)</b> |                                                        |          |            |                                                        |          |            |  |  |
|                                                            |                                                        |          | 3.11 %     |                                                        |          | 3.27 %     |  |  |
| <b>Net interest margin (fully-taxable equivalent)</b>      |                                                        |          |            |                                                        |          |            |  |  |
|                                                            |                                                        |          | 3.13 %     |                                                        |          | 3.30 %     |  |  |

- (1) Reported on tax-equivalent basis calculated using a tax rate of 35%.
- (2) Non-accrual loans and loans held for sale are included in total average loans.

### Provision and Allowance for Loan Losses

The provision for loan losses is a recorded expense determined by management that adjusts the ALL to a level that, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. The provision for loan losses reflects loan quality trends, including, among other factors, the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans, net charge-offs or recoveries and growth in the loan portfolio. Accordingly, the amount of the provision reflects both the necessary increases in the allowance for loan losses related to newly identified criticized loans, as well as the actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools. The provision for credit losses for the nine months ended September 30, 2013 and 2012 was \$2.0 million and \$2.7 million, respectively. The provision for credit losses for the three months ended September 30, 2013 and 2012 was \$665,000 and \$868,000, respectively. Please see the caption "Financial Condition—Asset Quality" below for additional discussion regarding the ALL.

### Non-Interest Income

The following table presents the components of non-interest income for the three and nine months ended September 30, 2013 and 2012:

|                                                                                  | Three Months  |         |         |         | Nine Months   |          |         |        |
|----------------------------------------------------------------------------------|---------------|---------|---------|---------|---------------|----------|---------|--------|
|                                                                                  | Ended         |         | Change  |         | Ended         |          | Change  |        |
| (Dollars in thousands)                                                           | September 30, |         |         |         | September 30, |          |         |        |
|                                                                                  | 2013          | 2012    | \$      | %       | 2013          | 2012     | \$      | %      |
| Service charges on deposit accounts                                              | \$1,750       | \$1,386 | \$364   | 26 %    | \$5,189       | \$3,857  | \$1,332 | 35 %   |
| Other service charges and fees                                                   | 1,568         | 1,003   | 565     | 56 %    | 4,510         | 2,804    | 1,706   | 61 %   |
| Income from fiduciary services                                                   | 1,149         | 1,155   | (6)     | (1) %   | 3,567         | 3,883    | (316)   | (8) %  |
| Mortgage banking income, net                                                     | 93            | 8       | 85      | 1,063 % | 1,251         | 476      | 775     | 163 %  |
| Brokerage and insurance commissions                                              | 354           | 360     | (6)     | (2) %   | 1,175         | 1,109    | 66      | 6 %    |
| Bank-owned life insurance                                                        | 334           | 353     | (19)    | (5) %   | 986           | 1,034    | (48)    | (5) %  |
| Net gain on sale of securities and other-than-temporary impairment of securities | 647           | 187     | 460     | 246 %   | 785           | 1,059    | (274)   | (26) % |
| Other income                                                                     | 580           | 586     | (6)     | (1) %   | 1,724         | 1,798    | (74)    | (4) %  |
| Total non-interest income                                                        | \$6,475       | \$5,038 | \$1,437 | 29 %    | \$19,187      | \$16,020 | \$3,167 | 20 %   |

Non-interest income represents 25% and 22% of total revenues (net interest income and non-interest income) for the nine months ended September 30, 2013 and 2012, respectively. Non-interest income of \$19.2 million for the nine months ended September 30, 2013 increased by \$3.2 million, or 20%, compared to \$16.0 million for the nine months ended September 30, 2012.

The significant changes in non-interest income for the nine months ended September 30, 2013 compared to the same period for 2012 include:

• An increase in deposit-related service fees and other service charges and fees of \$3.0 million. The primary driver for the increase is the new customer accounts from the branch acquisition in the fourth quarter of 2012;

• An increase in mortgage banking income of \$775,000, primarily due to gains recognized upon the sale of our 30-year fixed-rate mortgages to the secondary market and the retention of the associated mortgage servicing rights; and

• A decrease in net gain on sale of securities and other-than-temporary impairment of securities of \$274,000 due to fewer sales.

Non-interest income represents 26% and 22% of total revenues (net interest income and non-interest income) for the three months ended September 30, 2013 and 2012, respectively. Non-interest income of \$6.5 million for the three

months ended September 30, 2013 increased by \$1.4 million, or 29%, compared to \$5.0 million for the three months ended September 30, 2012.

The significant changes in non-interest income for the three months ended September 30, 2013 compared to the same period for 2012 include:

An increase in deposit-related service fees and other service charges and fees of \$929,000. The primary driver for the increase is the new customer accounts from the branch acquisition in the fourth quarter of 2012; and

An increase in net gain on sale of securities and other-than-temporary impairment of securities of \$460,000 from the sale of securities.

#### Non-Interest Expense

Non-interest expense increased \$1.8 million, or 14%, and \$7.1 million, or 18%, for the three and nine months ended September 30, 2013, respectively, compared to the same periods for 2012.

The following table presents the components of non-interest expense for the three and nine months ended September 30, 2013 and 2012:

|                                                   | Three Months Ended September 30, |          |         |       | Nine Months Ended September 30, |          |         |       |
|---------------------------------------------------|----------------------------------|----------|---------|-------|---------------------------------|----------|---------|-------|
|                                                   | 2013                             | 2012     | Change  |       | 2013                            | 2012     | Change  |       |
| (Dollars in thousands)                            |                                  |          | \$      | %     |                                 |          | \$      | %     |
| Salaries and employee benefits                    | \$8,115                          | \$7,270  | \$845   | 12 %  | \$24,437                        | \$21,150 | \$3,287 | 16 %  |
| Furniture, equipment and data processing          | 1,668                            | 1,131    | 537     | 47 %  | 5,203                           | 3,555    | 1,648   | 46 %  |
| Net occupancy                                     | 1,242                            | 930      | 312     | 34 %  | 4,201                           | 3,061    | 1,140   | 37 %  |
| Other real estate owned and collection costs, net | 489                              | 571      | (82)    | (14)% | 1,355                           | 1,694    | (339)   | (20)% |
| Consulting and professional fees                  | 504                              | 408      | 96      | 24 %  | 1,636                           | 1,351    | 285     | 21 %  |
| Regulatory assessments                            | 496                              | 450      | 46      | 10 %  | 1,495                           | 1,317    | 178     | 14 %  |
| Amortization of intangible assets                 | 289                              | 144      | 145     | 101 % | 863                             | 433      | 430     | 99 %  |
| Branch acquisition/divestiture costs              | 47                               | 396      | (349)   | (88)% | 279                             | 704      | (425)   | (60)% |
| Other expenses                                    | 2,349                            | 2,070    | 279     | 13 %  | 7,878                           | 7,003    | 875     | 12 %  |
| Total Non-Interest Expense                        | \$15,199                         | \$13,370 | \$1,829 | 14 %  | \$47,347                        | \$40,268 | \$7,079 | 18 %  |

