

BAR HARBOR BANKSHARES

Form 10-Q

August 08, 2017

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: June 30, 2017

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

For the transition period from _____ to _____

Commission File Number: 001-13349

BAR HARBOR BANKSHARES

(Exact name of registrant as specified in its charter)

Maine

01-0393663

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

PO Box 400

82 Main Street, Bar Harbor, ME

04609-0400

(Address of principal executive offices)

(Zip Code)

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

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

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

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

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

Emerging growth company ☐

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

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

Yes ☐ No ☒

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

Table of Contents

BAR HARBOR BANKSHARES AND SUBSIDIARIES
FORM 10-Q

INDEX

Page

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements (unaudited)

Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016 4

Consolidated Statements of Income for the Three and Six Months Ended June 30, 2017 and 2016 5

Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2017 and 2016 6

Consolidated Statements of Changes in Shareholders' Equity for the Six Months Ended June 30, 2017 and 2016 7

Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2017 and 2016 8

Notes to Consolidated Financial Statements

Note 1 Basis of Presentation 9

Note 2 Acquisition 13

Note 3 Securities Available for Sale 17

Note 4 Loans 21

Note 5 Loan Loss Allowance 32

Note 6 Borrowed Funds 36

Note 7 Deposits 37

Note 8 Capital Ratios and Shareholders Equity 38

Note 9 Earnings per Share 43

Note 10 Derivative Financial Instruments and Hedging Activities 43

Note 11 Fair Value Measurements 46

Note 12 Subsequent Events 52

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 53

Selected Financial Data 55

Loan and Deposit Analysis 57

Average Balances and Average Yields/Rates 58

Non-GAAP Financial Measures 59

<u>Financial Summary</u>	<u>62</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>69</u>
<u>Item 4. Controls and Procedures</u>	<u>71</u>

Table of Contents

PART II. OTHER
INFORMATION

Item 1. Legal 71
 Proceedings

Item 1A. Risk Factors 71

Item 2. Unregistered
 Sales of Equity 72
 Securities and
 Use of Proceeds

Item 3. Defaults Upon 72
 Senior Securities

Item 4. Mine Safety 72
 Disclosures

Item 5. Other Information 72

Item 6. Exhibits 73

Signatures 74

Table of Contents

PART I

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

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

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Less: cost of 1,017,987 and 1,067,016 shares of treasury stock at June 30, 2017 and December 31, 2016, respectively	(5,640) (6,027)
Total shareholders' equity	347,122	156,740	
Total liabilities and shareholders' equity	\$3,503,411	\$ 1,755,349	
The accompanying notes are an integral part of these consolidated financial statements.			

Table of ContentsBAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

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

Weighted average common shares outstanding:

Basic	15,393	9,032	14,935	9,023
Diluted	15,506	9,129	15,049	9,125

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

Table of ContentsBAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

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

Table of Contents

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

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

Table of ContentsBAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

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

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Income taxes paid, net	3,084	3,926
Acquisition of non-cash assets and liabilities:		
Assets acquired	1,454,076	—
Liabilities assumed	1,406,672	—
Other non-cash changes:		
Real estate owned acquired in settlement of loans	32	—
The accompanying notes are an integral part of these consolidated financial statements.		

Table of Contents

BAR HARBOR BANKSHARES AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

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

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

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

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

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

Recently Adopted Accounting Principles

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

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

Table of Contents

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

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

Future Application of Accounting Pronouncements

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

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

Table of Contents

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

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

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

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

Table of Contents

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

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

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

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

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

Table of Contents

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

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

NOTE 2. ACQUISITION

Lake Sunapee Bank Group

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

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

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

Table of Contents

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

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

Explanation of Certain Fair Value Adjustments

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

Pro Forma Information (unaudited)

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

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

Table of Contents

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

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

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

Table of Contents

NOTE 3. SECURITIES AVAILABLE FOR SALE

The following is a summary of securities available for sale:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2017				
Securities available for sale				
Debt securities:				
Obligations of US Government sponsored enterprises	\$ 6,937			