

BAR HARBOR BANKSHARES  
Form 10-K  
March 16, 2010

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2009  
 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: 0-13666

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.)

P.O. Box 400, 82 Main Street  
Bar Harbor, Maine

04609-0400

(207) 288-3314

(Zip Code)

(Registrant's telephone number,  
including area code)

(Address of principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

Title of class

Common Stock, \$2.00 par value per share

Name of exchange on which registered

NYSE Amex

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act: YES \_\_\_ NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act: YES \_\_\_ NO x

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 registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days: YES \_\_\_ NO x

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. \_\_\_

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: Large accelerated filer \_\_\_ Accelerated filer x Non-accelerated filer (do not check if a smaller reporting company) \_\_\_ Smaller reporting

## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

company \_\_\_\_

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): YES \_\_\_\_ NO

The aggregate market value of the common stock held by non-affiliates of Bar Harbor Bankshares was \$86,538,384 based on the closing sale price of the common stock on the NYSE Amex on June 30, 2009, the last trading day of the registrant's most recently completed second quarter.

Number of shares of Common Stock par value \$2.00 outstanding as of March 1, 2010: **3,773,204**

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 18, 2010 are incorporated by reference into Part III, Items 10-14 of this Annual Report on Form 10-K.

### FORWARD-LOOKING STATEMENTS DISCLAIMER

Certain statements, as well as certain other discussions contained in this Annual Report on Form 10-K, or incorporated herein by reference, contain statements which may be considered to be forward-looking within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. You can identify these forward-looking statements by the use of words like "strategy," "expects," "plans," "believes," "will," "estimates," "intends," "projects," "goals," "targets," and other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts.

Investors are cautioned that forward-looking statements are inherently uncertain. Forward-looking statements include, but are not limited to, those made in connection with estimates with respect to the future results of operations, financial condition, and the business of Bar Harbor Bankshares (the "Company") which are subject to change based on the impact of various factors that could cause actual results to differ materially from those projected or suggested due to certain risks and uncertainties. Those factors include but are not limited to:

- (i) The Company's success is dependent to a significant extent upon general economic conditions in Maine, and Maine's ability to attract new business, as well as factors that affect tourism, a major source of economic activity in the Company's immediate market areas;
- (ii) The Company's earnings depend to a great extent on the level of net interest income (the difference between interest income earned on loans and securities and the interest expense paid on deposits and borrowings) generated by the Company's wholly-owned banking subsidiary, Bar Harbor Bank & Trust, (the "Bank"), and thus the Company's results of operations may be adversely affected by increases or decreases in interest rates;
- (iii) The banking business is highly competitive and the profitability of the Company depends on the Bank's ability to attract loans and deposits in Maine, where the Bank competes with a variety of traditional banking and nontraditional institutions, such as credit unions and finance companies;
- (iv) A significant portion of the Bank's loan portfolio is comprised of commercial loans and loans secured by real estate, exposing the Company to the risks inherent in financings based upon analysis of credit risk, the value of underlying collateral, and other intangible factors which are considered in making commercial loans and, accordingly, the Company's profitability may be negatively impacted by judgment errors in risk analysis, by loan defaults, and the ability of certain borrowers to repay such loans during a downturn in general economic conditions;
- (v) A significant delay in or inability to execute strategic initiatives designed to increase revenues and or control expenses;
- (vi) The potential need to adapt to changes in information technology systems, on which the Company is highly dependent, could present operational issues or require significant

- capital spending;
- (vii) Significant changes in the Company's internal controls, or internal control failures;
  - (viii) Acts or threats of terrorism and actions taken by the United States or other governments as a result of such threats, including military action, could further adversely affect business and economic conditions in the United States generally and in the Company's markets, which could have an adverse effect on the Company's financial performance and that of borrowers and on the financial markets and the price of the Company's common stock;
  - (ix) Significant changes in the extensive laws, regulations, and policies governing bank holding companies and their subsidiaries, which could alter the Company's business environment or affect its operations;
  - (x) Changes in general, national, international, regional or local economic conditions and credit markets which are less favorable than those anticipated by Company management that could impact the Company's investment securities portfolio, quality of credits, or the overall demand for the Company's products or services; and
  - (xi) The Company's success in managing the risks involved in all of the foregoing matters.

You should carefully review all of these factors as well as the risk factors set forth in Item 1A. Risk Factors contained in this Annual Report of Form 10-K. There may be other risk factors that could cause differences from those anticipated by management.

The forward-looking statements contained herein represent the Company's judgment as of the date of this Annual Report on Form 10-K, and the Company cautions readers not to place undue reliance on such statements. The Company disclaims any obligation to publicly update or revise any forward-looking statement contained in the succeeding discussion, or elsewhere in this Annual Report on Form 10-K, except to the extent required by federal securities laws.

## TABLE OF CONTENTS

### **PART I**

<b>ITEM 1</b>	<b>BUSINESS</b>	6
	Organization	6
	Bar Harbor Bank & Trust	6
	Bar Harbor Trust Services	8
	Competition	8
	Management and Employees	9
	Supervision and Regulation	10
	Financial Information About Industry Segments	21
	Availability of Information Company Website	21
<b>ITEM 1A</b>	<b>RISK FACTORS</b>	21
<b>ITEM 1B</b>	<b>UNRESOLVED STAFF COMMENTS</b>	27
<b>ITEM 2</b>	<b>PROPERTIES</b>	27
<b>ITEM 3</b>	<b>LEGAL PROCEEDINGS</b>	28
<b>ITEM 4</b>	<b>RESERVED</b>	28

### **PART II**

<b>ITEM 5</b>	<b>MARKET FOR REGISTRANT'S COMMON STOCK, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</b>	29
	Market Information	29
	Dividends	30
	Recent Sale of Unregistered Securities; Use of Proceeds from Registered Securities	30
	Purchase of Equity Securities by the Issuer and Affiliated Purchasers	31
	Stock Based Compensation Plans	31

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

	Transfer Agent Services	32
<b>ITEM 6</b>	<b>SELECTED CONSOLIDATED FINANCIAL DATA</b>	32
<b>ITEM 7</b>	<b>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</b>	33
	Executive Overview	34
	Application of Critical Accounting Policies	40
	Financial Condition	41
	Results of Operations	67
<b>ITEM 7A</b>	<b>QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK</b>	83
<b>ITEM 8</b>	<b>FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</b>	89
<b>ITEM 9</b>	<b>CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES</b>	131
<b>ITEM 9A</b>	<b>CONTROLS AND PROCEDURES</b>	131
<b>ITEM 9B</b>	<b>OTHER INFORMATION</b>	133
<b><u>PART III</u></b>		
<b>ITEM 10</b>	<b>DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE OF THE REGISTRANT</b>	133
<b>ITEM 11</b>	<b>EXECUTIVE COMPENSATION</b>	133
<b>ITEM 12</b>	<b>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</b>	134
<b>ITEM 13</b>	<b>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE</b>	134
<b>ITEM 14</b>	<b>PRINCIPAL ACCOUNTING FEES AND SERVICES</b>	134
<b><u>PART IV</u></b>		
<b>ITEM 15</b>	<b>EXHIBITS, FINANCIAL STATEMENTS SCHEDULES</b>	134
	<b>SIGNATURES</b>	136

PART I

ITEM 1. BUSINESS

Organization

Bar Harbor Bankshares (the "Company") ("BHB") was incorporated under the laws of the state of Maine on January 19, 1984. At December 31, 2009, the Company had total consolidated assets of \$1.1 billion and total shareholders equity of \$114 million.

The Company has one, wholly-owned first tier operating subsidiary, Bar Harbor Bank & Trust (the "Bank"), a community bank, which offers a wide range of deposit, loan, and related banking products, as well as brokerage services provided through a third-party brokerage arrangement. In addition, the Company offers trust and investment management services through its second tier subsidiary, Bar Harbor Trust Services ("Trust Services"), a Maine chartered non-depository trust company. These products and services are offered to individuals, businesses, not-for-profit organizations and municipalities.

The Company is a bank holding company ("BHC") registered under the Bank Holding Company Act of 1956, as amended (the "BHC Act"), and is subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve System (the "FRB"). The Company is also 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 (the

"Superintendent") of the Maine Bureau of Financial Institutions ("BFI").

#### Bar Harbor Bank & Trust

The Bank, originally founded in 1887, is a Maine financial institution, and its deposits are insured by the Federal Deposit Insurance Corporation (the "FDIC") up to the maximum extent permitted by law. The Bank is subject to the supervision, regulation, and examination of the FDIC and the BFI. It is not a member of the Federal Reserve Bank.

The Bank has twelve (12) branch offices located throughout downeast and midcoast Maine, including its principal office located at 82 Main Street, Bar Harbor. The Bank's offices are located in Hancock, Washington, and Knox Counties, representing the Bank's principal market areas. The Hancock County offices, in addition to Bar Harbor, are located in Blue Hill, Deer Isle, Ellsworth, Northeast Harbor, Somesville, Southwest Harbor, and Winter Harbor. The Washington County offices are located in Milbridge, Machias, and Lubec. The Knox County office is located in Rockland. The Bank delivers its operations and technology support services from its operations center located in Ellsworth, Maine.

The Bank is a retail bank serving individual and business customers, retail establishments and restaurants, seasonal lodging, and a large contingent of retirees. As a coastal bank, it serves the tourism, hospitality, lobstering, fishing, boat building and marine services industries. It also serves Maine's wild blueberry industry through its Hancock and Washington County offices. The Bank operates in a competitive market that includes other community banks, savings institutions, credit unions, and branch offices of statewide and interstate bank holding companies located in the Bank's market area. The Bank continues to be one of the larger independent commercial banks in the state of Maine.

The Bank has a broad deposit base and loss of any one depositor or closely aligned group of depositors would not have a material adverse effect on its business. Historically, the banking business in the Bank's market area has been seasonal, with lower deposits in the winter and spring, and higher deposits in the summer and autumn. These seasonal swings have been fairly predictable and have historically not had a material adverse impact on the Bank or its liquidity position. Approximately 91% of the Bank's deposits are in interest bearing accounts. The Bank has paid, and anticipates that it will continue to pay, competitive interest rates on all of the deposit account products it offers and does not anticipate any material loss of these deposits.

The Bank emphasizes personal service to the community, with a concentration on retail banking. Customers are primarily individuals and small businesses to which the Bank offers a wide variety of products and services.

#### Retail Products and Services

: The Bank offers a variety of consumer financial products and services designed to satisfy the deposit and borrowing needs of its retail customers. The Bank's retail deposit products and services include checking accounts, interest bearing NOW accounts, money market accounts, savings accounts, club accounts, short-term and long-term certificates of deposit, Health Savings Accounts, and Individual Retirement Accounts. Credit products and services include home mortgages, residential construction loans, home equity loans and lines of credit, credit cards, installment loans, and overdraft protection services. The Bank provides secured and unsecured installment loans for new or used automobiles, boats, recreational vehicles, mobile homes and other personal needs. The Bank also offers other customary products and services such as safe deposit box rentals, wire transfers, check collection services, foreign currency exchange, money orders, and U.S. Savings Bonds.

The Bank staffs a customer service center, providing customers with telephone and e-mail responses to their questions and needs. The Bank also offers free banking-by-mail services.

#### Retail Brokerage Services:

The Bank retains Infinex Investments, Inc., ("Infinex") as a full service third-party broker-dealer, conducting business under the assumed business name "Bar Harbor Financial Services." Bar Harbor Financial Services is a branch office of Infinex, an independent registered broker-dealer offering securities and insurance products that is not affiliated with the Company or its subsidiaries. These products are not deposits, are not insured by the FDIC or any other government agency, are not guaranteed by the Bank or any affiliate, and may be subject to investment risk, including possible loss of value.

Bar Harbor Financial Services principally serves the brokerage needs of individuals, from first-time purchasers, to sophisticated investors. It also offers a line of life insurance, annuity, and retirement products, as well as financial planning services. Infinex was formed by a group of member banks, and is reportedly the current largest provider of third party investment and insurance services to banks and their customers in New England. Through Infinex, the Bank is able to take advantage of the expertise, capabilities, and experience of a well-established third-party broker-dealer in a cost effective manner.

#### Electronic Banking Services:

The Bank continues to offer free Internet banking services, including free check images and electronic bill payment, through its dedicated website at [www.BHBT.com](http://www.BHBT.com). Additionally, the Bank offers TeleDirect, an interactive voice response system through which customers can check account balances and activity, as well as initiate money transfers between their accounts. Automated Teller Machines (ATMs) are located at each of the Bank's twelve (12) branch locations, as well as two machines in non-Bank locations. These ATMs access major networks throughout the United States, including Plus, NYCE, and other major ATM and credit card companies. The Bank is also a member of Maine Cash Access, providing customers with surcharge-free access to 217 ATMs throughout the state of Maine. Visa debit cards are also offered, providing customers with free access to their deposit account balances at point of sale locations throughout most of the world.

#### Commercial Products and Services

: The Bank serves the small business market throughout downeast and midcoast Maine. It offers business loans to individuals, partnerships, corporations, and other business entities for capital construction, real estate and equipment financing, working capital, real estate development, and a broad range of other business purposes. Business loans are provided primarily to organizations and sole proprietors in the tourism, hospitality, healthcare, blueberry, boatbuilding, and fishing industries, as well as to other small and mid-size businesses associated with coastal communities. Certain larger loans, which exceed the Bank's lending limits, are written on a participation basis with other financial institutions, whereby the Bank retains only such portions of those loans that are within its lending limits and credit risk tolerances.

The Bank offers a variety of commercial deposit accounts, most notably business checking and tiered money market accounts. These accounts are typically used as operating accounts or short-term savings vehicles. The Bank's cash management services provide business customers with short-term investment opportunities through a cash management sweep program, whereby excess operating funds over established thresholds are swept into overnight securities sold under agreements to repurchase. The Bank also offers *Business On Line Direct* ("**BOLD**") an Internet banking service for businesses. This service allows business clients to view their account histories, print statements, view check images, order stop payments, transfer funds between accounts, transmit Automated Clearing House (ACH) files, and order both domestic and foreign wire transfers. The Bank also offers remote deposit capture, enabling its business customers to deposit checks remotely. Other commercial banking services include merchant credit card processing provided through a third party vendor, night depository, and coin and currency handling.

#### Bar Harbor Trust Services

Trust Services is a Maine chartered non-depository trust company and a wholly-owned subsidiary of the Bank. Trust Services provides a comprehensive array of trust and investment management services to individuals, businesses, not-for-profit organizations, and municipalities of varying asset size.

Trust Services serves as trustee of both living trusts and trusts under wills, including revocable and irrevocable, charitable remainder and testamentary trusts, and in this capacity holds, accounts for and manages financial assets, real estate and special assets. Trust Services offers custody, estate settlement, and fiduciary tax services. Additionally, Trust Services offers employee benefit trust services for which it acts as trustee, custodian, administrator and/or investment advisor, for employee benefit plans and for corporate, self employed, municipal and not-for-profit employers located throughout the Company's market areas.

The staff includes credentialed investment and trust professionals with extensive experience. At December 31, 2009, Trust Services served 766 client accounts, with assets under management and assets held in custody amounting to \$270.1 million and \$15.4 million, respectively.

### Competition

The Company competes principally in downeast and midcoast Maine, which can generally be characterized as rural areas. The Company considers its primary market areas to be in Hancock, Knox, and Washington counties, each in the state of Maine. According to the 2008 Census Bureau Report estimate, the population of these three counties was 53,197, 40,686 and 32,499 respectively, representing a combined population of approximately 126,382. The economies in these three counties are based primarily on tourism, healthcare, fishing, aquaculture, agriculture, and small local businesses, but are also supported by a large contingent of retirees. Major competitors in these market areas include local independent banks, local branches of large regional bank affiliates, thrift institutions, savings and loan institutions, mortgage companies, and credit unions. Other competitors in the Company's primary market area include financing affiliates of consumer durable goods manufacturers, insurance companies, brokerage firms, investment advisors, and other non-bank financial service providers.

Like most financial institutions in the United States, the Company competes with an ever-increasing array of financial service providers. As the national economy moves further towards a concentration of service companies, competitive pressures will mount.

As a bank holding company and state-chartered commercial financial institution, respectively, the Company and the Bank are subject to extensive regulation and supervision, including, in many cases, regulations that limit the type and scope of their activities. The non-bank financial service providers that compete with the Company and the Bank may not be subject to such extensive regulation, supervision, and tax burden. Competition from nationwide banks, as well as local institutions, continues to be aggressive.

The financial services industry is undergoing rapid changes in technology. In addition to improving customer services, effective use of technology increases efficiency and enables financial institutions to reduce costs. Further technological advances are likely to intensify competition by enabling more companies to provide financial resources. Accordingly, the Company's future success will depend in part on its ability to address customer needs by using technology. There is no assurance that the Company will be able to develop new technology-driven products and services or be successful in marketing these products to its customers. Many of the Company's competitors have far greater resources to invest in technology.

The Company has generally been able to compete effectively with other financial institutions by emphasizing quality customer service, making decisions at the local level, maintaining long-term customer relationships, building customer loyalty, and providing products and services designed to address the specific needs of customers; however, no assurance can be given that the Company will continue to be able to compete effectively with other financial institutions in the future.

No material part of the Company's business is dependent upon one, or a few customers, or upon a particular industry segment, the loss of which would have a material adverse impact on the operations of the Company.

#### Management and Employees

The Company has two principal officers: Joseph M. Murphy, President and Chief Executive Officer, and Gerald Shencavitz, Executive Vice President, Chief Financial Officer and Treasurer.

Joseph M. Murphy also serves as President and Chief Executive Officer of the Bank. Gerald Shencavitz also serves as Executive Vice President, Chief Financial Officer, Chief Operating Officer and Treasurer of the Bank, and Chief Financial Officer of Trust Services. Other senior operating positions in the Company include a President of Trust Services, and Senior Vice Presidents in charge of retail banking, business banking, credit administration, operations, human resources and marketing.

As of December 31, 2009, the Bank employed 149 full-time equivalent employees, Trust Services employed 13 full-time equivalent employees, and the holding company employed 3 full-time employees, representing a full-time equivalent complement of 165 employees of the Company.

The Company maintains comprehensive employee benefit programs, which provide health, dental, long-term and short-term disability, and life insurance. All Company employees are eligible for participation in the Bar Harbor Bankshares 401(k) Plan provided they meet minimum age and service requirements. Certain officers and employees of the Company and its subsidiaries also participate in the Company's 2000 Stock Option Plan and/or have incentive bonus compensation plans, supplemental executive retirement agreements and change in control, confidentiality and non-compete agreements.

The Company's management believes that employee relations are good and there are no known disputes between management and employees.

#### Supervision and Regulation

The business in which the Company and its subsidiaries are engaged is subject to extensive supervision, regulation, and examination by various federal and state bank regulatory agencies, including the Federal Reserve Bank (the "FRB"), Federal Deposit Insurance Corporation (the "FDIC"), and the Superintendent of the Maine Bureau of Financial Institutions (the "Superintendent"), as well as other governmental agencies in the states in which the Company and its subsidiaries operate. The supervision, regulation, and examination to which the Company and its subsidiaries are subject are intended primarily to protect depositors and other customers, or are aimed at carrying out broad public policy goals, and are not necessarily for the protection of the shareholders.