The significant changes in non-interest expense for the nine months ended September 30, 2013, compared to the same period for 2012 include:

An increase in salaries and employee benefits of \$3.3 million, or 16%, due to an increase in headcount at the Company, primarily related to the new positions associated with the branch acquisition;

An increase in furniture, equipment and data processing of \$1.6 million, or 46%, primarily related to an increase in equipment maintenance and depreciation expense and on-line banking costs of \$688,000 and \$520,000, respectively, largely due to the addition of 14 new branches in the fourth quarter of 2012, and conversion of our core operating system for Acadia Trust, N.A. ("Acadia Trust") of \$161,000;

An increase in net occupancy of \$1.1 million, or 37%, primarily due to the increased costs associated with supporting additional branch facilities, closing one leased facility, and an increase in general building maintenance costs; and

An increase in other expenses of \$875,000, or 12%, primarily related to an increase in debit card costs of \$360,000 as our customer-base grew due to the branch acquisition in the fourth quarter of 2012, and an increase in miscellaneous operating costs, including, but not limited to, supplies, communication, and training costs also due to an increase in headcount and branch locations. This increase was partially offset by a decrease in prepayment fees on borrowings of \$728,000.





The significant changes in non-interest expense for the three months ended September 30, 2013, compared to the same period for 2012 include:

An increase in salaries and employee benefits of \$845,000, or 12%, due to an increase in headcount at the Company, primarily related to the new positions associated with the branch acquisitions;

An increase in furniture, equipment and data processing of \$537,000, or 47%, primarily related to an increase in equipment maintenance and depreciation expense and on-line banking banking costs of \$205,000 and \$156,000, respectively, largely due to the addition of 14 new branches in the fourth quarter of 2012, and an increase in vendor costs of \$100,000 as data processing for Acadia Trust transitioned from in-house to external; and

An increase in other expenses of \$279,000, or 13% is primarily related to an increase in debit card costs of \$175,000 as our customer-base grew due to the branch acquisition in the fourth quarter of 2012, and an increase in miscellaneous operating costs, including, but not limited to, supplies, communication, and training costs also due to an increase in headcount and branch locations.

## FINANCIAL CONDITION

### Overview

Total assets at September 30, 2013 were \$2.6 billion, an increase of \$32.5 million, or 1%, from December 31, 2012. The growth in total assets was primarily due to an increase in total loans (excluding loans held for sale) of \$26.1 million. Total liabilities increased \$34.0 million, or 1%, since December 31, 2012. The increase in total liabilities is driven by an increase in total deposits of \$43.9 million, offset by a decrease in total borrowings and accrued interest and other liabilities of \$9.9 million. Total shareholders' equity decreased \$1.5 million, or 1%, since December 31, 2012 due to accumulated other comprehensive losses of \$14.3 million and dividends of \$6.2 million, offset by year-to-date earnings as of September 30, 2013 of \$18.4 million.

For the first nine months of 2013 average total assets were \$2.6 billion. This is an increase of \$224.0 million, or 10%, compared to the same period for 2012. The growth in average total assets was fueled by increases in our average investment and loan balances of \$147.9 million and \$56.2 million, respectively. The increase in our investment portfolio, which accounted for 66% of average total assets growth, was due to the purchase of securities with a portion of the cash from the branch acquisition in the fourth quarter of 2012. Within our loan portfolio, the consumer and commercial real estate portfolios experienced the largest growth with increased average balances of \$28.0 million and \$24.5 million, respectively, followed by the commercial loan portfolio, which grew \$7.9 million. Average residential real estate loan balances declined \$2.1 million due to the sale of 30-year fixed-rate production to manage our interest rate risk profile. Average funding liabilities increased \$217.6 million through the increase in deposits from the branch acquisition and organic deposit growth of 2%, partially offset by a reduction in total average borrowings of \$93.2 million.

### Investment Securities

We purchase and hold investment securities such as U.S. government sponsored enterprises, states and political subdivisions, mortgage-backed securities, FHLB and Federal Reserve Bank ("FRB") stock, investment grade corporate bonds and equities to diversify our revenues, to provide interest rate and credit risk diversification and to provide for liquidity and funding needs. At September 30, 2013, our total holdings in investment securities were \$803.0 million, an increase of \$883,000, from December 31, 2012. During the first nine months of 2013, we purchased \$152.7 million of securities, of which \$14.4 million had not settled as of September 30, 2013, and we received proceeds from the sale of securities and maturities of \$121.8 million and realized gains of \$785,000.

Unrealized gains or losses on securities classified as available-for-sale ("AFS") are recorded as adjustments to shareholders' equity, net of tax, and are a component of other comprehensive income (loss) in the consolidated statement of comprehensive income. At September 30, 2013, we had \$5.1 million of unrealized losses on AFS

securities, net of tax, compared to \$12.9 million of unrealized gains, net of taxes, at December 31, 2012. The fair value of the AFS securities shifted to a loss position as a result of an increase in long term bond rates since December 31, 2012.

Within our AFS portfolio, we held senior tranches of non-agency collateralized mortgage obligations (“non-agency”), which were rated Triple-A by Moody’s, Standard and Poor’s, and/or Fitch at the time of purchase. At September 30, 2013, our non-agencies had a total fair value of \$7.5 million and \$211,000 in net unrealized losses. We believe that the decline in the fair values is temporary and does not reflect deterioration in the securities. We have the intent and ability to hold these securities until recovery and we will continue to evaluate the unrealized losses within our portfolio each quarter to determine if the impairment is other than temporary.