Some of the more significant statutory and regulatory provisions applicable to banks and BHCs, to which the Company and its subsidiaries are subject, are described more fully below, together with certain statutory and regulatory matters concerning the Company and its subsidiaries. In response to the deterioration of the financial markets in 2008, comprehensive financial regulatory reform proposals are pending in both the U.S. House of Representatives and the U.S. Senate which may be adopted in whole or in part in 2010. These proposals would restructure the regulatory regime for financial institutions and impose significant additional requirements for banks and bank holding companies. Any change in applicable law or regulation may have a material effect on the Company's business and operations, as well as those of its subsidiaries. The description of these statutory and regulatory provisions does not purport to be complete and is qualified in its entirety by reference to the particular statutory or regulatory provision.

#### Bank Holding Company Act



: As a registered BHC and a Maine financial institution holding company, the Company is subject to regulation under the BHC Act and Maine law and to examination and supervision by the Board of Governors of the FRB and the Superintendent, and is required to file reports with, and provide additional information requested by, the FRB and the Superintendent. The FRB has the authority to issue orders to BHCs to cease and desist from unsound banking practices and violations of conditions imposed by, or violations of agreements with, the FRB. The FRB is also empowered to assess civil money penalties against companies or individuals that violate the BHC Act or orders or regulations thereunder, to order termination of non-banking activities of non-banking subsidiaries of BHCs, and to order termination of ownership and control of a non-banking subsidiary of a BHC.

Under the BHC Act, the Company may not generally engage in activities or acquire more than 5% of any class of voting securities of any company engaged in activities other than banking or activities that are closely related to banking. However, a bank holding company that has elected to be treated as a "financial holding company" may engage in activities that are financial in nature or incidental or complementary to such financial activities, as determined by the FRB alone, or together with the Secretary of the Department of the Treasury. The Company has not elected financial holding company status. Under certain circumstances, the Company may be required to give notice to or seek approval of the FRB before engaging in activities other than banking. In addition, Maine law requires approval by the Superintendent prior to acquisition of more than 5% of the voting shares of a Maine financial institution or any financial institution holding company that controls a Maine financial institution. The Superintendent also must approve acquisition by a Maine financial institution holding company of more than 5% of a financial institution or financial institution holding company domiciled outside of the state of Maine.

#### Bank Holding Company Support of Subsidiary Banks:

Under FRB policy, a bank holding company is expected to act as a source of financial and managerial strength to each of its subsidiaries and to commit resources to their support. This support may be required at times when the bank holding company may not have the resources to provide it. Similarly, under the cross-guarantee provisions of Federal Deposit Insurance Act, as amended, the FDIC can hold any FDIC-insured depository institution liable for any loss suffered or anticipated by the FDIC in connection with (1) the "default" of a commonly controlled FDIC-insured depository institution; or (2) any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution "in danger of default." The Company's bank subsidiary, Bar Harbor Bank & Trust, is an FDIC insured depository institution.

#### Regulatory Capital Requirements

: The FRB and the FDIC have issued substantially similar risk-based and leverage capital guidelines applicable to United States banking organizations. In addition, these regulatory agencies may from time to time require that a banking organization maintain capital above the minimum levels, whether because of its financial condition or actual or anticipated growth.

The FRB risk-based guidelines define a three-tier capital framework. Tier 1 capital includes common shareholders equity and qualifying preferred stock, less goodwill and other adjustments. Tier 2 capital consists of preferred stock not qualifying as Tier 1 capital, mandatory convertible debt, limited amounts of subordinated debt, other qualifying term debt and the allowance for credit losses up to 1.25% of risk-weighted assets. Tier 3 capital includes subordinated debt that is unsecured, fully paid, has an original maturity of at least two years, is not redeemable before maturity without prior approval by the FRB and includes a lock-in clause precluding payment of either interest or principal if the payment would cause the issuing bank's risk-based capital ratio to fall or remain below the required minimum. The sum of Tier 1 and Tier 2 capital less investments in unconsolidated subsidiaries represents qualifying total capital. Risk-based capital ratios are calculated by dividing Tier 1 and total capital by risk-weighted assets. Assets and off-balance sheet exposures are assigned to one of four categories of risk-weights, based primarily on relative credit risk. The minimum Tier 1 capital ratio is 4% and the minimum total capital ratio is 8%. The Company's Tier 1 capital ratio as of December 31, 2009, was 15.34% and its total capital ratio was 17.14%.

The leverage ratio is determined by dividing Tier 1 capital by adjusted average total assets. Although the stated minimum ratio is 100 to 200 basis points above 3%, banking organizations are required to maintain a ratio of at least 5% to be classified as well-capitalized. The Company's leverage ratio as of December 31, 2009 was 10.35%.

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), among other things, identifies five capital categories for insured depository institutions (well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) and requires the federal bank regulatory agencies to implement systems for "prompt corrective action" for insured depository institutions that do not meet minimum capital requirements within such categories. FDICIA imposes progressively more restrictive constraints on operations, management and capital distributions, depending on the category in which an institution is classified. Failure to meet the capital guidelines could also subject a banking institution to capital raising requirements. An "undercapitalized" bank must develop a capital restoration plan and its parent holding company must guarantee that bank's compliance with the plan. The liability of the parent holding company under any such guarantee is limited to the lesser of 5% of the bank's assets at the time it became "undercapitalized" or the amount needed to comply with the plan. Furthermore, in the event of the bankruptcy of the parent holding company, such guarantee would take priority over the parent's general unsecured creditors. In addition, FDICIA requires the various regulatory agencies to prescribe certain non-capital standards for safety and soundness relating generally to operations and management, asset quality and executive compensation, and permits regulatory action against a financial institution that does not meet such standards.

The various regulatory agencies have adopted substantially similar regulations that define the five capital categories identified by FDICIA, using the total risk-based capital, Tier 1 risk-based capital and leverage capital ratios as the relevant capital measures. Such regulations establish various degrees of corrective action to be taken when an institution is considered undercapitalized. Under the regulations, a bank generally shall be deemed to be:

- "well-capitalized" if it has a total risk based capital ratio of 10.0% or greater, has a Tier I risk based capital ratio of 6.0% or more, has a leverage ratio of 5.0% or greater and is not subject to any written agreement, order or capital directive or prompt corrective action directive;
- "adequately capitalized" if it has a total risk based capital ratio of 8.0% or greater, a Tier I risk based capital ratio of 4.0% or more, and a leverage ratio of 4.0% or greater (3.0% under certain circumstances) and does not meet the definition of a "well-capitalized bank;"
- "undercapitalized" if it has a total risk based capital ratio that is less than 8.0%, a Tier I risk based capital ratio that is less than 4.0% or a leverage ratio that is less than 4.0% (3.0% under certain circumstances);
  - "significantly undercapitalized" if it has a total risk based capital ratio that is less than 6.0%, a Tier I risk based capital ratio that is less than 3.0% or a leverage ratio that is less than 3.0%; and
  - "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%.

Regulators also must take into consideration (1) concentrations of credit risk; (2) interest rate risk (when the interest rate sensitivity of an institution's assets does not match the sensitivity of its liabilities or its off-balance-sheet position); and (3) risks from non-traditional activities, as well as an institution's ability to manage those risks, when determining the adequacy of an institution's capital. This evaluation will be made as a part of the institution's regular safety and soundness examination. In addition, the Company, and any bank with significant trading activity, must incorporate a measure for market risk into their regulatory capital calculations. At December 31, 2009, and at the time of this report, the Company's risk-based capital ratio and leverage ratio were well in excess of regulatory requirements, and its management expects these ratios to remain in excess of regulatory requirements. In addition, at December 31, 2009, and at the time of this report the Bank was well in excess of applicable FDIC requirements.

An institution generally must file a written capital restoration plan which meets specified requirements with an appropriate FDIC regional director within 45 days of the date that the institution receives notice or is deemed to have

notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. An institution, which is required to submit a capital restoration plan, must concurrently submit a performance guaranty by each company that controls the institution. A critically undercapitalized institution generally is to be placed in conservatorship or receivership within 90 days unless the FDIC formally determines that forbearance from such action would better protect the deposit insurance fund. Immediately upon becoming undercapitalized, an institution becomes subject to the provisions of Section 38 of the Federal Deposit Insurance Act ("FDIA"), including for example, (i) restricting payment of capital distributions and management fees, (ii) requiring that the FDIC monitor the condition of the institution and its efforts to restore its capital, (iii) requiring submission of a capital restoration plan, (iv) restricting the growth of the institution's assets and (v) requiring prior approval of certain expansion proposals.

The federal banking agencies issued a final rule entitled "Risk Based Capital Standards: Advanced Capital Adequacy Framework-Basel II" ("Basel II") which became effective on April 1, 2008, and "core banks" ("core banks" are the approximately 20 largest U. S. bank holding companies) were required to adopt a board-approved plan to implement Basel II by October 1, 2008. It is possible Basel II may never be put into effect. If implemented, Basel II will result in significant changes to the risk-based capital standards for "core banks" subject to Basel II and other banks that elect to use such rules to calculate their risk-based capital requirements. In connection with Basel II, the Agencies published a joint notice of proposed rulemaking entitled "Risk-Based Capital Guidelines: Capital Adequacy Guidelines: Standardized Framework" on July 29, 2008 (the "Standardized Approach Proposal"). The Standardized Approach Proposal, if adopted by the Agencies, would provide all non-core banks with an optional framework, based upon the standardized approach under the international Basel II Accord, for calculating their risk-based capital requirements. The Bank does not currently expect to calculate its capital ratios under Basel II or in accordance with the Standardized Approach Proposal. Accordingly, the Company is not yet in a position to determine the effect of such rules on its risk capital requirements.

Information concerning the Company and its subsidiaries with respect to capital requirements is incorporated by reference from Part II, Item 7, section entitled "Capital Resources" and from Part II, Item 8, Notes to Consolidated Financial Statements, Note 12 "Shareholders' Equity," each in this Annual Report on Form 10-K for the year ended December 31, 2009.

#### Transactions with Affiliates:

Under Sections 23A and 23B of the FRA and Regulation W thereunder, there are various legal restrictions on the extent to which a bank holding company and its non-bank subsidiaries may borrow, obtain credit from or otherwise engage in "covered transactions" with its FDIC-insured depository institution subsidiaries. Such borrowings and other covered transactions by an insured depository institution subsidiary (and its subsidiaries) with its non-depository institution affiliates are limited to the following amounts:

- in the case of one such affiliate, the aggregate amount of covered transactions of the insured depository institution and its subsidiaries cannot exceed 10% of the capital stock and surplus of the insured depository institution; and
- in the case of all affiliates, the aggregate amount of covered transactions of the insured depository institution and its subsidiaries cannot exceed 20% of the capital stock and surplus of the insured depository institution.

"Covered transactions" are defined by statute for these purposes to include a loan or extension of credit to an affiliate, a purchase of or investment in securities issued by an affiliate, a purchase of assets from an affiliate unless exempted by the FRB, the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any person or company, or the issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate. Covered transactions are also subject to certain collateral security requirements. Further, a bank holding company and its subsidiaries are prohibited from engaging in certain tying arrangements in connection with any extension of credit, lease or sale of property of any kind, or furnishing of any service.

#### Change in Bank Control Act

: The Change in Bank Control Act prohibits a person or group of persons from acquiring "control" of a BHC, unless the FRB has been notified and has not objected to the transaction. Under a rebuttable presumption established by the FRB, the acquisition of 10% or more of a class of voting securities of a BHC with a class of securities registered under section 12 of the Securities Exchange Act of 1934 as amended (the "Exchange Act"), would, under the circumstances set forth in the presumption, constitute acquisition of control of the BHC. In addition, a company is required to obtain the approval of FRB under the BHC Act before acquiring 25% (5% in the case of an acquirer that is a BHC) or more of any class of outstanding voting securities of a BHC, or otherwise obtaining control or a "controlling influence" over that BHC. In September 2008 the FRB released guidance on minority investment in banks which relaxed the presumption of control for investments of greater than 10% of a class of outstanding voting securities of a bank holding company in certain instances discussed in the guidance.

#### Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994

: Riegle-Neal permits adequately or well-capitalized and adequately or well managed bank holding companies, as determined by the FRB, to acquire banks in any state subject to certain concentration limits and other conditions. Riegle-Neal also generally authorizes the interstate merger of banks. In addition, among other things, Riegle-Neal permits banks to establish new branches on an interstate basis provided that the law of the host state specifically authorizes such action. However, as a bank holding company, The Company is required to obtain prior FRB approval before acquiring more than 5% of a class of voting securities, or substantially all of the assets, of a bank holding company, bank or savings association.

#### Declaration of Dividends

: The FRB has authority to prohibit bank holding companies from paying dividends if such payment is deemed to be an unsafe or unsound practice. The FRB has indicated generally that it may be an unsafe or unsound practice for bank holding companies to pay dividends unless the bank holding company's net income over the preceding year is sufficient to fund the dividends and the expected rate of earnings retention is consistent with the organization's capital needs, asset quality and overall financial condition. The Company depends upon dividends received from its subsidiary Bank to fund its activities, including the payment of dividends to shareholders. As described below, FDIC may also regulate the amount of dividends payable by the subsidiary banks. The inability of the Bank to pay dividends may have an adverse effect on the Company.

Under current Maine corporation law, the directors of a corporation may make distributions (including declaration of a dividend) to its shareholders (subject to restriction by the articles of incorporation) unless, after giving effect to the distribution: (1) the corporation's total assets would be less than its total liabilities, with liquidation preferences of any senior preferred shares treated as liabilities (the "balance sheet test"); or (2) the corporation would not be able to pay its debts as they become due in the usual course of business (the "equity solvency test"). In order for a distribution to be lawful under Maine corporate law, it must satisfy both the balance sheet test and equity solvency test. These limitations generally apply to investor owned Maine financial institutions and financial institution holding companies.

#### Limitations on Bank Dividends

: The FDIC has the authority to use its enforcement powers to prohibit a bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice. Federal law also prohibits the payment of dividends by a bank that will result in the bank failing to meet its applicable capital requirements on a pro forma basis.

#### Activities and Investments of Insured State-Chartered Banks:

FDIC insured, state-chartered banks, such as the Bank, are also subject to similar restrictions on their business and activities. Section 24 of the Federal Deposit Insurance Act ("FDIA"), generally limits the activities as principal and equity investments of FDIC insured, state-chartered banks to those activities that are permissible to national banks. In 1999, the FDIC substantially revised its regulations implementing Section 24 of the FDIA to ease the ability of state-chartered banks to engage in certain activities not permissible for national banks, and to expedite FDIC review of bank applications and notices to engage in such activities.

#### Safety and Soundness Standards:

FDICIA, as amended, directs each federal banking agency to prescribe safety and soundness standards for depository institutions relating to internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate risk, asset growth, compensation, asset quality, earnings, and stock valuation. The Community Development and Regulatory Improvement Act of 1994 amended FDICIA by allowing federal banking agencies to publish guidelines rather than regulations covering safety and soundness.

FDICIA also contains a variety of other provisions that may affect the Company's and the Bank's operations, including reporting requirements, regulatory guidelines for real estate lending, "truth in savings" provisions, and the requirement that a depository institution give 90 days prior written notice to customers and regulatory authorities before closing any branch.

#### Community Reinvestment:

The Community Reinvestment Act ("CRA") requires lenders to identify the communities served by the institution's offices and other deposit taking facilities and to make loans and investments and provide services that meet the credit needs of these communities. Regulatory agencies examine each of the banks and rate such institutions' compliance with CRA as "Outstanding," "Satisfactory," "Needs to Improve" or "Substantial Noncompliance." Failure of an institution to receive at least a "Satisfactory" rating could inhibit such institution or its holding company from undertaking certain activities, including engaging in activities newly permitted as a financial holding company under the Gramm-Leach-Bliley Act ("GLBA") and acquisitions of other financial institutions. The FRB must take into account the record of performance of banks in meeting the credit needs of the entire community served, including low- and moderate-income neighborhoods. The Bank has achieved a rating of "Satisfactory" on their respective most recent examination. Maine also has enacted substantially similar community reinvestment requirements.

#### Customer Information Security:

The FDIC and other bank regulatory agencies have adopted final guidelines for establishing standards for safeguarding nonpublic personal information about customers. These guidelines implement provisions of the Gramm-Leach-Bliley Act of 1999 ("GLBA"), which establishes a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers by revising and expanding the BHCA framework. Specifically, the Information Security Guidelines established by the GLBA require each financial institution, under the supervision and ongoing oversight of its Board of Directors or an appropriate committee thereof, to develop, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information, to protect against anticipated threats or hazards to the security or integrity of such information and to protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer. The federal banking regulators have issued guidance for banks on response programs for unauthorized access to customer information. This guidance, among other things, requires notice to be sent to customers whose "sensitive information" has been compromised if unauthorized use of this information is "reasonably possible." A majority of states have enacted legislation concerning breaches of data security and Congress is considering federal legislation that would require consumer notice of data security breaches.

## Consumer Protection Laws

: In connection with its lending activities, the Bank is subject to a number of federal and state laws designed to protect borrowers and promote lending to various sectors of the economy. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Fair and Accurate Credit Transactions Act, the Truth in Lending Act, the Home Mortgage Disclosure Act, and the Real Estate Settlement Procedures Act, and various state law counterparts.

In addition, federal law currently contains extensive customer privacy protection provisions. Under these provisions, a financial institution must provide to its customers, at the inception of the customer relationship and annually thereafter, the institution's policies and procedures regarding the handling of customers' nonpublic personal financial information. These provisions also provide that, except for certain limited exceptions, a financial institution may not provide such personal information to unaffiliated third parties unless the institution discloses to the customer that such information may be so provided and the customer is given the opportunity to opt out of such disclosure. Federal law makes it a criminal offense, except in limited circumstances, to obtain or attempt to obtain customer information of a financial nature by fraudulent or deceptive means.

Effective July 1, 2010, a new federal banking rule under the Electronic Fund Transfer Act will prohibit financial institutions from charging consumers fees for paying overdrafts on automated teller machines ("ATM") and one-time debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those type of transactions. If a consumer does not opt in, any ATM transaction or debit that overdraws the consumer's account will be denied. Overdrafts on the payment of checks and regular electronic bill payments are not covered by this new rule. Before opting in, the consumer must be provided a notice that explains the financial institution's overdraft services, including the fees associated with the service, and the consumer's choices. Financial institutions must provide consumers who do not opt in with the same account terms, conditions and features (including pricing) that they provide to consumers who do opt in. The Bank has not in the past charged its customers for paying overdrafts on ATM transactions and one-time debit card transactions.

In 2009, the Maine legislature enacted, "An Act to Preserve Home Ownership and Stabilize the Economy by Preventing Unnecessary Foreclosures." This new state law provides for mediation of foreclosures of residential mortgages beginning January 1, 2010. Under the new law, borrowers may choose mediation at which the parties must attend and evaluate foreclosure alternatives in good faith. The new law also provides that issues such as reinstatement of the mortgage, modification of the loan and restructuring of the mortgage debt are to be addressed at these mediations. Maine's new residential foreclosure law also requires that leasehold tenants be informed when a foreclosure judgment is issued against a landlord property owner.

### Truth in Lending Act:

In July 2008 and effective October 1, 2009, the Federal Reserve Board issued final rules amending Regulation Z, which implements the Truth in Lending Act ("TILA"). Final rules adopted new protections for consumer mortgage loans, including several provisions that address recent problems in the sub-prime mortgage market. Among other things, the rules added four key protections for a newly defined category of "higher-priced mortgage loans" secured by a consumer's principal dwelling. For loans in this category, these protections will: (i) prohibit a lender from making a loan without regard to borrowers' ability to repay the loan from income and assets other than the home's value. A lender complies, in part, by assessing repayment ability based on the highest scheduled payment in the first seven years of the loan. To show that a lender violated this prohibition, a borrower does not need to demonstrate that it is part of a "pattern or practice"; (ii) require creditors to verify the income and assets they rely upon to determine repayment ability; (iii) ban any prepayment penalty if the payment can change in the initial four years. For other higher-priced loans, a prepayment penalty period cannot last for more than two years; (iv) require creditors to establish escrow accounts for property taxes and homeowner's insurance for all first-lien mortgage loans.

In addition to the rules governing higher-priced loans, the rules adopted the following protections for loans secured by a consumer's principal dwelling, regardless of whether the loan is higher-priced: (i) creditors and mortgage brokers are prohibited from coercing a real estate appraiser to misstate a home's value. (ii) companies that service mortgage loans are prohibited from engaging in certain practices, such as pyramiding late fees; (iii) mortgage loan servicers are required to credit consumers' loan payments as of the date of receipt and provide a payoff statement within a reasonable time of request.

The rule's definition of "higher-priced mortgage loans" will capture virtually all loans in the sub-prime market, but generally exclude loans in the prime market. To provide an index, the Federal Reserve Board will publish the "average prime offer rate," based on a survey currently published by Freddie Mac. A loan is higher-priced if it is a first-lien mortgage and has an annual percentage rate that is 1.5 percentage points or more above this index, or 3.5 percentage points if it is a subordinate-lien mortgage.

#### USA Patriot Act:

The USA Patriot Act of 2001 (the "Patriot Act"), designed to deny terrorists and others the ability to obtain anonymous access to the U.S. financial system, has significant implications for depository institutions, broker-dealers and other businesses involved in the transfer of money. The Patriot Act, together with the implementing regulations of various federal regulatory agencies, has caused financial institutions, including the Bank and Trust Services, to adopt and implement additional or amend existing policies and procedures with respect to, among other things, anti-money laundering compliance, suspicious activity and currency transaction reporting, customer identity verification and customer risk analysis. The statute and its underlying regulations also permit information sharing for counter-terrorist purposes between federal law enforcement agencies and financial institutions, as well as among financial institutions, subject to certain conditions. It also requires the Federal Reserve Board (and other federal banking agencies) to evaluate the effectiveness of an applicant in combating money-laundering activities when considering applications filed under Section 3 of the BHC Act, or under the Bank Merger Act. In 2006, final regulations under the USA Patriot Act were issued requiring financial institutions, including the Bank, to take additional steps to monitor their correspondent banking and private banking relationships as well as their relationships with "shell banks."

#### Identity Theft Red Flags

: The federal banking agencies (the "Agencies") jointly issued final rules and guidelines in November 2007, implementing section 114 of the Fair and Accurate Credit Transactions Act of 2003 ("FACT Act") and final rules implementing section 315 of the FACT Act. The rules implementing section 114 require each financial institution or creditor to develop and implement a written Identity Theft Prevention Program (the "Program") to detect, prevent, and mitigate identity theft in connection with the opening of certain accounts or certain existing accounts. In addition, the Agencies issued guidelines to assist financial institutions and creditors in the formulation and maintenance of a Program that satisfies the requirements of the rules. The rules implementing section 114 also require credit and debit card issuers to assess the validity of notifications of changes of address under certain circumstances. Additionally, the Agencies are issuing joint rules under section 315 that provide guidance regarding reasonable policies and procedures that a user of consumer reports must employ when a consumer reporting agency sends the user a notice of address discrepancy. The joint final rules and guidelines were effective January 1, 2008. The mandatory compliance date for this rule was November 1, 2008. Management believes the Company is in compliance with all of the requirements prescribed by the FACT Act and all applicable final implementing rules.

#### Insurance of Accounts and FDIC Regulation:

As an institution with deposits insured by the FDIC, the Bank is subject to FDIC deposit insurance assessments. The Bank pays deposit insurance premiums to the FDIC based on an assessment rate established by the FDIC. In 2006, the FDIC enacted various rules to implement the provisions of the Federal Deposit Insurance Reform Act of 2005 (the "FDI Reform Act"). Pursuant to the FDI Reform Act, in 2006 the FDIC merged the Bank Insurance Fund with the

Savings Association Insurance Fund to create a newly named Deposit Insurance Fund (the "DIF") that covers both banks and savings associations. Under the provisions of the FDI Reform Act, the regular insurance assessments to be paid by insured institutions are specified in schedules issued by the FDIC that specify a target reserve ratio designed to maintain that ratio between 1.15% and 1.50% of estimated insured deposits.

Under the FDI Reform Act, the FDIC imposed deposit insurance assessments based on one of four assessment categories depending on an institution's capital classification under the prompt corrective action provisions described above and an institution's long-term debt issuer ratings. The adjusted assessment rates for insured institutions under the modified system range from 5 to 43 basis points of assessable deposits depending upon the assessment category into which the insured institution is placed. The annual assessment rate for the Bank during 2008 was 7 basis points.

In December 2008, the FDIC approved a final rule on deposit assessment rates for the first quarter of 2009. The rule raised assessment rates uniformly by 7 basis points (annually) for the first quarter of 2009 only. On February 27, 2009, the FDIC adopted a final rule modifying the risk-based assessment system and setting initial base assessment rates beginning April 1, 2009 and an interim final rule imposing a special assessment on each insured depository institution to increase the DIF reserve ratio. The final rule revising the FDIC risk-based assessment system, which was first proposed in October 2008, adjusted the risk-based calculation for an institution's unsecured debt, secured liabilities and brokered deposits. The revisions effectively result in a range of possible assessments under the risk-based system of 7 to 77.5 basis points of assessable deposits. The basic assessments for Risk Category I, applicable to the least risky institutions, including the Bank, range from 12 to 16 basis points, but can be adjusted to 7 to 24 basis points under the revised system. The total 2009 annual assessment rate for the Bank amounted to 12 basis points. The FDIC's interim final rule proposing the emergency assessment contemplated a 20 basis point assessment on each insured depository institution's insured deposits as of June 30, 2009 and collected on September 30, 2009.

On May 22, 2009, the FDIC adopted a final rule reducing the amount of the proposed emergency assessment and imposed a 5 basis point special assessment on each insured depository institution's assets minus Tier 1 capital as of June 30, 2009. The amount of the special assessment for any institution could not exceed 10 basis points times the institution's assessment base for the second quarter of 2009. The Bank's special assessment amounted to \$492,126 and was collected on September 30, 2009.

On September 29, 2009, the FDIC proposed a rule that was subsequently adopted in final form by the FDIC board of directors on November 12, 2009 that required insured depository institutions to prepay their quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012, on December 30, 2009, along with each institution's risk-based deposit insurance assessment for the third quarter of 2009. For purposes of calculating the amount to prepay, the FDIC required that institutions use their total base assessment rate in effect on September 30, 2009 and increase that assessment base quarterly at a 5 percent annual growth rate through the end of 2012. On September 29, 2009, the FDIC also increased annual assessment rates uniformly by 3 basis points beginning in 2011 such that an institution's assessment for 2011 and 2012 would be increased by an annualized 3 basis points. The Bank's prepayment for 2010, 2011 and 2012 amounted to \$3,791,550, of which \$3,550,596 represented the prepayment for 2010, 2011, and 2012.

Incremental to insurance fund assessments, the FDIC assesses deposits to fund the repayment of debt obligations of the Financing Corporation ("FICO"). FICO is a government agency-sponsored entity that was formed to borrow the money necessary to carry out the closing and ultimate disposition of failed thrift institutions by the Resolution Trust Corporation. The current annualized rate established by the FDIC is 1.06 basis points. The Bank's 2009 FICO assessment amounted to \$64,191.

#### Regulatory Enforcement Authority:

The enforcement powers available to federal banking regulators include, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to initiate injunctive actions against banking



organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities. Under certain circumstances, federal and state law requires public disclosure and reports of certain criminal offenses and also final enforcement actions by the federal banking agencies.

**Securities Regulation:**

The common stock of the Company is registered with the U. S. Securities and Exchange Commission ("SEC") under Section 12(g) of the Securities Exchange Act of 1934, as amended. Accordingly, the Company is subject to the information, proxy solicitation, insider trading restrictions and other requirements of the Act.

**Temporary Liquidity Guarantee Program:**

Following a systemic risk determination pursuant to the FDI Reform Act, the FDIC announced a Temporary Liquidity Guarantee Program ("TLGP"), which temporarily guarantees the senior debt of all FDIC-insured institutions and certain holding companies, as well as deposits in traditional noninterest-bearing deposit transaction accounts, including certain types of attorney trust accounts, and NOW accounts as long as the interest rate does not exceed 0.50%. The TLGP was available to those institutions and holding companies that did not elect to opt out of the TLGP by December 5, 2008. The Bank chose to continue its participation in the TLGP and, thus, did not opt out.

Since October 2008, the Bank has participated in the Transaction Account Guarantee ("TAG") component of the TLGP. Under this program, all noninterest-bearing transaction accounts (including certain types of attorney trust accounts, and NOW accounts as long as the interest rate does not exceed 0.50%) were fully guaranteed by the FDIC for the entire amount in the account through December 31, 2009. Coverage under the TAG was available for the first 30 days without charge and a 10 basis point surcharge was applied to the current assessment rate for the Bank thereafter on amounts in covered accounts exceeding \$250,000. Coverage under this program is in addition to, and separate from, the coverage available under the FDIC's general deposit insurance rules that currently insure up to at least \$250,000 per depositor through December 31, 2013, after which the standard insurance amount will return to \$100,000 per depositor for all account categories except for certain retirement accounts that will remain at \$250,000 per depositor.

On August 26, 2009, the FDIC extended the TAG for an additional six months for those insured depository institutions that elected to continue in the program. The Bank elected to continue in the TAG through June 30, 2010, when the program will end. The surcharge for coverage in the program after December 31, 2009 was raised to 15 basis points based upon the Bank being assigned the lowest risk category by the FDIC under its risk-based premium system. Pursuant to the terms of the TAG, after June 30, 2010 funds held by the Bank in noninterest-bearing transaction accounts will no longer be guaranteed in full, but will be insured under the FDIC's general deposit insurance rules.

***The Emergency Economic Stabilization Act of 2008; American Recovery and Reinvestment Act of 2009:*** In the third quarter of 2008, the Federal Reserve, the U.S. Treasury and the FDIC initiated measures to stabilize the financial markets and to provide liquidity for financial institutions. The Emergency Economic Stabilization Act of 2008 ("EESA") was signed into law on October 3, 2008 and authorized the U.S. Treasury to provide funds to be used to restore liquidity and stability to the U.S. financial system pursuant to the Troubled Asset Relief Program ("TARP"). Under the authority of EESA, the U.S. Treasury instituted a voluntary capital purchase program ("CPP") under TARP to encourage healthy U.S. financial institutions to build capital to increase the flow of financing to U.S. businesses and consumers and to support the U.S. economy. Under the CPP program, the U.S. Treasury purchased senior preferred shares of financial institutions which pay cumulative dividends at a rate of 5% per year for five years and thereafter at a rate of 9% per year. The minimum subscription amount available to a participating institution was one percent of total risk-weighted assets. In general, the maximum subscription amount was three percent of risk-weighted assets.

The terms of the senior preferred shares, as amended by the American Recovery and Reinvestment Act of 2009 ("ARRA"), provide that the shares may be redeemed, in whole or in part, at par value plus accrued and unpaid dividends upon approval of the U.S. Treasury and the participating institution's primary banking regulators. The senior preferred shares are non-voting and qualify as Tier 1 capital for regulatory reporting purposes.

On January 16, 2009, as part of the CPP established by the Treasury under the EESA, the Company sold to Treasury (i) 18,751 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A, no par value, having a liquidation preference of one thousand dollars per share; and (ii) a ten-year warrant to purchase up to 104,910 shares of the Company's common stock, par value two dollars per share at an initial exercise price of \$26.81 per share (the "Warrant"), for an aggregate purchase price of \$18,751,000 in cash. All of the proceeds from the sale were treated as Tier 1 capital for regulatory purposes. The investment in the Company by Treasury through the CPP increased the Company's and the Bank's already strong Tier 1 Leverage, Tier 1 Risk-based and Total Risk-based capital ratios by approximately 200, 300, and 300 basis points, respectively.

On December 21, 2009, the Company completed its offering of 800,000 shares of common stock to the public at \$27.50 per share. The net proceeds from this offering, after deducting underwriting discounts and estimated expenses amounted to \$20,412,000. As a result of the successful completion of this common stock offering, the number of shares of the Company's common stock subject to the Warrant sold to the Treasury was subsequently reduced by one half to 52,455 shares.

On January 20, 2010 the Company completed the closing of the underwriter's exercise of its over-allotment option to purchase an additional 82,021 shares of the Company's common stock at a purchase price to the public of \$27.50 per share. The Company received total net proceeds from the offering, including the exercise of the over-allotment option, after deducting underwriting discounts and expenses, amounting to \$22,442,000.

On February 24, 2010, the Company redeemed all 18,751 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A, it sold to the Treasury as part of the CPP. The Company paid \$18,774,439 to the Treasury to redeem the Preferred Stock, consisting of \$18,751,000 of principal and \$23,439 of accrued and unpaid dividends. The Company and the Bank received approvals from their respective regulators to redeem the Preferred Stock. The Company's redemption of the Preferred Stock is not subject to any additional conditions or stipulations from the Treasury or the Company's and the Bank's principal regulators.

The Company intends to seek agreement with the Treasury to repurchase the Warrant at its fair market value. However, there can be no assurance that the Company will reach agreement with the Treasury as to a fair market value of the Warrant, or that the Company will repurchase the Warrant.

#### Sarbanes-Oxley Act of 2002:

The Sarbanes-Oxley Act of 2002 implemented a broad range of corporate governance, accounting and reporting measures for companies that have securities registered under the Exchange Act, including publicly-held bank holding companies such as the Company. Specifically, the Sarbanes-Oxley Act of 2002 and the various regulations promulgated thereunder, established, among other things: (i) requirements for audit committees, including independence, expertise, and responsibilities; (ii) responsibilities regarding financial statements for the Chief Executive Officer and Chief Financial Officer of the reporting company; (iii) the forfeiture of bonuses or other incentive-based compensation and profits from the sale of the reporting company's securities by the Chief Executive Officer and Chief Financial Officer in the twelve-month period following the initial publication of any financial statements that later require restatement; (iv) the creation of an independent accounting oversight board; (v) standards for auditors and regulation of audits, including independence provisions that restrict non-audit services that accountants may provide to their audit clients; (vi) disclosure and reporting obligations for the reporting company and their directors and executive officers, including accelerated reporting of stock transactions and a prohibition on trading during pension blackout periods; (vii) a prohibition on personal loans to directors and officers, except certain loans

made by insured financial institutions on non-preferential terms and in compliance with other bank regulatory requirements; and (viii) a range of civil and criminal penalties for fraud and other violations of the securities laws.

#### Taxation:

The Company is subject to those rules of federal income taxation generally applicable to corporations under the Internal Revenue Code. The Company is also subject to state taxation under the laws of the state of Maine.

#### Governmental Policies:

The earnings of the Company are significantly affected by the monetary and fiscal policies of governmental authorities, including the Federal Reserve Board. Among the instruments of monetary policy used by the Federal Reserve Board to implement these objectives are open-market operations in U.S. Government securities and federal funds, changes in the discount rate on member bank borrowings and changes in reserve requirements against member bank deposits. These instruments of monetary policy are used in varying combinations to influence the overall level of bank loans, investments and deposits, and the interest rates charged on loans and paid for deposits. The Federal Reserve Board frequently uses these instruments of monetary policy, especially its open-market operations and the discount rate, to influence the level of interest rates and to affect the strength of the economy, the level of inflation or the price of the dollar in foreign exchange markets. The monetary policies of the Federal Reserve Board have had a significant effect on the operating results of banking institutions in the past and are expected to continue to do so in the future. It is not possible to predict the nature of future changes in monetary and fiscal policies, or the effect which they may have on the Company's business and earnings.

***Other Legislative Initiatives:*** Proposals may be introduced in the United States Congress and in the Maine State Legislature and before various bank regulatory authorities which would alter the powers of, and restrictions on, different types of banking organizations and which would restructure part or all of the existing regulatory framework for banks, bank holding companies and other providers of financial services. Moreover, other bills may be introduced in Congress which would further regulate, deregulate or restructure the financial services industry, including proposals to substantially reform the regulatory framework. It cannot be predicted what additional legislative and/or regulatory proposals, if any, will be considered in the future, whether any such proposals will be adopted or, if adopted, how any such proposals would affect the Company or the Bank.

#### Financial Information about Industry Segments

The information required under this item is included in the Company's financial statements, which appear in Part II, Item 8 of this Annual Report on Form 10-K, and is incorporated herein by cross reference thereto.

#### Availability of Information – Company Website

The Company maintains a website on the Internet at [www.bhbt.com](http://www.bhbt.com). The Company makes available, free of charge, on its website its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K (proxy materials), and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission the ("SEC"). The Company's reports filed with, or furnished to, the SEC are also available at the SEC's website at [www.sec.gov](http://www.sec.gov). Information contained on the Company's website does not constitute a part of this report.

## ITEM 1A. RISK FACTORS

### Risks Related to the Company

In its normal course of business, the Company is subject to many risks and uncertainties inherent with providing banking and financial services. Although the Company continually seeks ways to manage these risks, and has established programs and procedures to ensure controls are in place and operating effectively, the Company ultimately cannot predict the future. Actual results may differ materially from the Company's expectations due to certain risks and uncertainties. The following discussion sets forth the most significant risk factors that the Company believes could cause its actual future results to differ materially from expected results.

The risks and uncertainties discussed below are not all inclusive. Additional risks and uncertainties that the Company is unaware of, or that it currently deems immaterial, may also become important factors relating to the Company's future operating results and financial condition.

Difficult market conditions have adversely affected the banking and financial services industry.

Dramatic declines in the national housing market since 2008, with falling home prices and increasing foreclosures, unemployment and under-employment, have negatively impacted the credit performance of mortgage loans and resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities as well as major commercial and investment banks. These write-downs, initially of mortgage-backed securities but spreading to credit default swaps and other derivative and cash securities, in turn, have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail. Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced or ceased providing funding to borrowers, including to other financial institutions. This market turmoil and tightening of credit have led to an increased level of commercial and consumer delinquencies, lack of consumer confidence, increased market volatility and widespread reduction of business activity generally. The resulting economic pressure on consumers and lack of confidence in the financial markets could adversely affect the Company's business, financial condition and results of operations. In particular, the Company may face the following risks in connection with these events:

- The Company expects to face increased regulation of the banking and financial services industry. Compliance with such regulation may increase the Company's costs and limit its ability to pursue business opportunities.
- Market developments may affect customer confidence levels and may cause increases in loan delinquencies and default rates, which the Company expects could impact the Bank's charge-offs and provision for loan losses.
- Market developments may affect the Bank's securities portfolio by causing other-than-temporary impairments, prompting write-downs and securities losses.
- The Company's and the Bank's ability to borrow from other financial institutions or to access the debt or equity capital markets on favorable terms or at all could be adversely affected by further disruptions in the capital markets or other events, including actions by rating agencies and deteriorating investor expectations.
- Competition in banking and financial services industry could intensify as a result of the increasing consolidation of financial services companies in connection with current market conditions.
- The Bank may be required to pay significantly higher premiums to the Federal Deposit Insurance Corporation (the "FDIC") because market developments have significantly depleted the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits.