Each month we determine if a security has OTTI by evaluating the present value of projected credit losses that result from a discounted cash flow analysis. The analyses include several stress tests scenarios, which determine expected cash flows and forecast potential losses. Stress tests, which are performed monthly on higher risk investments (non-investment grade and/or coverage ratio of less than 1.00), use current statistical data to determine expected cash flows and forecast potential losses. Information on the securities is sourced from the Bloomberg and FTN Financial models, which enables management to track loan and performance data for the individual tranche and the entire issue as well as prepayment history. We review the significant inputs of the discounted cash flow analysis to ensure reasonableness and a prudent measure; we compare the Bloomberg assumptions to the assumptions used by FTN Financial, which is a division of First Tennessee Bank. Included in the monthly analyses is a review of the performance of the individual tranches held and the related entire issue, a base case and several stress test scenarios. The base case stress test uses both current data and historical performance and provides a basis for determining if a credit loss is projected during the life of the investment. When appropriate, the significant inputs for the base case stress test are adjusted to better reflect future expected cash flows. Based on the results of this analysis, we did not record any OTTI write-down during the nine months ended September 30, 2013.

#### Federal Home Loan Bank Stock

We are required to maintain a level of investment in FHLB of Boston (“FHLBB”) stock based on the level of our FHLBB advances. As of September 30, 2013, our investment in FHLBB stock totaled \$18.8 million. No market exists for shares of the FHLBB. FHLBB stock may be redeemed at par value five years following termination of FHLBB membership, subject to limitations or restrictions that may be imposed by the FHLBB or its regulator, the Federal Housing Finance Agency, to maintain capital adequacy of the FHLBB. While we currently have no intention to terminate our FHLBB membership, the ability to redeem our investment in FHLBB stock would be subject to the conditions imposed by the FHLBB. The FHLBB repurchased \$1.3 million of FHLBB stock from the Company in 2013.

#### Loans

We provide loans primarily to customers located within our geographic market area. At September 30, 2013, total loans of \$1.6 billion (excluding loans held-for-sale) increased \$26.1 million from December 31, 2012. Loan growth was centered in our consumer and commercial real estate portfolios, which experienced increases of \$29.9 million and \$16.4 million, respectively. The growth in the consumer portfolio was led by our promotions on home equity lines and a short-term fixed-rate home equity product. Since December 31, 2012, we experienced decreases in our residential real estate and commercial portfolios of \$7.8 million and \$12.6 million, respectively. The residential real estate portfolio decreased primarily due to the sale of \$28.2 million in 30-year fixed-rate production to manage our interest rate risk profile.

## Asset Quality

Non-Performing Assets. Non-performing assets include non-accrual loans, accruing loans 90 days or more past due, renegotiated loans, and property acquired through foreclosure or repossession.

The following table sets forth the amount of our non-performing assets as of the dates indicated:

| (Dollars in Thousands)                               | September 30,<br>2013 | December 31,<br>2012 |  |   |
|------------------------------------------------------|-----------------------|----------------------|--|---|
| Non-accrual loans                                    |                       |                      |  |   |
| Residential real estate                              | \$ 10,224             | \$ 10,584            |  |   |
| Commercial real estate                               | 9,847                 | 6,719                |  |   |
| Commercial                                           | 2,994                 | 3,409                |  |   |
| Consumer and home equity loans                       | 2,018                 | 1,771                |  |   |
| Total non-accrual loans                              | 25,083                | 22,483               |  |   |
| Accruing loans past due 90 days                      | 24                    | 611                  |  |   |
| Accruing renegotiated loans not included above       | 5,379                 | 4,674                |  |   |
| Total non-performing loans                           | 30,486                | 27,768               |  |   |
| Other real estate owned                              | 1,802                 | 1,313                |  |   |
| Total non-performing assets                          | \$ 32,288             | \$ 29,081            |  |   |
| Non-performing loans to total loans                  | 1.92                  | % 1.78               |  | % |
| Allowance for credit losses to non-performing loans  | 74.42                 | % 83.15              |  | % |
| Non-performing assets to total assets                | 1.24                  | % 1.13               |  | % |
| Allowance for credit losses to non-performing assets | 70.27                 | % 79.40              |  | % |

Potential Problem Loans. Potential problem loans consist of classified accruing commercial and commercial real estate loans that were between 30 and 89 days past due. Such loans are characterized by weaknesses in the financial condition of borrowers or collateral deficiencies. Based on historical experience, the credit quality of some of these loans may improve due to changes in collateral values or the financial condition of the borrowers, while the credit quality of other loans may deteriorate, resulting in some amount of loss. These loans are not included in the above analysis of non-accrual loans. At September 30, 2013, potential problem loans amounted to approximately \$120,000 as compared to \$2.2 million at December 31, 2012.

Past Due Loans. Past due loans consist of accruing loans that were between 30 and 89 days past due. The following table sets forth information concerning the past due loans at the date indicated:

| (Dollars in Thousands)                   | September 30,<br>2013 | December 31,<br>2012 |  |   |
|------------------------------------------|-----------------------|----------------------|--|---|
| Loans 30-89 days past due:               |                       |                      |  |   |
| Residential real estate                  | \$ 1,419              | \$ 1,658             |  |   |
| Commercial real estate                   | 833                   | 2,618                |  |   |
| Commercial                               | 529                   | 1,043                |  |   |
| Consumer and home equity loans           | 1,207                 | 2,721                |  |   |
| Total loans 30-89 days past due          | \$ 3,988              | \$ 8,040             |  |   |
| Loans 30-89 days past due to total loans | 0.25                  | % 0.51               |  | % |

Allowance for Loan Losses. We use a methodology to systematically measure the amount of estimated loan loss exposure inherent in the loan portfolio for purposes of establishing a sufficient ALL. The ALL is management's best estimate of the probable loan losses as of the balance sheet date. The allowance is increased by provisions charged to earnings and by recoveries of amounts previously charged-off, and is reduced by charge-offs on loans. During the first nine months of 2013, there were no significant changes to the allowance assessment methodology.