The Bank's allowance for loan losses may not be adequate to cover loan losses.

A significant source of risk for the Company arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loan agreements. Most loans originated by the Bank are secured, but some loans are unsecured based upon management's evaluation of the creditworthiness of the borrowers. With respect to secured loans, the collateral securing the repayment of these loans principally includes a wide variety of real estate, and to a lesser extent personal property, either of which may be insufficient to cover the obligations owed under such loans.

Collateral values and the financial performance of borrowers may be adversely affected by changes in prevailing economic, environmental and other conditions, including declines in the value of real estate, changes in interest rates and debt service levels, changes in oil and gas prices, changes in monetary and fiscal policies of the federal government, widespread disease, terrorist activity, environmental contamination and other external events, which are beyond the control of the Bank. In addition, collateral appraisals that are out of date or that do not meet industry recognized standards might create the impression that a loan is adequately collateralized when in fact it is not. Although the Bank may acquire any real estate or other assets that secure defaulted loans through foreclosures or other similar remedies, the amounts owed under the defaulted loans may exceed the value of the assets acquired.

The Bank has adopted underwriting and credit monitoring policies and procedures, including the establishment and ongoing review of the allowance for loan losses and review of borrower financial statements and collateral appraisals, which management believes are appropriate to mitigate the risk of loss by assessing the likelihood of borrower non-performance and the value of available collateral. The Bank also manages credit risk by diversifying its loan portfolio. An ongoing independent review, subsequent to management's review, of individual credits is performed by an independent loan review function, which reports to the Audit Committee of the Board of Directors. However, such policies and procedures have limitations, including judgment errors in management's risk analysis, and may not prevent unexpected losses that could have a material adverse effect on the Company's business, financial condition and results of operations.

The Bank's loans are principally concentrated in certain areas of Maine and adverse economic conditions in those markets could adversely affect the Company's operations.

The Company's success is dependent to a significant extent upon general economic conditions in the United States and, in particular, the local economies of downeast and midcoast Maine, the primary markets served by the Bank. The Bank is particularly exposed to real estate and economic factors in the downeast and midcoast areas of Maine, as most of its loan portfolio is concentrated among borrowers in these markets. Furthermore, because a substantial portion of the Bank's loan portfolio is secured by real estate in these areas, the value of the associated collateral is also subject to regional real estate market conditions.

A continuing or deepening economic recession in the markets served by the Bank, and the nation as a whole, could negatively impact household and corporate incomes. This impact could lead to decreased loan demand and increase the number of borrowers who fail to pay the Bank interest or principal on their loans, and accordingly, could have a material adverse effect on the Company's business, financial condition, results of operations, or liquidity.

Federal and state governments could pass legislation responsive to current credit conditions, which could cause the Bank to experience higher credit losses.

The Company could experience higher credit losses because of federal or state legislation or regulatory action that reduces the amount the Bank's borrowers are otherwise contractually required to pay under existing loan contracts. Also, the Company could experience higher credit losses because of federal or state legislation or regulatory action that limits the Bank's ability to foreclose on property or other collateral or makes foreclosure less economically feasible.

Interest rate volatility could significantly reduce the Company's profitability.

The Company's earnings largely depend on the relationship between the yield on its earning assets, primarily loans and investment securities, and the cost of funds, primarily deposits and borrowings. This relationship, commonly known as the net interest margin, is susceptible to significant fluctuation and is affected by economic and competitive factors that influence the yields and rates, and the volume and mix of the Bank's interest earning assets and interest bearing liabilities.

Interest rate risk can be defined as an exposure to movement in interest rates that could have an adverse impact on the Bank's net interest income. Interest rate risk arises from the imbalance in the re-pricing, maturity and/or cash flow characteristics of assets and liabilities. The Company is subject to interest rate risk to the degree that its interest bearing liabilities re-price or mature more slowly or more rapidly or on a different basis than its interest earning assets. Significant fluctuations in interest rates could have a material adverse impact on the Company's business, financial condition, results of operations, or liquidity.

The Bank's interest rate risk measurement and management techniques incorporate the re-pricing and cash flow attributes of its balance sheet and off-balance sheet instruments as they relate to current and potential changes in interest rates. The level of interest rate risk, measured in terms of the potential future effect on net interest income, is determined through the use of modeling and other techniques under multiple interest rate scenarios. Management's objectives are to measure, monitor and develop strategies in response to the interest rate risk profile inherent in the Bank's balance sheet, in order to preserve the sensitivity of net interest income to actual or potential changes in interest rates.

The Company is exposed to a variety of operational risks that could result in significant financial losses.

The Company is exposed to many types of operational risk, including reputation risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems.

Negative public opinion can result from the Company's actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions, and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect the Company's ability to attract and keep customers and can expose it to litigation and regulatory action.

Given the volume of transactions at the Company, certain errors may be repeated or compounded before they are discovered and successfully rectified. The Company's necessary dependence upon automated systems to record and process its transaction volumes may further increase the risk that technical system flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. The Company may also be subject to disruptions of its operating systems arising from events that are wholly or partially beyond its control (for example, computer viruses or electrical telecommunication outages), which may give rise to disruption of service to customers and to financial loss or liability. The Company is further exposed to the risk that its external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as is the Company) and to the risk that the Company's (or its vendors') business continuity and data security systems prove to be inadequate.

The Company regularly assesses the level of operational risk throughout the organization and has established systems of internal controls that provide for timely and accurate information. Testing of the operating effectiveness of these control systems is performed regularly. While not providing absolute assurance, these systems of internal controls have been designed to manage operational risks at appropriate, cost-effective levels. Procedures exist that are designed to ensure policies relating to conduct, ethics, and business practices are followed. From time to time losses from operational risk may occur, including the effects of operational errors. Such losses are recorded as non-interest expense.

While the Company continually monitors and improves its system of internal controls, data processing systems, and corporate-wide risk management processes and procedures, there can be no assurances that future losses arising from operational risk will not occur and have a material impact on the Company's business, financial condition, results of operations, or liquidity.

The Company may not be able to meet its cash flow needs on a timely basis at a reasonable cost, and its cost of funds for banking operations may significantly increase as a result of general economic conditions, interest rates and competitive pressures.

Liquidity is the ability to meet cash flow needs on a timely basis and at a reasonable cost. The liquidity of the Bank is used to make loans and to repay deposit and borrowing liabilities as they become due, or are demanded by customers and creditors. Many factors affect the Bank's ability to meet liquidity needs, including variations in the markets served by its network of offices, its mix of assets and liabilities, reputation and standing in the marketplace, and general economic conditions.

The Bank's primary source of funding is retail deposits, gathered throughout its network of twelve banking offices. Wholesale funding sources principally consist of secured borrowing lines from the Federal Home Loan Bank of Boston of which it is a member, secured borrowing lines from the Federal Reserve Bank of Boston, and brokered certificates of deposit obtained from the national market. The Bank's securities and loan portfolios provide a source of contingent liquidity that could be accessed in a reasonable time period through sales.

Significant changes in general economic conditions, market interest rates, competitive pressures or otherwise, could cause the Bank's deposits to decrease relative to overall banking operations, and it would have to rely more heavily on brokered funds and borrowings in the future, which are typically more expensive than deposits.

The Bank actively manages its liquidity position through target ratios established under its Asset Liability Management Policy. Continual monitoring of these ratios, both historical and through forecasts under multiple rate scenarios, allows the Bank to employ strategies necessary to maintain adequate liquidity.

Changes in economic conditions, including consumer savings habits and availability or access to the brokered deposit market could potentially have a significant impact on the Company's liquidity position, which in turn could materially impact its financial condition, results of operations and cash flows. For further information about the Company's liquidity position, refer below in this Report to Part II, Item 7, "Liquidity Risk."

Declines in value may adversely impact the investment securities portfolio.

The Bank may be required to record other-than-temporary impairment charges on its investment securities if they suffer a decline in value that is considered other-than-temporary. Numerous factors, including collateral deterioration underlying certain private label mortgage-backed securities, lack of liquidity for re-sales of certain investment securities, absence of reliable pricing information for certain investment securities, adverse changes in business climate, adverse actions by regulators, or unanticipated changes in the competitive environment could have a negative effect the Bank's securities portfolio in future periods. An other-than-temporary impairment charge could have a material adverse effect on the Company's results of operations and financial condition

A substantial decline in the value of the Bank's Federal Home Loan Bank ("FHLB") of Boston common stock may adversely affect the Company's results of operations, liquidity and financial condition.

As a requirement of membership in the FHLB of Boston, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. Borrowings from the FHLB represent the Bank's primary source of short-term and long-term wholesale funding.

Recent published reports indicate that certain member banks ("branches") of the FHLB system may be subject to accounting rules and asset quality risks that could result in materially lower regulatory capital levels. In an extreme situation, it is possible that the capitalization of a FHLB, including FHLB of Boston, could be substantially

diminished or reduced to zero. Consequently, given that there is no market for the Bank's FHLB of Boston common stock, Company management believes that there is a risk that its investment could be deemed other than temporarily impaired at some time in the future. If this occurs, it may adversely affect the Company's results of operations and financial condition.

In addition, if the capitalization of FHLB of Boston is substantially diminished, the Bank's liquidity may be adversely impaired if it is not able to obtain alternative sources of funding.

The Company's information technology systems may be vulnerable to attack or other technological failures, exposing the Company to significant loss.

The Company depends upon data processing software, communication and information exchange on a variety of computing platforms and networks including the Internet. Despite instituted safeguards, the Company cannot be certain that all of its systems are entirely free from vulnerability to electronic attack or other technological difficulties or failures. The Company also relies on the services of a variety of third party vendors to meet its data processing and communication needs. If information security is breached or other technology difficulties or failures occur, information may be misappropriated, services and operations may be interrupted and the Company could be exposed to claims from customers, suffer loss of business and suffer loss of reputation in its marketplace. Any of these results could have a material adverse effect on the Company's business, financial condition, results of operations or liquidity.

Strong competition within the Company's markets may significantly impact its profitability.

The Company competes with an ever-increasing array of financial service providers. As a bank holding company and state-chartered financial institution, respectively, the Company and the Bank are subject to extensive regulation and supervision, including, in many cases, regulations that limit the type and scope of their activities. The non-bank financial service providers that compete with the Company and the Bank may not be subject to such extensive regulation, supervision, and tax burden. Competition from nationwide banks, as well as local institutions, continues to mount in the Company's markets.

The financial services industry is undergoing rapid changes in technology. In addition to improving customer services, effective use of technology increases efficiency and enables financial institutions to reduce costs. Furthermore, technological advances are likely to intensify competition by enabling more companies to provide financial resources. Accordingly, the Company's future success will depend in part on its ability to address customer needs by using technology. There is no assurance that the Company will be able to develop new technology driven products and services, or be successful in marketing these products to its customers. Many of the Company's competitors have far greater resources to invest in technology.

Regional, national and international competitors have far greater assets and capitalization than the Company and have greater access to capital markets and can offer a broader array of financial services than the Company.

No assurance can be given that the Company will continue to be able to compete effectively with other financial institutions in the future. Furthermore, developments increasing the nature or level of competition could have a material adverse affect on the Company's business, financial condition, results of operations, or liquidity. For further information on competition, refer to Part I, Item 1, "Competition" and "Supervision and Regulation."

The business of the Company and the Bank is highly regulated and impacted by monetary policy, limiting the manner in which the Company and the Bank may conduct its business and obtain financing.

The Company and the Bank are subject to extensive regulation and supervision under federal and state laws and regulations. The restrictions imposed by such laws and regulations limit the manner in which the Company and the Bank conducts its business, undertakes new investments and activities, and obtains financing. These laws and



regulations are designed primarily for the protection of the deposit insurance funds and consumers and not to benefit the Company's shareholders. These laws and regulations may sometimes impose significant limitations on the Company's operations. The more significant federal and state banking regulations that affect the Company and the Bank are described in this report at Part I, Item 1, "Supervision and Regulation." These regulations, along with the existing tax, accounting, securities, insurance, and monetary laws, regulations, rules, standards, policies and interpretations control the methods by which financial institutions conduct business, implement strategic initiatives and tax compliance, and govern financial reporting and disclosures. These laws, regulations, rules, standards, policies and interpretations are constantly evolving and may change significantly over time.

The nature, extent, and timing of the adoption of significant new laws and regulations, or changes in or repeal of existing laws and regulations, or specific actions of regulators, could have a material adverse effect on the Company's business, financial condition, results of operations or liquidity. Furthermore, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects credit risk and interest rate risk conditions for the Company, and any unfavorable change in these conditions could have a material adverse effect on the Company's business, financial condition, results of operations or liquidity.

The preparation of the Company's financial statements requires the use of estimates that could significantly vary from actual results.

The preparation of the consolidated financial statements in conformity with U. S. generally accepted accounting principles requires management to make significant estimates that affect the financial statements. The most critical estimate is the allowance for loan losses. Due to the inherent nature of estimates, the Company cannot provide absolute assurance that it will not significantly increase the allowance for loan losses and/or sustain credit losses that are significantly higher than the provided allowance, which could have a material adverse effect on the Company's business, financial condition, results of operations, or liquidity. For further information on the use of estimates, refer to this report at Part II, Item 7, "Application of Critical Accounting Policies."

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

None

#### ITEM 2. PROPERTIES

The Company's headquarters are located at 82 Main Street, Bar Harbor, Maine, which also serves as the main office for the Bank.

As of December 31, 2009, the Bank operated 12 full-service banking offices throughout downeast and midcoast Maine; namely: Bar Harbor, Northeast Harbor, Southwest Harbor, Somesville, Deer Isle, Blue Hill, Ellsworth, Rockland, Winter Harbor, Milbridge, Machias, and Lubec. The Bank owns eleven of these banking offices and leases one at prevailing market rates.

The Bank's Ellsworth office consists of a building constructed in 1982 and two additional parcels contiguous to this branch. The City of Ellsworth is considered the hub of downeast Maine and the Bank's Ellsworth office is by far its busiest location. The Bank is currently exploring a substantial reconfiguration of the Ellsworth banking office and its surrounding campus to better meet the Bank's needs at that location.

An Operations Center is located in Ellsworth, Maine, that houses the Company's operations and data processing centers. The Bank also owns a 22,000-square-foot office building at 135 High Street, Ellsworth, Maine, which is occupied by the Bank and Trust Services. Trust Services also leases space at One Cumberland Place in Bangor, Maine.

In the opinion of management, the physical properties of the Company and the Bank are considered adequate to meet the needs of customers in the communities served. Additional information relating to the Company's properties is provided in Item 8, Note 6 of the Consolidated Financial Statements contained in this Annual Report on Form 10-K and incorporated herein by reference.

### ITEM 3. LEGAL PROCEEDINGS

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

### ITEM 4. [RESERVED]

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

#### Market Information

The common stock of the Company is traded on the NYSE Amex under the trading symbol BHB.

The following table sets forth the market prices per share of BHB Common Stock as reported by NYSE Amex:

	1st Quarter		2nd Quarter		3rd Quarter		4th Quarter	
	High	Low	High	Low	High	Low	High	Low
2009	\$26.65	\$17.28	\$31.76	\$22.30	\$37.20	\$30.53	\$35.00	\$26.27
2008	\$32.00	\$28.50	\$31.45	\$27.00	\$30.52	\$19.25	\$28.00	\$25.00

As of March 1, 2010, there were 2,629 registered holders of record of BHB Common Stock.

#### Performance Graph

The following graph illustrates the estimated yearly percentage change in the Company's cumulative total stockholder return on its common stock for each of the last five years. Total stockholder return is computed by taking the difference between the ending price of the common stock at the end of the previous year and the current year, plus any dividends paid divided by the ending price of the common stock at the end of the previous year. For purposes of comparison, the graph also illustrates the comparable stockholder return of NYSE Amex listed banks as a group as measured by the NYSE Amex Composite Index and the NYSE Arca Banks & Financial Services index. The graph assumes a \$100 investment on December 31, 2004 in the common stock of each of the Company, the NYSE Amex Composite index and the NYSE Arca Bank & Financial Services index as a group and measures the amount by which the market value of each, assuming reinvestment of dividends, has increased as of December 31 of each calendar year since the base measurement point of December 31, 2004.

[Performance graph]

Market values are based on information obtained from the NYSE Amex.

12/04      12/05      12/06      12/07      12/08      12/09

## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Bar Harbor Bankshares	100.00	93.63	116.55	118.87	100.91	111.60
NYSE Amex Composite	100.00	125.80	150.40	178.95	108.56	147.27
NYSE ARCA. Banks & Financial Services	100.00	89.32	98.82	90.05	70.60	65.60

### Dividends

Common stock dividends paid by the Company in 2009 and 2008 are summarized below:

Quarter	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	4 <sup>th</sup> Quarter	Total
2009	\$0.26	\$0.26	\$0.26	\$0.26	\$1.04
2008	\$0.25	\$0.25	\$0.26	\$0.26	\$1.02

During 2009, the Company declared and distributed regular cash dividends on its common stock in the aggregate amount of \$2,994, compared with \$3,004 in 2008. The Company's 2009 dividend payout ratio amounted to 32.6% compared with 38.8% in 2008. The total regular cash dividends paid in 2009 amounted to \$1.04 per share of common stock, compared with \$1.02 in 2008, representing an increase of \$0.02, or 2.0%.

In the first quarter of 2010, the Company's Board of Directors declared a regular cash dividend of \$0.26 per share of common stock, unchanged from the prior quarter and the same quarter in 2009. The dividend will be paid March 15, 2010 to shareholders of record as of the close of business on February 16, 2010.

The Company has a history of paying quarterly dividends on its common stock. However, the Company's ability to pay such dividends depends on a number of factors, including the Company's financial condition, earnings, its need for funds and restrictions on the Company's ability to pay dividends under federal laws and regulations. Therefore, there can be no assurance that dividends on the Company's common stock will be paid in the future.

In January 2009 the Company became subject to certain material restrictions and limitations on its ability to declare or pay dividends on its shares of common stock that arose from the Company's participation in the Treasury's Capital Purchase Program ("CPP"). Generally, the consent of the U.S. Treasury was required for the Company to increase its quarterly cash dividend in excess of \$0.26 per share of common stock. In February 2010, the Company redeemed all of its Preferred Stock it sold to the Treasury as part of the CPP. The Company's redemption of the Preferred Stock is not subject to any additional conditions or stipulations from the Treasury or the Company's and the Bank's principal regulators, including limitations on the Company's ability to increase quarterly cash dividends above \$0.26 per share of common stock.

For further information, refer to Item 6, Selected Consolidated Financial Data for dividend related ratios and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, (specifically the "Capital Resources" section), for dividend restrictions, which is incorporated herein by cross reference thereto.

### Recent Sale of Unregistered Securities; Use of Proceeds from Registered Securities

Except as disclosed in the Company's Quarterly Reports and Current Reports on Form 8-K, no unregistered securities were sold by the Company during the year ended December 31, 2009.

### Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table provides information with respect to any purchase of shares of the Company's common stock made by or on behalf of the Company or any "affiliated purchaser" for the quarter ended December 31, 2009.

Period	Total Number of	Average Price Paid	Total Number of Shares Purchased	Maximum Number of Shares that May
--------	-----------------	--------------------	----------------------------------	-----------------------------------

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

	Shares Purchased	per Share	as Part of Publicly Announced Plans or Programs	Yet Be Purchased Under the Plans or Programs (1)
October 1-31, 2009	---	\$ ---	---	233,218
November 1-30, 2009	---	\$ ---	---	233,218
December 1-31, 2009	---	\$ ---	---	233,218

(1) In August 2008, the Company's Board of Directors approved a program to repurchase of up to 300,000 shares of the Company's common stock, or approximately 10.2% of the shares currently outstanding. The new stock repurchase program became effective as of August 21, 2008 and is authorized to continue for a period of up to twenty-four consecutive months. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time, or from time to time, without prior notice and may be made in the open market or through privately negotiated transactions. The program will remain in effect until fully utilized or until modified, superseded or terminated.

In January 2009 the Company suspended purchases under the stock repurchase plan as required under the Purchase Agreement with Treasury in connection with the Company's participation in the CPP. In February 2010, the Company redeemed all of its Preferred Stock it sold to the Treasury as part of the CPP. The Company's redemption of the Preferred Stock is not subject to any additional conditions or stipulations from the Treasury or the Company's and the Bank's principal regulators, including limitations on the Company's ability to repurchase shares of its common stock.

During the quarter ended December 31, 2009, there were no purchases made by or on behalf of the Company or any "affiliated purchaser," as defined in Sec. 240.10b-18(a)(3) under the Exchange Act, of shares of the Company's common stock.

#### Stock Based Compensation Plans

Information regarding stock-based compensation awards outstanding and available for future grants as of December 31, 2009, represents stock-based compensation plans approved by shareholders and is presented in the table below. There are no plans that have not been approved by shareholders. Additional information is presented in Note 13, *Stock-Based Compensation Plans*, in the Notes to the Consolidated Financial Statements included in Item 8, *Financial Statements and Supplementary Data*, within this Annual Report on Form 10-K.

	Number of securities to be issued upon exercise of outstanding options, warrants, and rights, net of forfeits and exercised shares (a)	Weighted average exercise price of outstanding options, warrants, and rights (b)	Number of securities remaining available for issuance under equity compensation (excluding securities referenced in column (a)) (c)
Equity compensation plans approved by security holders	273,797	\$22.80	190,829
Equity compensation plans not approved by security holders	---	N/A	---
Total	273,797	\$22.80	190,829

#### Transfer Agent Services

American Stock Transfer & Trust Company provides transfer agent services for the Company. Inquiries may be directed to: American Stock Transfer & Trust Company, 6201 15<sup>th</sup> Avenue, 3<sup>rd</sup> Floor, Brooklyn, NY, 11219,

telephone: 1-800-937-5449, Internet address: [www.amstock.com](http://www.amstock.com).

## ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The supplementary financial data presented in the following table contains information highlighting certain significant trends in the Company's financial condition and results of operations over an extended period of time.

The following information should be analyzed in conjunction with Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations, and with the audited consolidated financial statements included in this Annual Report on Form 10-K.

Unless otherwise noted, all dollars are expressed in thousands except share data.

### FIVE-YEAR SUMMARY OF FINANCIAL DATA As of and For the Years Ended December 31,

	2009	2008	2007	2006	2005
<b>Balance Sheet Data</b>					
Total assets	\$1,072,381	\$972,288	\$889,472	\$824,877	\$747,945
Total securities	347,026	290,502	264,617	213,252	183,300
Total loans	669,492	633,603	579,711	555,099	514,866
Allowance for loan losses	(7,814)	(5,446)	(4,743)	(4,525)	(4,647)
Total deposits	641,173	578,193	539,116	496,319	445,731
Total borrowings	311,629	323,903	278,853	260,712	239,696
Total shareholders' equity	113,514	65,445	65,974	61,051	56,104
Average assets	1,052,496	926,357	841,206	788,557	689,644
Average shareholders' equity	88,846	65,139	62,788	57,579	56,132
<b>Results Of Operations</b>					
Interest and dividend income	\$ 54,367	\$ 53,594	\$ 51,809	\$ 46,145	\$ 37,195
Interest expense	21,086	26,403	28,906	24,449	15,336
Net interest income	33,281	27,191	22,903	21,696	21,859
Provision for loan losses	3,207	1,995	456	131	---
Net interest income after provision for loan losses	30,074	25,196	22,447	21,565	21,859
Non-interest income	6,022	6,432	5,929	6,876	6,415
Non-interest expense	21,754	20,513	18,201	18,677	19,268
Income before income taxes	14,342	11,115	10,175	9,764	9,006
Income taxes	3,992	3,384	3,020	2,885	2,582
Net income	\$ 10,350	\$ 7,731	\$ 7,155	\$ 6,879	\$ 6,424
Preferred stock dividends and accretion of discount	1,034	---	---	---	---
Net income available to common shareholders	\$ 9,316	\$ 7,731	\$ 7,155	\$ 6,879	\$ 6,424
<b>Per Common Share Data:</b>					
Basic earnings per share	\$ 3.19	\$ 2.63	\$ 2.36	\$ 2.26	\$ 2.09
Diluted earnings per share	\$ 3.12	\$ 2.57	\$ 2.30	\$ 2.20	\$ 2.03

## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Cash dividends per share	\$ 1.04	\$ 1.02	\$ 0.96	\$ 0.91	\$ 0.84
Dividend payout ratio	32.56%	38.84%	40.54%	40.12%	40.23%

### Selected Financial Ratios:

Return on total average assets	0.98%	0.83%	0.85%	0.87%	0.93%
Return on total average equity	11.65%	11.87%	11.40%	11.95%	11.44%
Tax-equivalent net interest margin	3.40%	3.13%	2.91%	2.98%	3.44%

### Capital Ratios:

Tier 1 leverage capital ratio	10.35%	6.61%	7.10%	7.34%	7.52%
Tier 1 risk-based capital ratio	15.34%	9.95%	10.76%	10.82%	11.10%
Total risk-based capital ratio	17.14%	11.60%	11.59%	11.65%	12.05%

### Asset Quality Ratios:

Net charge-offs to average loans	0.13%	0.21%	0.04%	0.05%	0.04%
Allowance for loan losses to total loans	1.17%	0.86%	0.82%	0.82%	0.90%
Allowance for loan losses to non-performing loans	85%	124%	230%	721%	535%
Non-performing loans to total loans	1.37%	0.70%	0.36%	0.11%	0.17%

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis, which follows, focuses on the factors affecting the Company's consolidated results of operations for the years ended December 31, 2009, 2008, and 2007, and financial condition at December 31, 2009, and 2008, and where appropriate, factors that may affect future financial performance. The following discussion and analysis of financial condition and results of operations of the Company and its subsidiaries should be read in conjunction with the consolidated financial statements and notes thereto, and selected financial and statistical information appearing elsewhere in this Annual Report on Form 10-K.

Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation.

Unless otherwise noted, all dollars are expressed in thousands except share data.

### Use of Non-GAAP Financial Measures:

Certain information discussed below is presented on a fully tax-equivalent basis. Specifically, included in 2009, 2008 and 2007 interest income was \$3,195, \$1,992, and \$1,495, respectively, of tax-exempt interest income from certain investment securities and loans. An amount equal to the tax benefit derived from this tax exempt income has been added back to the interest income totals discussed in certain sections of this Management's Discussion and Analysis, representing tax-equivalent adjustments of \$1,505, \$899 and \$655 in 2009, 2008 and 2007, respectively, which increased net interest income accordingly. The analysis of net interest income tables included in this Annual Report on Form 10-K provide a reconciliation of tax-equivalent financial information to the Company's consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles.

Management believes the disclosure of tax-equivalent net interest income information improves the clarity of financial analysis, and is particularly useful to investors in understanding and evaluating the changes and trends in the Company's results of operations. Other financial institutions commonly present net interest income on a tax-equivalent

basis. This adjustment is considered helpful in the comparison of one financial institution's net interest income to that of another institution, as each will have a different proportion of tax-exempt interest from their earning asset portfolios. Moreover, net interest income is a component of a second financial measure commonly used by financial institutions, net interest margin, which is the ratio of net interest income to average earning assets. For purposes of this measure as well, other financial institutions generally use tax-equivalent net interest income to provide a better basis of comparison from institution to institution. The Company follows these practices.

## EXECUTIVE OVERVIEW

### General Information

Bar Harbor Bankshares is a Maine corporation and a registered bank holding company under the Bank Holding Company Act of 1956, as amended. At December 31, 2009, the Company had consolidated assets of \$1.1 billion and was one of the larger independent community banking institutions in the state of Maine.

The Company's principal asset is all of the capital stock of Bar Harbor Bank & Trust (the "Bank"), a community bank incorporated in the late 19<sup>th</sup> century. With twelve (12) branch office locations, the Company is a diversified financial services provider, offering a full range of banking services and products to individuals, businesses, governments, and not-for-profit organizations throughout downeast and midcoast Maine.

The Company attracts deposits from the general public in the markets it serves and uses such deposits and other sources of funds to originate commercial business loans, commercial real estate loans, residential mortgage and home equity loans, and a variety of consumer loans. The Company also invests in mortgage-backed securities, obligations of government-sponsored enterprises, obligations of state and political subdivisions, as well as other debt securities. In addition to community banking, the Company provides a comprehensive array of trust and investment management services through its second tier subsidiary, Bar Harbor Trust Services ("Trust Services") a Maine chartered non-depository trust company.

### Major Sources of Revenue

The principal source of the Company's revenue is net interest income, representing the difference or spread between interest income from its earning assets and the interest expense paid on deposits and borrowed funds. In addition to net interest income, non-interest income is a significant source of revenue for the Company and an important factor in its results of operations. The Company's non-interest income is derived from financial services including trust, investment management and third-party brokerage services, as well as service charges on deposit accounts, merchant credit card processing referral and transaction fees, realized gains or losses on the sale of securities, and a variety of other miscellaneous product and service fees.

### Business Strategy

The Company, as a diversified financial services provider, pursues a strategy of achieving long-term sustainable growth, profitability, and shareholder value, without sacrificing its soundness. The Company works toward achieving this goal by focusing on increasing its loan and deposit market share in the coastal communities of Maine, either organically or by way of strategic acquisitions. The Company believes one of its more unique strengths is an understanding of the financial needs of coastal communities and the businesses vital to Maine's coastal economy, namely: tourism, hospitality, retail establishments and restaurants, seasonal lodging and campgrounds, fishing, lobstering, boat building, and marine services.

The Company's key strategic focus is vigorous financial stewardship, deploying investor capital safely yet efficiently for the best possible returns. The Company strives to provide unmatched service to its customers, while maintaining strong asset quality and a focus toward improving operating efficiencies. In managing its earning asset portfolios, the

Company seeks to utilize funding and capital resources within well-defined credit, investment, interest-rate and liquidity guidelines. In managing its balance sheet the Company seeks to preserve the sensitivity of net interest income to changes in interest rates, and to enhance profitability through strategies that promise sufficient reward for understood and controlled risk. The Company is deliberate in its efforts to maintain adequate liquidity under prevailing and expected conditions, and strives to maintain a balanced and appropriate mix of loans, securities, core deposits, brokered deposits and borrowed funds.

#### Material Risks and Challenges

In its normal course of business, the Company faces many risks inherent with providing banking and financial services. Among the more significant risks managed by the Company are losses arising from loans not being repaid, commonly referred to as "credit risk," and losses of income arising from movements in interest rates, commonly referred to as "interest rate and market risk." The Company is also exposed to national and local economic conditions, downturns in the economy, or adverse changes in real estate markets, which could negatively impact its business, financial condition, results of operations or liquidity.

Management has numerous policies and control processes in place that provide for the monitoring and mitigation of risks based upon and driven by a variety of assumptions and actions which, if changed or altered, could impact the Company's business, financial condition, results of operations or liquidity. The foregoing matters are more fully discussed in Part I, Item 1A, "Risk Factors," and throughout this Annual Report on Form 10-K.

#### Summary Financial Condition

Total assets ended the year at \$1,072,381, representing an increase of \$100,093, or 10.3%, compared with December 31, 2008.

##### ◆ Loans:

Total loans ended the year at \$669,492, representing an increase of \$35,889, or 5.7%, compared with December 31, 2008. Loan growth was led by commercial loans and tax-exempt loans to local municipalities, which were up \$47,471 and \$8,780, or 14.8% and 163.9%, compared with December 31, 2008, respectively. Consumer loans, which principally consist of residential real estate mortgage loans, declined \$20,107 or 6.6% compared with December 31, 2008, largely reflecting principal pay-downs from the Bank's residential mortgage loan portfolio.

While the Bank's residential mortgage loan portfolio declined in 2009, residential mortgage loan origination activity increased significantly, principally reflecting declines in residential mortgage loan interest rates, borrower refinancing activity, more affordable home prices and tax incentive programs. Because of the interest rate risk considerations associated with holding low coupon mortgage loans, \$29,842 of low fixed rate residential mortgages originated in 2009 were sold in the secondary market with customer servicing retained by the Bank and as a result were not reflected in outstanding loan balances at period end.

##### ◆ Credit Quality:

At December 31, 2009, the Bank's total non-performing loans amounted to \$9,176 or 1.37% of total loans, compared with \$4,404, or 0.70% at December 31, 2008. One agricultural loan accounted for \$1,500 of total year-end 2009 non-performing loans and represented approximately one-third of the year-over-year increase. Non-performing commercial real



estate mortgages and residential real estate mortgages ended the year at \$3,096 and \$2,498, respectively, up \$1,451 and \$802 compared with December 31, 2008.

During 2009 the Bank's loan loss experience showed improvement compared with the loan loss experience in 2008. Total net loan charge-offs amounted to \$839 in 2009, or net charge-offs to average loans outstanding of 0.13%, compared with \$1,292, or net charge-offs to average loans outstanding of 0.21% in 2008.

For the year ended December 31, 2009, the Bank recorded a provision for loan losses (the "provision") of \$3,207, representing an increase of \$1,212, or 60.8%, compared with 2008. The increase in the provision was principally attributed to a deterioration in overall credit quality, growth in the loan portfolio, and depressed economic conditions, including elevated unemployment levels and declining real estate values in the markets served by the Bank.

The Bank maintains an allowance for loan losses (the "allowance") which is available to absorb probable losses on loans. The allowance is maintained at a level that, in management's judgment, is appropriate for the amount of risk inherent in the current loan portfolio and adequate to provide for estimated probable losses. At December 31, 2009, the allowance stood at \$7,814, representing an increase of \$2,368 or 43.5% compared with December 31, 2008. At December 31, 2009, the allowance expressed as a percentage of total loans stood at 1.17%, up from 0.86% at December 31, 2008.

◆ Securities:

Total securities ended the year at \$347,026, representing an increase of \$56,524, or 19.5%, compared with December 31, 2008. Securities purchased during 2009 consisted of mortgage-backed securities issued by U.S. Government agencies and sponsored enterprises, debt obligations of U.S. Government-sponsored enterprises, and obligations of state and political subdivisions thereof.

◆ Deposits:

Total deposits ended the year at \$641,173, representing an increase of \$62,980, or 10.9%, compared with December 31, 2008. Total retail deposits ended the year at \$549,183, up \$59,496 or 12.1% compared with December 31, 2008. Savings, money market, and NOW account deposits combined were up \$14,802 or 6.4%, while retail time deposits were up \$44,905 or 22.4% compared with December 31, 2008.

Brokered deposits obtained from the national market ended the year at \$91,990, representing an increase of \$3,484, or 3.9%, compared with December 31, 2008. Brokered deposits are generally utilized to help support the Bank's earning asset growth, while maintaining its strong, on-balance sheet liquidity position via secured borrowing lines of credit with the Federal Home Loan Bank and the Federal Reserve Bank.

◆ Borrowings:

Total borrowings ended the year at \$311,629, representing a decline of \$12,274, or 3.8%, compared with December 31, 2008. The 2009 decline in borrowings was attributed to the sale of 18,751 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock to the

U.S. Treasury in the first quarter of 2009, the cash proceeds from which amounted to \$18,751. The decline in 2009 borrowings was also attributed to the issuance of 800,000 shares of common stock to the public in the fourth quarter of 2009, the net cash proceeds from which amounted to \$20,412. The net cash proceeds from the foregoing transactions were deployed to pay down short-term borrowings, while largely supporting 2009 earning asset growth.

◆ Capital:

At December 31, 2009, the Bank continued to exceed regulatory requirements for "well-capitalized" institutions. Company management considers this to be vital in promoting depositor and investor confidence and providing a solid foundation for future growth. Under the capital adequacy guidelines administered by the Bank's principal regulators, "well-capitalized" institutions are those with Tier I Leverage, Tier I Risk-based, and Total Risk-based ratios of at least 5%, 6% and 10%, respectively. At December 31, 2009, the Company's Tier I Leverage, Tier I Risk-based, and Total Risk-based capital ratios were 10.35%, 15.34% and 17.14%, compared with 6.61%, 9.95% and 11.60% at December 31, 2008, respectively.

In January 2009, the Company issued and sold \$18,751 in Fixed Rate Cumulative Perpetual Preferred Stock, Series A, no par value, to the U.S. Treasury in connection with its participation in the U.S. Treasury's Capital Purchase Program ("CPP"). The CPP is a voluntary program designed by the U.S. Treasury to provide additional capital to healthy, "well-capitalized" banks, to help provide economic stimulus through the creation of additional lending capacity in local banking markets.

In December 2009 the Company completed its previously announced offering of 800,000 shares of common stock to the public at \$27.50 per share. The net proceeds from this offering, after deducting underwriting discounts and estimated expenses amounted to \$20,412. As previously reported, in January 2010 the Company completed the closing of the underwriter's exercise of its over-allotment option to purchase an additional 82,021 shares of the Company's common stock at a purchase price to the public of \$27.50 per share. The Company received total net proceeds from the offering, including the exercise of the over-allotment option, after deducting underwriting discounts and expenses, amounting to \$22,442.

On February 4, 2010 the Company redeemed all 18,751 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A, it sold to the Treasury as part of the CPP. The Company paid \$18,774 to the Treasury to redeem the Preferred Stock, consisting of \$18,751 of principal and \$23 of accrued and unpaid dividends. The Company and the Bank received approvals from their respective regulators to redeem the Preferred Stock. The Company's redemption of the Preferred Stock is not subject to any additional conditions or stipulations from the Treasury or the Company's and the Bank's principal regulators.

The Company intends to seek agreement with the Treasury to repurchase the Warrant at its fair value. However, there can be no assurance that the Company will reach agreement with the Treasury as to a fair value of the Warrant, or that the Company will repurchase the Warrant.

## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

At December 31, 2009, the Company's tangible common equity ratio stood at 8.60%, up from 6.42% at December 31, 2008.

### ◆ Shareholder Dividends:

Total regular cash dividends paid by the Company in 2009 amounted to \$1.04 per share of common stock, compared with \$1.02 in 2008, representing an increase of 2.0%.