The following table sets forth information concerning the activity in our ALL during the periods indicated.

| (Dollars in Thousands)                                                | Nine Months Ended |             |   |
|-----------------------------------------------------------------------|-------------------|-------------|---|
|                                                                       | September 30,     |             |   |
|                                                                       | 2013              | 2012        |   |
| Allowance at the beginning of the period                              | \$23,044          | \$23,011    |   |
| Provision for loan losses                                             | 2,051             | 2,676       |   |
| Charge-offs:                                                          |                   |             |   |
| Residential real estate loans                                         | 687               | 1,024       |   |
| Commercial real estate                                                | 762               | 209         |   |
| Commercial loans                                                      | 823               | 1,146       |   |
| Consumer and home equity loans                                        | 598               | 987         |   |
| Total loan charge-offs                                                | 2,870             | 3,366       |   |
| Recoveries:                                                           |                   |             |   |
| Residential real estate loans                                         | 5                 | 73          |   |
| Commercial real estate loans                                          | 106               | 219         |   |
| Commercial loans                                                      | 275               | 205         |   |
| Consumer and home equity loans                                        | 50                | 33          |   |
| Total loan recoveries                                                 | 436               | 530         |   |
| Net charge-offs                                                       | (2,434 )          | (2,836 )    |   |
| Allowance at the end of the period                                    | \$22,661          | \$22,851    |   |
| Components of allowance for credit losses:                            |                   |             |   |
| Allowance for loan losses                                             | \$22,661          | \$22,851    |   |
| Liability for unfunded credit commitments                             | 28                | 51          |   |
| Balance of allowance for credit losses at end of the period           | \$22,689          | \$22,902    |   |
| Average loans outstanding                                             | \$1,586,243       | \$1,530,006 |   |
| Net charge-offs (annualized) to average loans outstanding             | 0.20              | % 0.25      | % |
| Provision for credit losses (annualized) to average loans outstanding | 0.17              | % 0.24      | % |
| Allowance for credit losses to total loans                            | 1.43              | % 1.49      | % |
| Allowance for credit losses to net charge-offs (annualized)           | 699.11            | % 605.54    | % |
| Allowance for credit losses to non-performing loans                   | 74.42             | % 89.18     | % |
| Allowance for credit losses to non-performing assets                  | 70.27             | % 87.16     | % |

The determination of an appropriate level of ALL, and subsequent provision for loan losses which affects earnings, is based on our analysis of various economic factors and review of the loan portfolio. During our analysis and review, many factors are considered including, but not limited to, loan growth, payoffs of lower quality loans, recoveries on previously charged-off loans, improvement in the financial condition of the borrowers, risk rating downgrades/upgrades and charge-offs. We utilize a comprehensive approach toward determining the ALL, which includes an expanded risk rating system to assist us in identifying the risks being undertaken, as well as migration within the overall loan portfolio. During the first nine months of 2013, the Company provided \$2.0 million of expense to the ALL compared to \$2.7 million for the same period in 2012. The decrease in the provision for loan losses was primarily due to improving asset quality trends. Annualized net charge-offs to average loans decreased to 0.20% at September 30, 2013 compared to 0.25% for September 30, 2012. While as a whole we have seen improving asset quality trends when compared to the same period a year ago, during the third quarter of 2013 we placed one large relationship on non-accrual status resulting in a higher level of non-performing assets. Through our analysis and review, we do not believe that this one relationship is indicative of a credit deterioration trend within our residential real estate and commercial real estate loan portfolios.

Overall, economic conditions in Maine experienced minimal change during the third quarter of 2013, with modest gains in the unemployment rate and real estate values. Weaknesses in the real estate markets persist, particularly in the residential real estate market, where consumers face employment uncertainty and increasing interest rates compared to 2012. Economic forecasts for Maine continue to push the state's recovery out past 2015, lagging the national recovery by one to two years. However, the

Company has seen improved asset quality and lower losses during 2013. As updated financial statements are being collected and analyzed on the heels of this year's tax season, indications are of a slightly improved general financial condition among commercial customers. Auction activity has increased, resulting in more sales than transfers into OREO. We believe the ALL of \$22.7 million, or 1.43% of total loans outstanding and 74.42% of total non-performing loans at September 30, 2013, was appropriate given the current economic conditions in our service area and the condition of the loan portfolio. If conditions deteriorate, however, the provision will likely be increased. The ALL was 1.49% of total loans outstanding and 89.18% of total non-performing loans at September 30, 2012.

#### Liabilities and Shareholders' Equity

Total liabilities increased \$34.0 million since December 31, 2012 to \$2.4 billion at September 30, 2013. Total deposits, including brokered deposits, increased \$43.9 million since December 31, 2012. Core deposits (demand deposit, interest checking, savings and money market accounts) increased \$80.8 million since December 31, 2012, while retail certificates of deposit decreased \$39.2 million for the same period. The increase in core deposits was the result of normal business with customers and large deposits received from our municipal relationships in the third quarter of 2013. Short-term brokered deposits increased \$2.2 million since December 31, 2012, while borrowings decreased \$12.8 million since December 31, 2012. Coupled with decreasing interest rates, the increase in deposits and decrease in borrowings is driving the decrease in average funding costs for the first nine months of 2013 and is aiding the offset of our decreasing yield on interest-earnings assets.

Total shareholders' equity decreased \$1.5 million, or 1%, since December 31, 2012, primarily due to other comprehensive loss of \$18.0 million on AFS securities, net of tax, and dividends of \$6.2 million, offset by other comprehensive income of \$3.6 million on cash flow hedging derivatives, net of tax, and net income for the nine months ended September 30, 2013 of \$18.4 million.