### Summary Results of Operations

For the year ended December 31, 2009, net income available to common shareholders amounted to \$9,316 compared with \$7,731 for the year ended December 31, 2008, representing an increase of \$1,585, or 20.5%. The Company's diluted earnings per share, after preferred stock dividends and accretion of preferred stock discount, amounted to \$3.12 for 2009 compared with \$2.57 in 2008, representing an increase of \$0.55, or 21.4%. The Company's return on average shareholders' equity amounted to 11.65%, compared with 11.87% in 2008.

### ◆ Net Interest Income:

For the year ended December 31, 2009, net interest income on a tax-equivalent basis amounted to \$34,786, representing an increase of \$6,696, or 23.8%, compared with 2008. The increase in 2009 net interest income compared with 2008 was principally attributed to an improved net interest margin, combined with average earning asset growth of 14.0%. For the year ended December 31, 2009, the tax-equivalent net interest margin amounted to 3.40%, representing an improvement of 27 basis points compared with 2008.

During 2008 the targeted fed funds rate fell from 4.25% to a range of 0% to 0.25%, where it stayed for all of 2009. The decline in short-term interest rates favorably impacted the Bank's 2009 net interest margin, as the cost of interest bearing liabilities declined faster and to a greater degree than the decline in earning asset yields.

### ◆ Non-interest Income:

For the year ended December 31, 2009, total non-interest income amounted to \$6,022, representing a decline of \$410 or 6.4% compared with 2008. The decline in non-interest income was attributed to a variety of factors, including a \$1,265 or 61.9% decline in credit and debit card service charges and fees, reflecting the previously reported sale of the Bank's merchant processing and Visa credit card portfolios in the fourth quarter of 2008. This decline was offset by a comparable decline in debit and credit card expenses, which are included in non-interest expense in the Company's consolidated statements of income. The decline in 2009 non-interest income was also attributed to a \$313 gain recorded in 2008 representing the proceeds from shares redeemed in connection with the Visa, Inc. initial public offering. Service charges on deposit accounts declined \$182 or 11.4% compared with 2008, principally attributed to declines in deposit account overdraft activity.

Trust and financial services fees amounted to \$2,444 in 2009, representing a decline of \$69 or 2.7%, principally reflecting lower average market values of assets under management during 2009 compared with 2008. Following a recovery in the equity markets, assets under management at December 31, 2009 rose to \$270,115, representing an increase of \$39,892 or 17.3% compared with December 31, 2008.

The foregoing declines in non-interest income were offset in part by a \$475 increase in income from mortgage banking activities, largely reflecting the gains on sales of

certain residential mortgage loans in the secondary market during 2009.

Total securities gains, net of other-than-temporary impairment losses ("OTTI"), amounted to \$67 in 2009, compared with net securities losses net of OTTI of \$831 also in 2008. The \$67 in net securities gains were comprised of realized gains on the sale of securities amounting to \$2,528, offset by other-than-temporary impairment losses of \$2,461 on certain available-for-sale, 1-4 family, non-agency mortgage backed securities.

◆ Non-interest Expense:

For the year ended December 31, 2009, total non-interest expense amounted to \$21,754, representing an increase of \$1,241, or 6.0%, compared with 2008. The increase in non-interest expense was principally attributed to a \$1,286 or 959.7% increase in FDIC insurance assessments, including an emergency special FDIC assessment amounting to \$492. The special assessment was levied on all FDIC insured financial institutions. Deposit insurance premiums for all FDIC insured banks have increased as a result of the FDIC's plan to reestablish the Deposit Insurance Fund to levels required by the Federal Deposit Reform Act of 2005.

Salaries and employee benefits expense amounted to \$11,594 in 2009, representing an increase of \$767, or 7.1%, compared with 2008. The increase in salaries and employee benefits was principally attributed to increases in employee health insurance premiums, normal increases in base salaries, as well as changes in staffing levels and mix.

The increase in 2009 non-interest expense was also attributed to \$281 in write-downs of certain non-marketable venture capital equity investment funds considered other-than-temporarily impaired, compared with \$68 in 2008. These investment funds, which generally qualify for Community Reinvestment Act ("CRA") credit, represent socially responsible venture capital investments in small businesses throughout Maine and New England. These write-downs principally reflected the impact current economic conditions have had on these funds. Reflecting increased loan collection and foreclosure activity, the Bank's loan collection expenses increased \$185 in 2009, or 250.7%, compared with 2008.

The foregoing increases in 2009 non-interest expense were largely offset by the aforementioned decline in credit and debit card expenses of \$1,084 or 76.6% and a \$161 or 10.5% decline in furniture and equipment expenses.

◆ Efficiency Ratio:

The Company's efficiency ratio, or non-interest operating expenses divided by the sum of tax-equivalent net interest income and non-interest income other than net securities gains and other-than-temporary impairments, measures the relationship of operating expenses to revenues. Low efficiency ratios are typically a key factor for high performing financial institutions. For the year ended December 31, 2009, the Company's efficiency ratio amounted to 53.2%, which was significantly better than industry averages.

◆ Income Taxes:

For the year ended December 31, 2009, total income taxes amounted to \$3,992, representing an increase of \$608, or 18.0%, compared with the 2008. The Company's effective tax rate amounted to 27.8% in 2009, compared with 30.4% in 2008. Fluctuations in the Company's effective tax rate are generally attributed to changes in the relationship between non-taxable income and non-deductible expense, and income before income taxes, during any given reporting period.

## APPLICATION OF CRITICAL ACCOUNTING POLICIES

Management's discussion and analysis of the Company's financial condition and results of operations are based on the Consolidated Financial Statements, which are prepared in accordance with U.S. generally accepted accounting principles. The preparation of such financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. Management evaluates its estimates, including those related to the allowance for loan losses, on an ongoing basis. Management bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis in making judgments about the carrying values of assets that are not readily apparent from other sources. Actual results could differ from the amount derived from management's estimates and assumptions under different assumptions or conditions.

The Company's significant accounting policies are more fully enumerated in Note 1 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K. The reader of the financial statements should review these policies to gain a greater understanding of how the Company's financial performance is reported. Management believes the following critical accounting policies represent the more significant estimates and assumptions used in the preparation of the Consolidated Financial Statements:

### Allowance for Loan Losses:

The allowance for loan losses ("allowance") is a significant accounting estimate used in the preparation of the Company's consolidated financial statements. The allowance, which is established through a provision for loan loss expense, is based on management's evaluation of the level of allowance required in relation to the estimated inherent risk of probable loss in the loan portfolio. Management regularly evaluates the allowance for adequacy by taking into consideration factors such as previous loss experience, the size and composition of the portfolio, current economic and real estate market conditions and the performance of individual loans in relation to contract terms and estimated fair values of collateral. The use of different estimates or assumptions could produce different provisions for loan losses. A smaller provision for loan losses results in higher net income, and when a greater amount of provision for loan losses is necessary, the result is lower net income. Refer to Part II, Item 7, *Allowance for Loan Losses and Provision*, in this Annual Report on Form 10-K, for further discussion and analysis concerning the allowance.

### Other-Than-Temporary Impairments on Securities

: One of the significant estimates related to investment securities is the evaluation of other-than-temporary impairments. The evaluation of securities for other-than-temporary impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition and/or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period of unrealized losses.

Securities that are in an unrealized loss position, are reviewed at least quarterly to determine if an other-than-temporary impairment is present based on certain quantitative and qualitative factors and measures. The primary factors considered in evaluating whether a decline in value of securities is other-than-temporary include: (a) the cause of the impairment; (b) the financial condition, credit rating and future prospects of the issuer; (c) whether the

debtor is current on contractually obligated interest and principal payments; (d) the volatility of the securities fair value; (e) performance indicators of the underlying assets in the security including default rates, delinquency rates, percentage of nonperforming assets, loan to collateral value ratios, third party guarantees, current levels of subordination, vintage, and geographic concentration and; (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of the receipt of all principal and interest due. The Company also considers whether it intends to sell the security, or whether it believes it is more-likely-than-not that the Company will be required to sell the security, prior to recovery of cost or amortized cost.

For securitized financial assets with contractual cash flows, such as private-label mortgage-backed securities, the Company periodically updates its best estimate of cash flows over the life of the security. The Company's best estimate of cash flows is based upon assumptions consistent with an economic recession, similar to those the Company believes market participants would use. If the fair value of a securitized financial asset is less than its cost or amortized cost and there has been an adverse change in timing or amount of anticipated future cash flows since the last revised estimate to the extent that the Company does not expect to receive the entire amount of future contractual principal and interest, an other-than-temporary impairment charge is recognized. Estimating future cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain assumptions and judgments regarding the future performance of the underlying collateral. In addition, projections of expected future cash flows may change based upon new information regarding the performance of the underlying collateral.

Refer to Part II, Item 7, *Impaired Securities*, and Part II, Item 8, Note 1 of the Consolidated Financial Statements in this Annual Report on Form 10-K, for further discussion and analysis concerning other-than-temporary impairments.

#### Income Taxes:

The Company estimates its income taxes for each period for which a statement of income is presented. This involves estimating the Company's actual current tax liability, as well as assessing temporary differences resulting from differing timing of recognition of expenses, income and tax credits, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the Company's consolidated balance sheets. The Company must also assess the likelihood that any deferred tax assets will be recovered from historical taxes paid and future taxable income and, to the extent that the recovery is not likely, a valuation allowance must be established. Significant management judgment is required in determining income tax expense, and deferred tax assets and liabilities. As of December 31, 2009 and 2008, there was no valuation allowance for deferred tax assets, which are included in other assets on the consolidated balance sheet.

#### Goodwill:

The valuation techniques used by the Company to determine the carrying value of intangible assets acquired in acquisitions involves estimates for discount rates, projected future cash flows and time period calculations, all of which are susceptible to change based upon changes in economic conditions and other factors. Any changes in the estimates used by the Company to determine the carrying value of its goodwill may have an adverse effect on the Company's results of operations. In addition, as a result of stock market volatility over the past eighteen months, especially in the financial services sector, many community banking companies have experienced declines in their stock prices. If these declines continue or worsen in 2010, impairment of the Company's goodwill may occur.

Refer to Notes 1 and 7 of the consolidated financial statements in Item 8 of this Annual Report on Form 10-K for further details of the Company's accounting policies and estimates covering goodwill.

#### FINANCIAL CONDITION

## Asset / Liability Management

In managing its asset portfolios, the Bank utilizes funding and capital resources within well-defined credit, investment, interest rate, and liquidity risk guidelines. Loans and investment securities are the Bank's primary earning assets with additional capacity invested in money market instruments. Average earning assets represented 97.1% and 96.8% of total average assets during 2009 and 2008, respectively.

The Company, through its management of liabilities, attempts to provide stable and flexible sources of funding within established liquidity and interest rate risk guidelines. This is accomplished through retail deposit products offered within the markets served, as well as through the prudent use of borrowed and brokered funds.

The Company's objectives in managing its balance sheet are to preserve the sensitivity of net interest income to actual or potential changes in interest rates, and to enhance profitability through strategies that promise sufficient reward for understood and controlled risk. The Company is deliberate in its efforts to maintain adequate liquidity, under prevailing and forecasted economic conditions, and to maintain an efficient and appropriate mix of core deposits, brokered deposits, and borrowed funds.

## Earning Assets

For the year ended December 31, 2009, the Company's total average earning assets amounted to \$1,022,037, compared with \$896,350 in 2008, representing an increase of \$125,687, or 14.0%. The 2009 increase in average earning assets was principally attributed to an \$81,605 or 30.4% increase in the securities portfolio, followed by total average loan growth of \$43,828, or 7.2%.

The tax-equivalent yield on total average earning assets amounted to 5.47% in 2009 compared with 6.08% in 2008, representing a decline of 61 basis points. The decline in the weighted average earning asset yield was principally attributed to the reduction of short-term interest rates by the Federal Reserve, the impact of which reduced the weighted average yield on the Bank's variable rate loan portfolios. To a lesser extent, the weighted average loan yields were impacted by the renegotiation of certain fixed rate loans to variable rate loans with lower prevailing interest rates. The weighted average yield on the Bank's loan portfolio amounted to 5.33% in 2009 compared with 6.18% in 2008, representing a decline of 85 basis points.

The weighted average tax-equivalent yield on the securities portfolio amounted to 5.98% in 2009 compared with 6.00% in 2008. Because the majority of the securities portfolio is comprised of fixed rate securities, the decline in interest rates and market yields did not significantly impact the portfolio's weighted average yield during most of 2009. During the second half of 2009 the weighted average yield on the securities portfolio began to decline, with the fourth quarter yield amounting to 5.70% compared with 6.18% in the first quarter of 2009.

For the year ended December 31, 2009, total tax-equivalent interest and dividend income amounted to \$55,872 compared with \$54,493 in 2008, representing an increase of \$1,379, or 2.5%. Interest income from the securities portfolio contributed \$4,808 to the increase in 2009 interest and dividend income, largely offset by a \$2,825 decline in interest income from the loan portfolio.

## Total Assets

The Company's assets principally consist of loans and securities, which at December 31, 2009 represented 62.4% and 32.4% of total assets, compared with 65.2% and 29.9% at December 31, 2008, respectively.

At December 31, 2009 the Company's total assets stood at \$1,072,381 compared with \$972,288 at December 31, 2008, representing an increase of \$100,093, or 10.3%. The increase in total assets was principally attributed to a \$56,524 or 19.5% increase in securities, followed by a \$35,889 or 5.7% increase in loans.

## Securities

The average securities portfolio represented 34.3% of the Company's average earning assets during 2009 and generated 37.5% of its total tax-equivalent interest and dividend income, compared with 30.0% and 29.6% in 2008, respectively.

Bank management considers securities as a relatively attractive means to effectively leverage the Bank's strong capital position, as securities are typically assigned a significantly lower risk weighting for the purpose of calculating the Bank's and the Company's risk-based capital ratios. The overall objectives of the Bank's strategy for the securities portfolio include maintaining appropriate liquidity reserves, diversifying earning assets, managing interest rate risk, leveraging the Bank's strong capital position, and generating acceptable levels of net interest income. The securities portfolio is managed under the policy guidelines established by the Bank's Board of Directors.

The securities portfolio is primarily comprised of mortgage-backed securities issued by U.S. government agencies, U.S. government sponsored enterprises, and other non-agency, private-label issuers. The securities portfolio also includes tax-exempt obligations of state and political subdivisions, and obligations of other U.S. government sponsored enterprises. At December 31, 2009, the securities portfolio did not contain any pools of sub-prime mortgage-backed securities, collateralized debt obligations, or commercial mortgage-backed securities. Additionally, the Bank did not own any equity securities or have any corporate debt exposure in its securities portfolio, nor did it own any perpetual preferred stock in Federal Home Loan Mortgage Corporation ("FHLMC") or Federal National Mortgage Association ("FNMA"), or any interests in pooled trust preferred securities or auction rate securities.

### Total Securities

: At December 31, 2009, total securities stood at \$347,026 compared with \$290,502 at December 31, 2008, representing an increase of \$56,524, or 19.5%. Securities purchased during 2009 consisted of mortgage-backed securities issued by U.S. Government agencies and sponsored enterprises, debt obligations of U.S. Government-sponsored enterprises, and obligations of state and political subdivisions thereof.

### Trading Securities:

Trading securities are securities bought and held principally for the purpose of selling them in the near term with the objective of generating profits on short-term differences in price. During the years ended December 31, 2009 and 2008, the Bank did not own any trading securities.

### Securities Held to Maturity:

Securities held to maturity are debt securities for which the Bank has the positive intent and ability to hold until maturity. Held to maturity investments are reported at their aggregate cost, adjusted for amortization of premiums and accretion of discounts. During the years ended December 31, 2009 and 2008, the Bank did not own any securities held to maturity.

### Securities Available for Sale

: Securities available for sale represented 100% of total securities at December 31, 2009 and 2008.

The designation of securities available for sale is made at the time of purchase, based upon management's intent to hold the securities for an indefinite time; however, these securities would be available for sale in response to changes in market interest rates, related changes in the securities' prepayment risk, needs for liquidity, or changes in the availability of and yield on alternative investments. The securities available for sale portfolio is used for liquidity purposes while simultaneously producing earnings.



Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Securities classified as available for sale are reported at their fair value with unrealized gains or losses, net of taxes, excluded from earnings but shown separately as a component of shareholders' equity. Gains and losses on the sale of securities available for sale are determined using the specific-identification method and are shown separately in the consolidated statements of income.

The following table summarizes the securities available for sale portfolio as of December 31, 2009 and 2008:

	December 31, 2009			
	Amortized Cost*	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Available for Sale:</b>				
Obligations of US Government-sponsored enterprises	\$ 2,770	\$ 13	\$ 227	\$ 2,556
Mortgage-backed securities:				
US Government-sponsored enterprises	226,740	7,613	3	234,350
US Government agency	21,522	606	21	22,107
Private label	31,754	27	5,428	26,353
Obligations of states and political subdivisions thereof	63,821	1,674	3,835	61,660
Total	\$346,607	\$9,933	\$9,514	\$347,026

\*includes the cumulative write-down of securities considered to be other-than-temporarily impaired at December 31, 2009, with impairment write-downs totaling \$2,475; all related to private label mortgage backed securities

	December 31, 2008			
	Amortized Cost*	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Available for Sale:</b>				
Obligations of US Government-sponsored enterprises	\$ 700	\$ 1	\$ ---	\$ 701
Mortgage-backed securities:				
US Government-sponsored enterprises	172,661	4,874	10	177,525
US Government agency	32,750	961	26	33,685
Private-label	43,579	172	4,193	39,558
Obligations of states and political subdivisions thereof	42,534	166	3,667	39,033
Total	\$292,224	\$6,174	\$7,896	\$290,502

\*

includes the writedown of securities considered to be other than temporarily impaired at December 31, 2008, with impairment writedowns totaling \$1,435.

**Obligations of U.S. Government-sponsored Enterprises:**

This category of securities represents promissory notes (debt instruments) issued by U.S. Government-sponsored enterprises, such as FNMA, FHLMC, FHLB, etc. All of these securities were credit rated AAA by all of the major credit rating agencies at December 31, 2009 and 2007.

At December 31, 2009, obligations of U.S. Government-sponsored enterprises, at fair value, totaled \$2,556, compared with \$701 at December 31, 2008, representing an increase of \$1,855, or 264.6%.

At December 31, 2009, the Bank's weighted average yield on obligations of U.S. Government-sponsored enterprises amounted to 5.02%, compared with 5.50% at December 31, 2008.

**Mortgage-backed Securities Issued by U.S. Government-sponsored Enterprises:**

This category of securities represents mortgage backed securities issued and guaranteed by U.S. Government-sponsored enterprises, specifically, FNMA and FHLMC. These Government-sponsored enterprises were placed under the conservatorship of the U.S. Government on September 7, 2008. All of these securities were credit rated AAA by the major credit rating agencies at December 31, 2009 and 2008.

## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

At December 31, 2009, mortgage-backed securities issued by U.S. Government-sponsored enterprises, at fair value, totaled \$234,350, compared with \$177,525 at December 31, 2008, representing an increase of \$56,825, or 32.0%.

At December 31, 2009, the Bank's weighted average yield on mortgage-backed securities issued by U.S. Government-sponsored enterprises amounted to 5.39%, compared with 5.84% at December 31, 2008, representing a decline of 45 basis points. The decline in the weighted average yield was principally attributed prevailing market yields during 2009, with securities being added to the portfolio at yields lower than the existing weighted average yield for this segment of the portfolio.

### Mortgage-backed Securities Issued by U.S. Government Agencies:

This category of securities represents mortgage-backed securities backed by the full faith and credit of the U.S. Government, such as the Government National Mortgage Association ("GNMA"). All of these securities were credit rated AAA at December 31, 2009 and 2008.

At December 31, 2009, mortgage-backed securities issued by U.S. Government agencies, at fair value, totaled \$22,107, compared with \$33,685 at December 31, 2008, representing a decline of \$11,578, or 34.4%. This decline was principally attributed to principal pay downs exceeding historical norms and sales of certain securities, the proceeds from which were not reinvested in this class of securities.

At December 31, 2009, the weighted average yield on mortgage-backed securities issued by U.S. Government agencies amounted to 5.42%, compared with 5.77% at December 31, 2008, representing a decline of 35 basis points. The decline in the weighted average yield was principally attributed to the pay down or sale of securities with higher yields compared with the existing weighted yield for this segment of the portfolio.

### Mortgage-backed Securities Issued by Private-label Issuers:

This category of securities represents mortgage-backed securities issued by banks, investment banks, and thrift institutions. Typically, these securities are largely based on mortgages which exceed the conforming loan sizes required by agency securities. While private-label mortgage-backed securities are not guaranteed by any U.S. Government agency, they are credit rated by the major rating agencies (Moody's, Standard & Poor's and FITCH).

All of the Bank's mortgage-backed securities issued by private-label issuers carry various amounts of credit enhancement, and none are classified as sub-prime mortgage-backed security pools. These securities were purchased based on the underlying loan characteristics such as loan to value ratios, borrower credit scores, property type and location, and the level of credit enhancement.

At December 31, 2009, mortgage-backed securities issued by private-label issuers, at fair value, totaled \$26,353, compared with \$39,558 at December 31, 2008, representing a decline of \$13,205, or 33.4%. At December 31, 2009, the total amortized cost of the Bank's private label MBS amounted to \$31,754, compared with \$43,579 at December 31, 2008, representing a decline of \$11,825, or 27.1%. This decline was attributed to principal pay downs of \$8,576 and other-than-temporary impairment ("OTTI") write downs of \$2,461.

At December 31, 2009, \$10,899 of the total fair value of the Bank's private-label mortgage-backed securities portfolio was rated below investment grade by at least one of the major credit rating agencies. All of these below investment grade securities had been rated "AAA" by the credit rating agencies at the date of purchase and continued to be rated "AAA" through December 31, 2007. Beginning in 2008 and continuing into 2009, unprecedented market stresses began affecting all mortgage-backed securities (Agency and private label) as the economy in general and the housing market in particular seriously deteriorated. As a result, the Bank revised its assessments as to the full recoverability of its private label MBS and during 2009 and 2008 recorded \$2,461 and \$1,435 in OTTI write downs under existing accounting standards at that time. Refer to Part II, item 8, Notes to Consolidated Financial Statements, Notes 1 and 2

in this Annual Report on Form 10-K for further information on OTTI.

At December 31, 2009, the Bank's weighted average yield on its private-label mortgage-backed securities portfolio amounted to 6.10%, compared with 5.89% at December 31, 2008.

Obligations of States and Political Subdivisions Thereof:

Obligations of states and political subdivisions thereof ("municipal bonds") are issued by city, county and state governments, as well as by enterprises with a public purpose, such as certain electric utilities, universities and hospitals. Municipal obligations are supported by the general taxing authority of the municipality and, in the cases of school districts, are supported by state aid. The Bank's municipal bond portfolio is generally concentrated in school districts across the U.S.A., which historically have been considered among the safest municipal bond investments. One of the primary attractions of municipal bonds is that "Bank Qualified" issues are federally tax exempt.

At December 31, 2009, the Bank's municipal bond portfolio, at fair value, totaled \$61,660, compared with \$39,033 at December 31, 2008, representing an increase of \$22,627, or 58.0%. At December 31, 2009, the fully tax-equivalent yield on the Bank's municipal bond portfolio amounted to 7.53%, compared with 7.16% at December 31, 2008.

Municipal bonds are frequently supported with insurance, which guarantees that in the event the issuer experiences financial problems, the insurer will step in and assume payment of both principal and interest. Historically, insurance support has strengthened an issuer's underlying credit rating to AAA or AA status. Starting in 2008 and continuing into 2009, many of the insurance companies providing municipal bond insurance experienced financial difficulties and, accordingly, were downgraded by at least one of the major credit rating agencies. Consequently, in 2008 and 2009 a portion of the Bank's municipal bond portfolio was downgraded by at least one of the major credit rating agencies. Notwithstanding the credit rating downgrades, at December 31, 2009 and 2008, the Bank's municipal bond portfolio did not contain any below investment grade securities as reported by major credit rating agencies.

Securities Maturity Distribution and Weighted Average Yields:

The following table summarizes the maturity distribution of the amortized cost of the Bank's securities portfolio and weighted average yields of such securities on a fully tax-equivalent basis as of December 31, 2009. The Bank recognizes the amortization of premiums and accretion of discounts in interest income using the interest method over the estimated life of the security. The maturity distribution is based upon the final maturity date of the securities. Expected maturities may differ from contractual maturities because issuers may have the right to call or pre-pay certain securities. In the case of mortgage-backed securities, actual maturities may also differ from expected maturities due to the amortizing nature of the underlying mortgage collateral, and the fact that borrowers have the right to prepay.

SECURITIES  
Maturity Schedule and Weighted Average Yields  
December 31, 2009  
(at fair value)

	One Year or less		Greater than one year to Five years		Greater than Five to ten years		Greater than ten years		TOTAL	
	Estimated Fair Value	Weighted average yield	Estimated Fair Value	Weighted average rate	Estimated Fair Value	Weighted average yield	Estimated Fair Value	Weighted average yield	Estimated Fair Value	Weighted average yield
Obligations of US	\$ ---	---	\$1,013	2.50%	\$ ---	---	\$ 1,543	6.45%	\$ 2,556	5.02%

Government-sponsored

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

enterprises										
Mortgage-backed securities:										
US										
Government-sponsored enterprises	164	5.40%	301	4.73%	8,399	4.55%	225,486	5.42%	234,350	5.39%
US Government agency	---	---	83	2.17%	1,689	5.64%	20,335	5.41%	22,107	5.42%
Private-label	---	---	---	---	2,285	5.29%	24,068	6.17%	26,353	6.10%
Obligations of states and political subdivisions thereof	---	---	260	7.88%	4,672	7.26%	56,728	7.65%	61,660	7.53%
Total	\$164		\$1,657		\$17,045		\$328,160		\$347,026	

Securities Concentrations:

At December 31, 2009 and 2008, the Bank did not hold any securities for a single issuer, other than U. S. Government agencies and sponsored enterprises, where the aggregate book value of the securities exceeded 5% of the Company's shareholders' equity.

Impaired Securities:

The securities portfolio contains certain securities where amortized cost exceeds fair value, which at December 31, 2009, amounted to an excess of \$9,514, or 2.7% of the amortized cost total securities. At December 31, 2008 this amount represented an excess of \$7,896, or 2.7% of the total securities portfolio. As of December 31, 2009, unrealized losses on securities in a continuous unrealized loss position more than twelve-months amounted to \$6,675, compared with \$1,980 at December 31, 2008.

Further information regarding impaired securities, other-than-temporarily impaired securities and evaluation of securities for impairment is incorporated by reference to Part II, Item 8, Notes 1 and 2 of the Consolidated Financial Statements in this Annual Report on Form 10-K.

**Federal Home Loan Bank Stock**

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Boston. The FHLB of Boston is a cooperatively owned wholesale bank for housing and finance in the six New England states. Its mission is to support the residential mortgage and community-development lending activities of its members, which include over 450 financial institutions across New England. As a requirement of membership in the FHLB of Boston, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. The Bank uses the FHLB of Boston for most of its wholesale funding needs.

At December 31, 2009 the Bank's investment in FHLB stock totaled \$16,068, compared with \$14,796 at December 31, 2008, representing an increase of \$1,272, or 8.6%.

FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value. Shares held in excess of the minimum required amount are generally redeemable at par value. However, in the first quarter of 2009 the FHLB announced a moratorium on such redemptions in order to preserve its capital in response to current market conditions and declining retained earnings. The minimum required shares are redeemable, subject to certain limitations, five years following termination of FHLB membership. The Bank has no intention of terminating its FHLB membership.

In the first quarter of 2009, the FHLB of Boston advised its members that it is focusing on preserving capital in response to other-than-temporary impairment losses it had sustained, declining capital ratios and ongoing market volatility. Accordingly, dividend payments for the first quarter of 2009 were suspended, and no dividends were paid in

2009. The Company believes it is more likely than not that the suspension of FHLB stock dividends will continue throughout 2010.

The Company periodically evaluates its investment in FHLB stock for impairment based on, among other things, the capital adequacy of the FHLB of Boston and its overall financial condition. For the year ended December 31, 2009, the FHLB reported an unaudited loss of \$186.8 million, following a net loss of \$115.8 million in 2008. These net losses were entirely attributed to OTTI losses in the FHLB's securities portfolio. The FHLB also reported that it remained in compliance with all regulatory capital ratios as of December 31, 2009, and, in the most recent information available, was classified "adequately capitalized" by its regulator, the Federal Housing Finance Agency, as of September 30, 2009.

The FHLB has the capacity to issue additional debt if necessary to raise cash. If needed, the FHLB also has the ability to secure funding available to government-sponsored enterprises through the U.S. Treasury. Based on the capital adequacy and the liquidity position of the FHLB, management believes there is no impairment related to the carrying amount of the Bank's FHLB stock as of December 31, 2009. Further deterioration of the FHLB's capital levels may require the Bank to deem its restricted investment in FHLB stock to be other-than-temporarily impaired. If evidence of impairment exists in future periods, the FHLB stock would reflect fair value using observable or unobservable inputs. The Bank will continue to monitor its investment in FHLB of Boston stock.

## Loans

### Total Loans:

At December 31, 2009, total loans amounted to \$669,492, compared with \$633,603 at December 31, 2008, representing an increase of \$35,889, or 5.7%. Commercial loans and tax-exempt loans to local municipalities led the overall growth of the loan portfolio in 2009.

The loan portfolio is primarily secured by real estate in the counties of Hancock, Washington and Knox, Maine. The following table summarizes the major components of the Bank's loan portfolio, net of deferred loan origination fees and costs, as of December 31 over the past five years.

### SUMMARY OF LOAN PORTFOLIO AT DECEMBER 31

	2009	2008	2007	2006	2005
Commercial real estate mortgages	\$269,776	\$236,674	\$183,663	\$159,330	\$135,269
Commercial and industrial loans	77,284	65,717	65,238	61,634	58,542
Agricultural and other loans to farmers	22,192	19,390	15,989	17,706	18,962
Total commercial loans	369,252	321,781	264,890	238,670	212,773
Residential real estate mortgages	225,750	249,543	251,625	253,114	236,712
Home equity loans	54,889	51,095	45,783	45,062	49,221
Consumer loans	4,665	4,773	10,267	10,889	12,565
Total consumer loans	285,304	305,411	307,675	309,065	298,498
Tax exempt loans	14,138	5,358	6,001	6,213	2,732
Deferred origination costs	798	1,053	1,145	1,151	863
Total loans	669,492	633,603	579,711	555,099	514,866
Allowance for loan losses	(7,814)	(5,446)	(4,743)	(4,525)	(4,647)
Total loans, net of allowance for loan losses	\$661,678	\$628,157	\$574,968	\$550,574	\$510,219

At December 31, 2009, commercial loans comprised 55.2% of the total loan portfolio, compared with 50.8% at December 31, 2008. Consumer loans, which principally consisted of residential real estate mortgage loans, comprised 42.6% of total loans compared with 48.2% at December 31, 2008.

Factors contributing to the changes in the loan portfolio are enumerated in the following discussion and analysis.

Commercial Loans:

At December 31, 2009, total commercial loans amounted to \$369,252, compared with \$321,781 at December 31, 2008, representing an increase of \$47,471, or 14.8%. All categories of commercial loans posted meaningful increases.

Commercial loan growth has generally been challenged by a weakening economy, declining loan demand, and unrelenting competition for quality loans. Bank management attributes the overall growth in commercial loans, to an effective business banking team, deep local market knowledge, sustained new business development efforts, and a local economy that is faring better than the nation as a whole.

The 2009 growth in the commercial loan portfolio was principally attributed to commercial real estate mortgage loans, which posted an increase of \$33,102, or 14.0%, compared with December 31, 2008. At December 31, 2009 commercial real estate mortgage loans totaled \$269,776 and represented 40.3% of the total loan portfolio, compared with 37.4% at December 31, 2008. Reflecting the Bank's business region, approximately 26.3% of the CRE portfolio is represented by loans to the lodging industry. The Bank underwrites "hotel loans" as businesses versus properties and only to seasonal establishments

At December 31, 2009, commercial and industrial loans totaled \$77,284, compared with \$65,717 at December 31, 2008, representing an increase of \$11,567, or 17.6%. This category of loans represented 11.5% of the loan portfolio at December 31, 2009, compared with 10.4% at December 31, 2008. The Bank's market area demographics have historically limited the opportunity and growth potential in this particular category of loans.

Loans to finance agricultural production and other loans to farmers totaled \$22,192 as of December 31, 2009, compared with \$19,390 at December 31, 2008, representing an increase of \$2,802, or 14.5%. This category of loans represented 3.3% of the total loan portfolio at December 31, 2009, compared with 3.1% at December 31, 2008. The communities served by the Bank generally offer limited opportunities for lending in this industry sector. This category of loans includes loans related to Maine's wild blueberry industry.

Consumer Loans:

At December 31, 2009, total consumer loans, which principally consisted of residential real estate mortgage loans, stood at \$285,304 compared with \$305,411 at December 31, 2008, representing a decline \$20,107, or 6.6%.

Residential real estate mortgage loans totaled at \$225,750 as of December 31, 2009, compared with \$249,543 at December 31, 2008, representing a decline of \$23,793, or 9.5%. This category of loans represented 33.7% of the Bank's total loan portfolio at December 31, 2008, compared with 39.4% at December 31, 2008.

Residential mortgage loan origination activity increased significantly in 2009, principally reflecting the declines in residential mortgage loan interest rates, borrower refinancing activity, more affordable home prices and tax incentive programs. However, while the Bank originated and closed \$72,990 in residential real estate loans during 2009, this amount was largely offset by cash flows (principal pay-downs and re-financings) from the existing residential real estate loan portfolio. Additionally, because of the interest rate risk considerations associated with holding low coupon mortgage loans on the Bank's balance sheet, \$29,842 of the low fixed rate residential mortgages primarily originated in 2009 were sold in the secondary market with customer servicing retained and as a result were not reflected in outstanding loan balances at period end.

Loans to individuals for household, family and other personal expenditures ("consumer loans") totaled \$4,665 at December 31, 2009 compared with \$4,773 at December 31, 2008, representing a decline of \$108, or 2.3%. Given strong competition from the financing affiliates of consumer durable goods manufacturers, among other considerations, the Bank has not campaigned aggressively for consumer installment loans over the past five years.

## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Home equity loans totaled \$54,889 at December 31, 2009, compared with \$51,095 at December 31, 2008, representing an increase of \$3,794, or 7.4%. Approximately 91% of the Bank's home equity loan portfolio is represented by variable rate loans indexed to the Prime interest rate. Bank management believes the 2009 increase in home equity loans was principally attributed to a historically low Prime interest rate, providing borrowers with an attractive and readily available source of low cost borrowings, compared with other borrowing alternatives.

### Tax Exempt Loans:

Tax-exempt loans totaled \$14,138 at December 31, 2009, compared with \$5,358 at December 31, 2008, representing an increase of \$8,780, or 163.9%. Tax-exempt loans represented 2.1% of the loan portfolio at December 31, 2009, compared with 0.8% at December 31, 2008.

Tax-exempt loans principally include loans to local government municipalities and, to a lesser extent, not-for-profit organizations. Government municipality loans typically have short maturities (e.g., tax anticipation notes). Government municipality loans are normally originated through a bid process among local financial institutions and are typically priced aggressively, thus generating narrow net interest margins.

### Loan Concentrations:

Because of the Company's proximity to Acadia National Park, a large part of the economic activity in the area is generated from the hospitality business associated with tourism. At December 31, 2009, approximately \$70,846 or 10.6% of the Bank's loan portfolio was represented by loans to the lodging industry, compared with \$54,855 or 8.7% at December 31, 2008. Loan concentrations continued to principally reflect the Bank's business region.

### Subprime Mortgage Lending:

Subprime mortgage lending, which has been the riskiest sector of the residential housing market, is not a market that Bank management has ever actively pursued. In general, the industry does not apply a uniform definition of what actually constitutes "sub-prime" lending. In referencing sub-prime lending activities, Bank management relies upon several sources, including Maine's predatory lending law enacted January 1, 2008, and the "statement of Subprime Mortgage Lending" issued by the federal bank regulatory agencies (the "agencies") on June 29, 2007, which further references the expanded guidance for sub-prime lending programs (the "expanded guidance"), issued by the agencies by press release dated January 31, 2001.

In the expanded guidance, the agencies indicated that sub-prime lending does not refer to individual sub-prime loans originated and managed, in the ordinary course of business, as exceptions to prime risk selection standards. The agencies recognize that many prime loan portfolios will contain such accounts. The agencies also excluded prime loans that develop credit problems after origination and community development loans from the sub-prime arena. According to the expanded guidance, sub-prime loans are other loans to borrowers that display one or more characteristics of reduced payment capacity. Five specific criteria, which are not intended to be exhaustive and are not meant to define specific parameters for all sub-prime borrowers and may not match all markets' or institutions' specific sub-prime definitions, are set forth, including having a FICO (credit) score of 660 or lower. Based on the definitions and exclusions described above, Bank management considers the Bank as a prime lender. Within the Bank's residential mortgage loan portfolio there are loans that, at the time of origination, had fico scores of 660 or below. However, as a portfolio lender, the Bank reviews all credit underwriting data including all data included in borrower credit reports and does not base its underwriting decisions solely on fico scores. Bank management believes the aforementioned loans, when made, were amply collateralized and documented, and otherwise conformed to the Bank's prime lending standards.

### Real Estate Loans Under Foreclosure:

## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

At December 31, 2009, real estate loans under foreclosure totaled \$3,552 compared with \$2,463 at December 31, 2008, representing an increase of \$1,089, or 44.2%.

At December 31, 2009, real estate loans under foreclosure were represented by eleven residential mortgage loans totaling \$873 and 12 commercial real estate loans totaling \$2,679.

At December 31, 2008, real estate loans under foreclosure were represented by six residential mortgage loans totaling \$1,103 and six commercial real estate loans totaling \$1,360. During 2009, foreclosure proceedings were completed or otherwise resolved on eight of these loans, and any resulting charge-offs were recognized.

### Other Real Estate Owned:

Real estate acquired in satisfaction of a loan is reported in other assets. Properties acquired by foreclosure or deed in lieu of foreclosure are transferred to other real estate owned ("OREO") and recorded at the lower of cost or fair market value less estimated costs to sell based on appraised value at the date actually or constructively received. Loan losses arising from the acquisition of such property are charged against the allowance for loan losses. Subsequent reductions in fair value below the carrying value are charged to other operating expenses.