The following table presents certain information regarding shareholders' equity as of or for the periods indicated:

|                                       | September 30,<br>2013 | December 31,<br>2012 |   |
|---------------------------------------|-----------------------|----------------------|---|
| Return on average equity (annualized) | 10.52                 | % 10.31              | % |
| Average equity to average assets      | 9.05                  | % 9.48               | % |
| Dividend payout ratio                 | 33.80                 | % 32.67              | % |
| Dividends declared per share          | \$0.81                | \$1.00               |   |
| Book value per share                  | \$30.38               | \$30.67              |   |

#### LIQUIDITY

Our liquidity needs require the availability of cash to meet the withdrawal demands of depositors and credit commitments to borrowers. Liquidity is defined as our ability to maintain availability of funds to meet customer needs, as well as to support our asset base. The primary objective of liquidity management is to maintain a balance between sources and uses of funds to meet our cash flow needs in the most economical and expedient manner. Due to the potential for unexpected fluctuations in both deposits and loans, active management of liquidity is necessary. We maintain various sources of funding and levels of liquid assets in excess of regulatory guidelines in order to satisfy their varied liquidity demands. We monitor liquidity in accordance with internal guidelines and all applicable regulatory requirements. As of September 30, 2013 and 2012, our level of liquidity exceeded target levels. We believe that we currently have appropriate liquidity available to respond to liquidity demands. Sources of funds that we utilize consist of deposits, borrowings from the FHLBB and other sources, cash flows from operations, prepayments and maturities of outstanding loans, investments and mortgage-backed securities and the sales of mortgage loans.



Deposits continue to represent our primary source of funds. For the first nine months of 2013, average deposits (excluding brokered deposits) of \$1.8 billion increased \$310.8 million, compared to the same period in 2012, primarily due to the branch acquisition in the fourth quarter of 2012. We experienced growth in average balances of demand deposits and interest checking accounts of \$153.0 million, money market accounts of \$88.9 million, savings accounts of \$47.9 million, and retail certificates of deposit of \$21.0 million. Included in the money market and interest checking deposit categories are deposits from our wealth management subsidiary, Acadia Trust, which represent client funds. The deposits in the Acadia Trust client accounts, which totaled \$98.1 million at September 30, 2013, fluctuate with changes in the portfolios of the clients of Acadia Trust.

Borrowings are used to supplement deposits as a source of liquidity. In addition to borrowings from the FHLBB, we purchase federal funds and sell securities under agreements to repurchase. Our average total borrowings, which include long-term debt, totaled \$513.5 million for the first nine months of 2013, a decrease of \$93.2 million or 15%, from the same period in 2012, primarily due to the reduction in FHLBB term borrowings of \$40.4 million as result of using proceeds from the branch acquisition to reduce borrowings and a decrease in commercial repurchase agreements of \$34.2 million. We secure borrowings from the FHLBB, whose advances remain the largest non-deposit-related funding source, with qualified residential real estate loans, certain investment securities and certain other assets available to be pledged. The carrying value of loans pledged as collateral at the FHLBB was \$764.9 million and \$675.2 million at September 30, 2013 and 2012, respectively. The carrying value of securities pledged as collateral at the FHLBB was \$3.9 million and \$7.0 million at September 30, 2013 and 2012, respectively. Through the Bank, we had an available line of credit with the FHLBB of \$9.9 million at September 30, 2013 and 2012. We had no outstanding balance on the line of credit with the FHLBB at September 30, 2013. Long-term borrowings represent securities sold under repurchase agreements with major brokerage firms and a note payable with a maturity date over one year. Both wholesale and retail repurchase agreements are secured by mortgage-backed securities and government sponsored enterprises. The Company has \$10.0 million in other lines of credit with a maturity date of December 20, 2013. We had no outstanding balance on these lines of credit at September 30, 2013.

We believe the investment portfolio and residential loan portfolio provide a significant amount of contingent liquidity that could be accessed in a reasonable time period through sales of those portfolios. We also believe that we have additional untapped access to the brokered deposit market, commercial reverse repurchase transaction market and the FRB discount window. These sources are considered as liquidity alternatives in our contingent liquidity plan. We believe that the level of liquidity is sufficient to meet current and future funding requirements; however, changes in economic conditions, including consumer saving habits and the availability or access to the national brokered deposit and commercial repurchase markets, could significantly impact our liquidity position.

## CAPITAL RESOURCES

Under FRB guidelines, we are required to maintain capital based on risk-adjusted assets. These capital requirements represent quantitative measures of our assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. Our capital classification is also subject to qualitative judgments by our regulators about components, risk weightings and other factors. Quantitative measures established by regulation to ensure capital adequacy require us to maintain minimum amounts and ratios of total and Tier 1 capital (as defined in the applicable regulations) to risk-weighted assets (as defined in the applicable regulations), and of Tier 1 capital to average assets (as defined in the applicable regulations). These guidelines apply to us on a consolidated basis. Under the current guidelines, banking organizations must maintain a risk-based capital ratio of 8.0%, of which at least 4.0% must be in the form of core capital (as defined in the applicable regulations). In addition to risk-based capital requirements, the FRB requires bank holding companies to maintain a minimum leverage capital ratio of core capital to total assets of 4.0%. Total assets for this purpose do not include goodwill and any other intangible assets and investments that the FRB determines should be deducted. Our risk-based ratios and those of the Bank, exceeded regulatory guidelines at September 30, 2013, December 31, 2012 and September 30, 2012. The following table presents the Company's regulatory capital ratios at the periods indicated:

|                                        | September 30,<br>2013 | December 31,<br>2012 | September 30,<br>2012 |   |
|----------------------------------------|-----------------------|----------------------|-----------------------|---|
| Tier 1 capital to risk-weighted assets | 14.96                 | % 14.31              | % 15.13               | % |
| Total capital to risk-weighted assets  | 16.21                 | % 15.56              | % 16.39               | % |
| Tier 1 leverage capital ratio          | 9.24                  | % 8.94               | % 9.57                | % |

Although the junior subordinated debentures are recorded as a liability on our consolidated statements of condition, we are permitted, in accordance with regulatory guidelines, to include, subject to certain limits, the trust preferred securities in our calculation of risk-based capital. At September 30, 2013, \$43.0 million of the trust preferred securities were included in Tier 1 and total risk-based capital.

As part of our goal to operate a safe, sound and profitable financial organization, we are committed to maintaining a strong capital base. Shareholders' equity totaled \$232.3 million, \$233.8 million and \$235.0 million at September 30, 2013, December 31, 2012 and September 30, 2012, respectively, which amounted to 9%, 9% and 10% of total assets as of the respective dates. Total shareholders' equity at September 30, 2013 decreased \$1.5 million, or 1%, and \$2.7 million, or 1%, from

December 31, 2012 and September 30, 2012, respectively. Shareholders' equity decreased primarily as a result of a decrease in other comprehensive income and dividends declared and issued to shareholders during the first nine months of 2013, partially offset by current year earnings of \$18.4 million. The decrease in other comprehensive income was largely due to the change in fair value of our AFS securities due to the increase in long-term bond rates during 2013.

Our principal cash requirement is the payment of dividends on our common stock, as and when declared by the board of directors. We paid dividends to shareholders in the aggregate amount of \$6.1 million and \$5.8 million for the nine-months period ended September 30, 2013 and 2012, respectively. Our board of directors approves cash dividends on a quarterly basis after careful analysis and consideration of various factors, including the following: (i) capital position relative to total assets, (ii) risk-based assets, (iii) total classified assets, (iv) economic conditions, (v) growth rates for total assets and total liabilities, (vi) earnings performance and projections and (vii) strategic initiatives and related capital requirements. All dividends declared and distributed by the Company will be in compliance with applicable state corporate law and regulatory requirements.

We are primarily dependent upon the payment of cash dividends by our subsidiaries to service our commitments. We, as the sole shareholder of our subsidiaries, are entitled to dividends, when and as declared by each subsidiary's board of directors from legally available funds. The Bank declared dividends in the aggregate amount of \$9.5 million and \$9.8 million for the first nine months of 2013 and 2012, respectively. Under regulations prescribed by the Office of the Comptroller of the Currency (the "OCC"), without prior OCC approval, the Bank may not declare dividends in any year in excess of the Bank's (i) net income for the current year, (ii) plus its retained net income for the prior two years. If we are required to use dividends from the Bank to service unforeseen commitments in the future, we may be required to reduce the dividends paid to our shareholders going forward.

On September 24, 2013, the board of directors approved a common stock repurchase program for the repurchase of up to 250,000 shares of the Company's outstanding common stock. The program is expected to continue until the authorized number of shares is repurchased or the board of director's terminates the program.

## CONTRACTUAL OBLIGATIONS AND COMMITMENTS

In the normal course of business, we are a party to credit related financial instruments with off-balance sheet risk, which are not reflected in the consolidated statements of condition. These financial instruments include lending commitments and letters of credit. Those instruments involve varying degrees of credit risk in excess of the amount recognized in the consolidated statements of condition. We follow the same credit policies in making commitments to extend credit and conditional obligations as we do for on-balance sheet instruments, including requiring similar collateral or other security to support financial instruments with credit risk. Our exposure to credit loss in the event of nonperformance by the customer is represented by the contractual amount of those instruments. Since many of the commitments are expected to expire without being drawn upon, the total amount does not necessarily represent future cash requirements. At September 30, 2013, we had the following levels of commitments to extend credit:

| (Dollars in Thousands)                 | Total Amount<br>Committed | Commitment Expires in: |             |             |           |
|----------------------------------------|---------------------------|------------------------|-------------|-------------|-----------|
|                                        |                           | <1 Year                | 1 – 3 Years | 4 – 5 Years | >5 Years  |
| Letters of Credit                      | \$2,106                   | \$2,106                | \$—         | \$—         | \$—       |
| Commercial Commitment Letters          | 15,072                    | 15,072                 | —           | —           | —         |
| Residential Loan Origination           | 12,600                    | 12,600                 | —           | —           | —         |
| Home Equity Line of Credit Commitments | 320,993                   | 90,532                 | 8,179       | 19,504      | 202,778   |
| Other Commitments to Extend Credit     | 2,228                     | 2,228                  | —           | —           | —         |
| Total                                  | \$352,999                 | \$122,538              | \$8,179     | \$19,504    | \$202,778 |



We are a party to several off-balance sheet contractual obligations through lease agreements on a number of branch facilities. We have an obligation and commitment to make future payments under these contracts. At September 30, 2013, we had the following levels of contractual obligations:

| (Dollars in Thousands)           | Total Amount<br>of Obligations | Payments Due per Period |             |             |          |
|----------------------------------|--------------------------------|-------------------------|-------------|-------------|----------|
|                                  |                                | <1 Year                 | 1 – 3 Years | 4 – 5 Years | >5 Years |
| Operating Leases                 | \$5,337                        | \$1,127                 | \$1,736     | \$1,251     | \$1,223  |
| Capital Leases                   | 1,058                          | 59                      | 125         | 136         | 738      |
| FHLBB Borrowings – Overnight     | 14,000                         | 14,000                  | —           | —           | —        |
| FHLBB Borrowings – Advances      | 96,130                         | 40,000                  | 36,130      | 20,000      | —        |
| Commercial Repurchase Agreements | 30,154                         | —                       | 25,000      | 5,154       | —        |
| Other Borrowed Funds             | 162,080                        | 162,080                 | —           | —           | —        |
| Junior Subordinated Debentures   | 43,896                         | —                       | —           | —           | 43,896   |
| Note Payable                     | 35                             | 35                      | —           | —           | —        |
| Other Contractual Obligations    | 1,118                          | 1,118                   | —           | —           | —        |
| Total                            | \$353,808                      | \$218,419               | \$62,991    | \$26,541    | \$45,857 |

(1) Excludes contingent rentals, which are based on the Consumer Price Index and reset every five years. Total contingent rentals for year one through year five are \$18,000.

Borrowings from the FHLBB consist of short- and long-term fixed- and variable-rate borrowings and are collateralized by all stock in the FHLBB and a blanket lien on qualified collateral consisting primarily of loans with first mortgages secured by one- to four-family properties, certain pledged investment securities and other qualified assets. Other borrowed funds include federal funds purchased and securities sold under repurchase agreements. We have an obligation and commitment to repay all borrowings and debentures. These commitments, borrowings, junior subordinated debentures and the related payments are made during the normal course of business.

We may enter into derivative instruments as partial hedges against large fluctuations in interest rates. We may also enter into fixed-rate interest rate swaps and floor instruments to partially hedge against potentially lower yields on the variable prime rate loan category in a declining rate environment. If interest rates were to decline, resulting in reduced income on the adjustable rate loans, there would be an increased income flow from the interest rate swap and floor instrument. We may also enter into variable rate interest rate swaps and cap instruments to partially hedge against increases in short-term borrowing rates. If interest rates were to rise, resulting in an increased interest cost, there would be an increased income flow from the interest rate swaps and cap instruments. These financial instruments are factored into our overall interest rate risk position. We regularly review the credit quality of the counterparty from which the instruments have been purchased. At September 30, 2013, we had the following variable- for fixed- interest rate swaps on the junior subordinated debentures:

| Notional Amount | Fixed-Rate | Maturity Date  |
|-----------------|------------|----------------|
| \$10,000        | 5.09%      | June 30, 2021  |
| 10,000          | 5.84%      | June 30, 2029  |
| 10,000          | 5.71%      | June 30, 2030  |
| 5,000           | 4.35%      | March 30, 2031 |
| 8,000           | 4.14%      | July 7, 2031   |

At September 30, 2013, we had a notional amount of \$7.9 million in interest rate swap agreements with commercial customers and an equal notional amount with a dealer bank related to our commercial loan level derivative program. This program allows us to retain variable-rate commercial loans while allowing the customer to synthetically fix the loan rate by entering into a variable- for fixed- interest rate swap. It is anticipated that, over time, customer interest rate derivatives will reduce the interest rate risk inherent in the longer-term, fixed-rate commercial business.

At September 30, 2013, we had \$3.3 million of forward commitments to sell residential mortgages in the secondary market. We enter into these arrangements to reduce the market risk of originating loans with the intention of selling in the secondary market. At September 30, 2013, we also had \$2.0 million of mortgage loans with interest rate lock commitments to customers.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

#### MARKET RISK

Market risk is the risk of loss in a financial instrument arising from adverse changes in market rates/prices, such as interest rates, foreign currency exchange rates, commodity prices and equity prices. Our primary market risk exposure is interest rate risk. The ongoing monitoring and management of this risk is an important component of our asset/liability management process, which is governed by policies established by the Bank's board of directors, and are reviewed and approved annually. The Bank's board of directors' Asset/Liability Committee ("Board ALCO") delegates responsibility for carrying out the asset/liability management policies to the Management Asset/Liability Committee ("Management ALCO"). In this capacity, Management ALCO develops guidelines and strategies impacting our asset/liability management-related activities based upon estimated market risk sensitivity, policy limits and overall market interest rate levels/trends. Management ALCO and Board ALCO jointly meet on a quarterly basis to review strategies, policies, economic conditions and various activities as part of the management of these risks.

#### Interest Rate Risk

Interest rate risk represents the sensitivity of earnings to changes in market interest rates. As interest rates change, the interest income and expense streams associated with our financial instruments also change, thereby impacting net interest income ("NII"), the primary component of our earnings. Board and Management ALCOs utilize the results of a detailed and dynamic simulation model to quantify the estimated exposure of NII to sustained interest rate changes. While Board and Management ALCOs routinely monitor simulated NII sensitivity over a rolling two-year horizon, they also utilize additional tools to monitor potential longer-term interest rate risk.

The simulation model captures the impact of changing interest rates on the interest income received and interest expense paid on all interest-earning assets and interest-bearing liabilities reflected on our consolidated statements of condition, as well as for derivative financial instruments, if any. None of the assets used in the simulation were held for trading purposes. This sensitivity analysis is compared to Board ALCO policy limits, which specify a maximum tolerance level for NII exposure over a one-year horizon, assuming no balance sheet growth, given a 200 basis point ("bp") upward and 200 bp downward shift in interest rates. Although our policy specifies a downward shift of 200 bp, this could result in negative rates as many benchmark rates are currently below 2.00%. A parallel and pro rata shift in rates over a 12-month period is assumed. Using this approach, we are able to produce reports that illustrate the effect that both a gradual change of rates (Year 1) and a "rate shock" (Year 2 and beyond) have on margin expectations. In the down 100 bp scenario, Federal Funds and Treasury yields are floored at .01% while Prime is floored at 3.00%. All other market rates are floored at 0.25%.

During the first nine months of 2013 and 2012, our NII sensitivity analysis reflected the following changes to NII assuming no balance sheet growth and a parallel shift in interest rates over a one-year horizon. All rate changes were "ramped" over the first 12-month period and then maintained at those levels over the remainder of the ALCO simulation horizon.

| Rate Change from Year 1 - Base | Estimated Changes in NII |    |                       |    |
|--------------------------------|--------------------------|----|-----------------------|----|
|                                | September 30,<br>2013    |    | September 30,<br>2012 |    |
| Year 1                         |                          |    |                       |    |
| +400 bp                        | (4.69                    | )% | (1.50                 | )% |
| +200 bp                        | (4.71                    | )% | (1.50                 | )% |
| -100 bp                        | (0.78                    | )% | (0.90                 | )% |
| Year 2                         |                          |    |                       |    |
| +400 bp                        | (10.56                   | )% | (5.40                 | )% |



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|         |       |    |        |    |
|---------|-------|----|--------|----|
| +200 bp | (5.61 | )% | (3.30  | )% |
| -100 bp | (6.54 | )% | (11.00 | )% |

The preceding sensitivity analysis does not represent a forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions including, among others, the nature and timing of interest rate levels, yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits and reinvestment/replacement of asset and liability cash flows. The September 30, 2013 estimate includes the divestiture of our five branches in Franklin County, which was completed on October 4, 2013. While assumptions are

developed based upon current economic and local market conditions, we cannot make any assurances as to the predictive nature of these assumptions, including how customer preferences or competitor influences might change.

The most significant factors affecting the changes in market risk exposure during the first nine months of 2013 was the accumulation of long-term assets funded primarily with short-term borrowings plus the continued repricing/replacement of assets' cash flows at today's lower rate levels at a faster pace than the decline in overall funding costs. The divestiture and subsequent smaller loan portfolio will put further pressure on the level of ongoing net interest income. Further into the simulation, the downward trend begins to level out as asset yield erosion slows while long-term funding continues to reset into lower rates. The downward trend is steeper than the prior review for reasons mentioned, as well as the reduction in replacement yields on investment cash flows. If rates decline further, resulting in a flattening of the yield curve, net interest income remains close to the current rates scenario. However, the acceleration of asset cash flow would quickly outpace limited reductions in cost of funds and drive a sustained downward trend in net interest income. In a rising interest rate environment (up 200 bps/12 months), net interest income trends below the current rates scenario as increases to cost of funds outweigh delayed improvements to asset yields. By the end of Year 1, cost of funds have leveled while asset yields continue to cycle into the higher rate environment, producing an ongoing upward trend in net interest income. If market rate adjustments continue through Year 2, near term pressure on net interest income is intensified with greater benefit in the long term. A flattening of the yield curve would produce similar pressure in the interim with a longer recovery period.

Periodically, if deemed appropriate, we use interest rate swaps, floors and caps, which are common derivative financial instruments, to hedge our interest rate risk position. The Company's board of directors has approved hedging policy statements governing the use of these instruments. At September 30, 2013, we had a notional principal amount of \$43.0 million in interest rate swap agreements related to the junior subordinated debentures, and \$7.9 million interest rate swaps related to the Company's commercial loan level derivative program. The Board and Management ALCOs monitor derivative activities relative to their expectations and our hedging policies.

#### ITEM 4. CONTROLS AND PROCEDURES

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Company's management conducted an evaluation with the participation of the Company's Chief Executive Officer and Chief Financial Officer (Principal Financial & Accounting Officer), regarding the effectiveness of the Company's disclosure controls and procedures, as of the end of the last fiscal quarter covered by this report. In designing and evaluating the Company's disclosure controls and procedures, the Company and its management recognize that any controls and procedures, no matter how well designed and operated, can provide only a reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer (Principal Financial & Accounting Officer) concluded that they believe the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There was no change in the internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.



## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

In the normal course of business, the Company and its subsidiaries are subject to pending and threatened legal actions. Although the Company is not able to predict the outcome of such actions, after reviewing pending and threatened actions with counsel, management believes that based on the information currently available the outcome of such actions, individually or in the aggregate, will not have a material adverse effect on the Company's consolidated financial position as a whole.

### ITEM 1A. RISK FACTORS

The following Risk Factor is in addition to the Risk Factors described in Item 1A. of the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

We will become subject to more stringent capital requirements.

The Dodd-Frank Act required the federal banking agencies to establish minimum leverage and risk-based capital requirements for insured banks and their holding companies. The federal banking agencies issued a joint final rule, or the "Final Capital Rule," that implements the Basel III capital standards and establishes the minimum capital levels required under the Dodd-Frank Act. We must comply with the Final Capital Rule by January 1, 2015. The Final Capital Rule establishes a minimum common equity Tier I capital ratio of 6.5% of risk-weighted assets for a "well capitalized" institution and increases the minimum Tier I capital ratio for a "well capitalized" institution from 6% to 8%. Additionally, the Final Capital Rule requires an institution to maintain a 2.5% common equity Tier I capital conservation buffer over the 6.5% minimum risk-based capital requirement to avoid restrictions on the ability to pay dividends, discretionary bonuses, and engage in share repurchases. The Final Capital Rule permanently grandfathered trust preferred securities issued before May 19, 2010, subject to a limit of 25% of Tier I capital. The Final Capital Rule increases the required capital for certain categories of assets, including high volatility construction real estate loans and certain exposures related to securitizations; however, the Final Capital Rule retains the current capital treatment of residential mortgages. Under the Final Capital Rule, we may make a one-time, permanent election to continue to exclude accumulated other comprehensive income from capital. If we do not make this election, unrealized gains and losses will be included in the calculation of our regulatory capital. Implementation of these standards, or any other new regulations, may adversely affect our ability to pay dividends, or require us to reduce business levels or raise capital, including in ways that may adversely affect our results of operations or financial condition.

There have been no further material changes to the Risk Factors described in Item 1A. of the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

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

- (a) None.
- (b) None.
- (c) Purchases of equity securities by the issuer and affiliated purchasers

On September 24, 2013, the board of directors approved a common stock repurchase program for the repurchase of up to 250,000 shares of the Company's outstanding common stock. The program is expected to continue until the authorized number of shares is repurchased or the board of director's terminates the program.

There were no share repurchases during the three months ended September 30, 2013.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits

(23.1) Consent of Berry Dunn McNeil & Parker, LLC relating to the consolidated financial statements of Camden National Corporation\*

(31.1) Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934\*

(31.2) Certification of Chief Financial Officer, Principal Financial & Accounting Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934\*

(32.1) Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002\*\*

(32.2) Certification of Chief Financial Officer, Principal Financial & Accounting Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002\*\*

(101) – XBRL (Extensible Business Reporting Language)\*\*\*

The following materials from Camden National Corporation's Quarterly Report on Form 10-Q for the period ended September 30, 2013, formatted in XBRL: (i) Consolidated Statements of Condition - September 30, 2013 and December 31, 2012; (ii) Consolidated Statements of Income - Three and Nine Months Ended September 30, 2013 and 2012; (iii) Consolidated Statements of Comprehensive Income - Three and Nine Months Ended September 30, 2013 and 2012; (iv) Consolidated Statements of Changes in Shareholders' Equity - Nine Months Ended September 30, 2013 and 2012; (v) Consolidated Statements of Cash Flows - Nine Months Ended September 30, 2013 and 2012; and (vi) Notes to Consolidated Financial Statements.

\* Filed herewith

\*\* Furnished herewith

\*\*\* Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CAMDEN NATIONAL CORPORATION  
(Registrant)

/s/ Gregory A. Dufour  
Gregory A. Dufour  
President and Chief Executive Officer  
(Principal Executive Office)

November 8, 2013  
Date

/s/ Deborah A. Jordan  
Deborah A. Jordan  
Chief Financial Officer  
(Principal Financial & Accounting Officer)

November 8, 2013  
Date

Exhibit Index

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