At December 31, 2009 total OREO amounted to \$854, compared with \$83 as of December 31, 2008. Three residential properties comprised the December 31, 2009 balance of OREO.

### Mortgage Loan Servicing:

The Bank from time to time will sell residential mortgage loans to other institutions and investors such as the FHLMC. The sale of loans allows the Bank to make more funds available to customers in its servicing area, while the retention of servicing rights provides an additional source of income. Additionally, because of the interest rate risk considerations associated with holding low coupon mortgage loans on the Bank's balance sheet, in 2009 the Bank sold \$29,842 of its low fixed rate mortgage loans in the secondary market with customer servicing retained. At December 31, 2009, the unpaid balance of mortgage loans serviced for others totaled \$32,810 compared with \$4,575 at December 31, 2008, representing an increase of \$28,235 or 617.2%.

### Loan Portfolio Interest Rate Composition:

The following table summarizes the commercial, tax-exempt and consumer components of the loan portfolio by fixed and variable interest rate composition, as of December 31, 2009 and 2008:

	2009	2008
<b>Commercial:</b>		
Fixed	\$ 42,939	\$ 49,172
Variable	326,712	273,135
Total	\$369,651	\$322,307
<b>Tax exempt:</b>		
Fixed	\$ 9,138	\$ 5,358
Variable	5,000	---
Total	\$ 14,138	\$ 5,358
<b>Consumer:</b>		
Fixed	\$172,506	\$177,825
Variable	113,197	128,113
Total	\$285,703	\$305,938
<b>Total loans:</b>		
Fixed	\$224,583	\$232,355
Variable	444,909	401,248
Total	\$669,492	\$633,603



## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

At December 31, 2009, fixed and variable rate loans comprised 33.5% and 66.5% of the loan portfolio, respectively, compared with 36.7% and 63.3% at December 31, 2008. The 2009 increase in variable rate loans was principally driven by the historically low Prime interest rate, which is the index used for most of the Bank's variable rate commercial loans. Most new borrowers elected Prime based loan pricing in 2009, while some existing borrowers renegotiated their higher cost fixed rate borrowings to lower cost Prime based borrowings.

### Loan Maturities and Re-pricing Distribution:

The following table summarizes fixed rate loans reported by remaining maturity, and floating rate loans by next re-pricing date, as of December 31, 2009 and 2008. Actual maturity dates may differ from contractual maturity dates due to prepayments, modifications and re-financings.

Maturities	2009	2008
One year or less	\$237,293	\$235,261
Over 1 - 5 years	144,108	179,359
Over 5 years	288,091	218,983
Total loans	\$669,492	\$633,603

### Credit Risk:

Credit risk is managed through loan officer authorities, loan policies, and oversight from the Bank's Senior Credit Officer, the Bank's Senior Loan Officers' Committee, the Directors' Loan Committee, and the Bank's Board of Directors. Management follows a policy of continually identifying, analyzing and grading credit risk inherent in the loan portfolio. An ongoing independent review, subsequent to management's review, of individual credits is performed by an independent loan review function, which reports to the Audit Committee of the Board of Directors.

Management recognizes that early and accurate recognition of risk is the best means to reduce credit losses and maximize earnings. The Bank employs a comprehensive risk management structure to identify and manage the risk of loss. For consumer loans, the Bank identifies loan delinquency beginning at 10-day delinquency and provides appropriate follow-up by written correspondence or personal contact. Non-residential mortgage loan losses are recognized no later than the point at which a loan is 120 days past due. Residential mortgage loan losses are recognized during the foreclosure process, or sooner, when that loss is quantifiable and reasonably assured. For commercial loans the Bank applies a risk grading system, which stratifies the portfolio and allows management to focus appropriate efforts on the highest risk components of the portfolio. The risk grades include ratings that correlate with regulatory definitions of "Pass," "Other Assets Especially Mentioned," "Substandard," "Doubtful," and "Loss."

As a result of management's ongoing review of the loan portfolio, loans are placed on non-accrual status, either due to the delinquent status of principal and/or interest, or a judgment by management that, although payments of principal and/or interest are current, such action is prudent because collection in full of all outstanding principal and interest is in doubt. Loans are generally placed on non-accrual status when principal and or interest is 90 days overdue, or sooner if judged appropriate by management. Consumer loans are generally charged-off when principal and or interest payments are 120 days overdue, or sooner if judged appropriate by management.

### Non-performing Loans:

Non-performing loans include loans on non-accrual status, loans that have been treated as troubled debt restructurings, and loans past due 90 days or more and still accruing interest. At December 31, 2009, total non performing loans included one troubled debt restructuring (a residential real estate mortgage) amounting to \$301, compared with none at December 31, 2008.

The following table sets forth the details of non-performing loans over the past five years.

TOTAL NON-PERFORMING LOANS  
AT DECEMBER 31

	2009	2008	2007	2006	2005
Commercial real estate mortgages	\$3,096	\$1,645	\$1,519	\$253	\$532
Commercial construction and development	392	---	---	---	---
Commercial and industrial loans	237	294	---	162	60
Agricultural and other loans to farmers	1,848	199	79	41	---
Total commercial loans	5,573	2,138	1,598	456	592
Residential real estate mortgages	2,498	1,696	377	37	248
Home equity loans	304	26	73	73	19
Residential construction and development	24	25	---	---	---
Consumer loans	5	16	5	4	6
Total consumer loans	2,831	1,763	455	114	273
Total non-accrual loans	8,404	3,901	2,053	570	865
Accruing loans contractually past due 90 days or more	772	503	9	58	3
Total non-performing loans	\$9,176	\$4,404	\$2,062	\$628	\$868
Allowance for loan losses to non-performing loans	85%	124%	230%	721%	535%
Non-performing loans to total loans	1.37%	0.70%	0.36%	0.11%	0.17%
Allowance to total loans	1.17%	0.86%	0.82%	0.82%	0.90%

During the year ended December 31, 2009, the Bank's non-performing loans trended upward, but ended the year at manageable levels. The Bank attributes the overall stability of the loan portfolio to mature credit administration processes and disciplined underwriting standards, aided by a local economy that is faring better than the country as a whole. The Bank maintains a centralized loan collection and managed asset department, providing timely and effective collection efforts for problem loans.

At December 31, 2009, total non-performing loans amounted to \$9,176, or 1.37% of total loans, compared with \$4,404 or 0.70% of total loans as of December 31, 2008. One agricultural loan accounted for \$1,500 or 16.3% of total non-performing loans at December 31, 2009 and represented 31.4% of the increase compared with December 31, 2008.

Non-performing commercial real estate mortgages amounted to \$3,096 at December 31, 2009, representing an increase of \$1,451 or 88.2% compared with December 31, 2008. At December 31, 2009, non-performing commercial real estate loans were represented by seventeen business relationships, with outstanding balances ranging from \$30 to \$452.

Non-performing residential real estate mortgages amounted to \$2,498 at December 31, 2009, representing an increase of \$802 or 47.3% compared with December 31, 2008. At December 31, 2009, non-performing residential real estate loans were represented by twenty-five, conventional, 1-4 family mortgage loans, with outstanding balances ranging from \$12 to \$405.

While the level of non-performing loans to total loans ratio was well below industry averages and continued to reflect the overall quality of the loan portfolio at December 31, 2009, Bank management is cognizant of the continued softening of the real estate market, elevated unemployment rates and depressed economic conditions overall, and believes it is managing credit risk accordingly. Future levels of non-performing loans may be influenced by economic conditions, including the impact of those conditions on the Bank's customers, including debt service levels, declining collateral values, tourism activity, and other factors existing at the time. Management believes the economic activity and conditions in the local real estate markets will continue to be significant determinants of the quality of the loan portfolio in future periods and, thus, the Company's results of operations and financial condition.

Delinquencies and Potential Problem Loans:

In addition to the non-performing loans discussed above, the Bank also has loans that are 30 to 89 days delinquent. These loans amounted to \$4,255 and \$3,591 at December 31, 2009 and 2008, or 0.64% and 0.57% of total loans, respectively, net of any loans classified as non-performing that are within these delinquency categories. These loans and delinquency trends in general are considered in the evaluation of the allowance for loan losses and the related determination of the provision for loan losses.

On at least a quarterly basis, the Bank applies an internal credit quality rating system to commercial loans that are either past due or fully performing, but exhibit certain characteristics that could reflect a potential weakness. Loans are placed on non-accrual status when the likely amount of future principal and interest payments are expected to be less than the contractual amounts, even if such loans are not 90 days past due.

Periodically the Bank reviews the loan portfolio for evidence of potential problem loans. Potential problem loans are loans that are currently performing in accordance with contractual terms, but where known information about possible credit problems of the borrower causes doubt about the ability of the borrower to comply with the loan payment terms and may result in disclosure of such loans as nonperforming at some time in the future. Through the Bank's on-going credit monitoring, it considers loans which, in its internal classification system, are classified as substandard but continue to accrue interest to be potential problem loans. At December 31, 2009, the Bank identified 16 commercial relationships totaling \$2,624 as potential problem loans, or 0.39% of total loans. At December 31, 2008, the Bank identified 10 commercial relationships totaling \$1,733 as potential problem loans, or 0.27% of total loans. Factors such as payment history, value of supporting collateral, and personal or government guarantees led the Bank to conclude that the current risk exposure on these loans did not warrant accounting for the loans as nonperforming. Although in a performing status as of year-end, these loans exhibited certain risk factors, which have the potential to cause them to become nonperforming at some point in the future.

#### Allowance for Loan Losses:

At December 31, 2009, the allowance for loan losses (the "allowance") stood at \$7,814, compared with \$5,446 at December 31, 2008, representing an increase of \$2,368, or 43.5%. At December 31, 2009, the allowance expressed as a percentage of total loans stood at 117 basis points, up from 86 basis points at December 31, 2008. The increase in the allowance was principally attributed to an overall deterioration in credit quality, the growth of the loan portfolio in 2009 and depressed economic conditions, including elevated unemployment levels and declining real estate values in the markets served by the Bank.

The allowance is available to absorb probable losses on loans. The determination of the adequacy of the allowance and provisioning for estimated losses is evaluated quarterly based on review of loans, with particular emphasis on non-performing and other loans that management believes warrant special consideration.

The allowance is maintained at a level that, in management's judgment, is appropriate for the amount of risk inherent in the current loan portfolio, and adequate to provide for estimated, probable losses. Allowances are established for specific impaired loans, a pool of reserves based on historical net loan charge-offs by loan types, and supplemental reserves that adjust historical loss experience to reflect current economic conditions, industry specific risks, and other qualitative and environmental considerations impacting the inherent risk of loss in the current loan portfolio.

Specific allowances for impaired loans are determined based upon a discounted cash flows analysis, or as expedient, a collateral shortfall analysis. The amount of loans considered to be impaired totaled \$5,573 as of December 31, 2009, compared with \$2,138 as of December 31, 2008.

The related allowances for loan losses on these impaired loans amounted to \$702 and \$176 as of December 31, 2009 and 2008, respectively.

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Management reviews impaired loans to ensure such loans are transferred to interest non-accrual status, and written down when necessary. The amount of interest income not recorded on impaired loans amounted to \$382 and \$263 for the years ended December 31, 2009 and 2008, respectively.

General allowances for loan losses account for the risk and estimated loss inherent in certain pools of industry and geographic loan concentrations within the loan portfolio. There were no material changes in loan concentrations during 2009 compared with 2008.

Based upon the process employed and giving recognition to all attendant factors associated with the loan portfolio, management believes the allowance for loan losses at December 31, 2009 is appropriate for the risks inherent in the loan portfolio.

While management uses available information to recognize losses on loans, changing economic conditions and the economic prospects of the borrowers may necessitate future additions or reductions to the allowance. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance, which also may necessitate future additions or reductions to the allowance, based on information available to them at the time of their examination.

The following table details changes in the allowance for loan losses and summarizes loan loss experience by loan type over the past five years.

ALLOWANCE FOR LOAN LOSSES  
SUMMARY OF LOAN LOSS EXPERIENCE

	2009	2008	2007	2006	2005
Balance at beginning of period	\$ 5,446	\$ 4,743	\$ 4,525	\$ 4,647	\$ 4,829
Charge offs:					
Commercial real estate mortgages	73	280	60	193	19
Commercial and industrial loans	348	861	98	14	94
Residential real estate mortgages	495	86	8	23	125
Consumer loans	79	106	104	119	---
Home equity loans	---	3	33	---	---
Tax exempt loans	---	---	---	---	---
Total charge-offs	995	1,336	303	349	238
Recoveries:					
Commercial real estate mortgages	---	1	4	7	---
Commercial and industrial loans	21	1	25	4	14
Residential real estate mortgages	119	18	---	32	5
Consumer loans	16	24	36	53	37
Home equity loans	---	---	---	---	---
Tax exempt loans	---	---	---	---	---
Total recoveries	156	44	65	96	56
Net charge-offs	839	1,292	238	253	182
Provision charged to operations	3,207	1,995	456	131	---
Balance at end of period	\$ 7,814	\$ 5,446	\$ 4,743	\$ 4,525	\$ 4,647
Average loans outstanding during period	\$655,201	\$611,373	\$558,795	\$538,212	\$479,974
Net charge-offs to average loans outstanding	0.13%	0.21%	0.04%	0.05%	0.04%

The Bank's loan loss experience improved during 2009 with net loan charge-offs amounting to \$839 compared with \$1,292 in 2008, representing a decline of \$453, or 35.1%. Total net loan charge-offs to average loans outstanding amounted to 0.13% in 2009, compared with 0.21% in 2008, representing an improvement of 8 basis points. Two problem loans accounted for \$1,094, or 84.7%, of total net loan charge-offs in 2008.

The following table presents the five-year summary of the allowance by loan type at each respective year-end.

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

ALLOCATION OF ALLOWANCE FOR LOAN LOSSES  
(at December 31)

	2009		2008		2007		2006		2005	
	Amount	Percent of Loans in Each Category to Total loans	Amount	Percent of Loans in Each Category to Total loans	Amount	Percent of Loans in Each Category to Total loans	Amount	Percent of Loans in Each Category to Total loans	Amount	Percent of Loans in Each Category to Total loans
Commercial, financial, and agricultural	\$1,966	8.06%	\$1,612	9.36%	\$1,093	9.99%	\$1,435	9.83%	\$1,407	11.70%
Real estate mortgages:										
Real estate-construction	349	5.37%	251	6.04%	168	4.25%	205	6.26%	186	5.37%
Real estate-mortgage	5,377	83.33%	3,414	82.50%	3,247	82.24%	2,628	80.30%	2,768	80.00%
Installments and other loans to individuals	122	0.69%	169	0.77%	235	1.38%	257	1.92%	230	2.07%
Other	---	2.55%	---	1.33%	---	2.14%	---	1.69%	---	0.86%
Unallocated	---	0.00%	---	0.00%	---	0.00%	---	0.00%	56	0.00%
TOTAL	\$7,814	100.00%	\$5,446	100.00%	\$4,743	100.00%	\$4,525	100.00%	\$4,647	100.00%

#### Bank Owned Life Insurance

Bank-owned life insurance ("BOLI") represents life insurance on the lives of certain retired employees who had provided positive consent allowing the Bank to be the beneficiary of such policies. Increases in the cash value of the policies, as well as insurance proceeds received in excess of the cash value, are recorded in other non-interest income, and are not subject to income taxes. The cash surrender value of the BOLI is included on the Company's consolidated balance sheet.

At December 31, 2009, the cash surrender value of BOLI amounted to \$6,846, representing an increase of \$273, or 4.2%, compared with December 31, 2008.

#### Other Assets

The Company's other assets are principally comprised of accrued interest receivable, prepaid FDIC insurance assessments, deferred income taxes and other real estate owned.

At December 31, 2009 total other assets amounted to \$15,846, compared with \$9,206 at December 31, 2008, representing an increase of \$6,640, or 72.1%. The increase in other assets was principally attributed to prepaid FDIC insurance assessments, which at December 31, 2009 amounted to \$3,792. As more fully enumerated in Part 1, Item 1, *Supervision and Regulation - Insurance of Accounts and FDIC Regulation*, in this Annual Report on Form 10-K, in September 2009 the FDIC proposed a rule that was subsequently adopted in final form by the FDIC board of directors on November 12, 2009 that required insured depository institutions to prepay their quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012, on December 30, 2009.

#### Funding Sources

The Bank utilizes various traditional sources of funding to support its earning asset portfolios. Funding sources principally consist of retail deposits and, to a lesser extent, borrowings from the Federal Home Loan Bank of Boston

("FHLB") of which it is a member, the Federal Reserve Bank of Boston ("Federal Reserve"), and certificates of deposit obtained from the national market.

According to a January 2010 report prepared by the Maine Bureau of Financial Institutions, Maine banks rely on borrowings and other types of non-core funding to a much greater degree than the national average, as Maine banks historical core deposit growth has not kept pace with asset growth. At September 30, 2009, borrowings and other types of non-core funding such as brokered deposits supported 33.2% of Maine bank assets, down from 34.6% at December 31, 2008, and well above the national average. At December 31, 2009 the Bank's non-core funding represented 35.2% of total assets, compared with 40.5% at December 31, 2008.

While the foregoing ratios compare unfavorably to both Maine banks and the national average of all federally insured banks, the Bank has had a long and successful track record in managing its liquidity and funding its earning asset portfolios. Nevertheless, management believes that the Bank's future success in growing core deposits will be a determinant factor in its ability to meaningfully grow earning assets and leverage its strong capital position.

### Deposits

During 2009, the most significant source of funding for the Bank's earning assets continued to be retail deposits, gathered throughout its network of twelve banking offices throughout downeast and midcoast Maine.

Historically, the banking business in the Bank's market area has been seasonal, with lower deposits in the winter and spring and higher deposits in the summer and autumn. These seasonal swings have been fairly predictable and have not had a materially adverse impact on the Bank. Seasonal swings in deposits have been typically absorbed by the Bank's strong liquidity position, including borrowing capacity from the FHLB and FRB, brokered certificates of deposit obtained from the national market and cash flows from the securities portfolio.

### Total Deposits:

At December 31, 2009 total deposits amounted to \$641,173 compared with \$578,193 at December 31, 2008, representing an increase of \$62,980, or 10.9%. Retail deposits accounted for 94.5% of the 2009 deposit growth.

At December 31, 2009, total retail deposits amounted to \$549,183, compared with \$489,687 at December 31, 2008, representing an increase of \$59,496 or 12.1%.

### Demand Deposits:

The Bank's demand deposits are principally business accounts, which account for approximately two-thirds of total demand deposits. At December 31, 2009, total demand deposits amounted to \$57,743, compared with \$57,954 at December 31, 2008, representing a decline of \$211, or 0.4%. As discussed above, the Bank's deposits are seasonal in nature and the timing and extent of seasonal swings vary from year to year. This is particularly the case with demand deposits. For the year ended December 31, 2009, average demand deposits amounted to \$53,152, compared with \$54,664 in 2008, representing a decline of \$1,512, or 2.8%. Management believes the decline in demand deposits was due in part to the impacts of the economic recession in the markets served by the Bank.

The Bank strives to attract demand deposits in connection with its commercial lending activities, on a total relationship basis. The Bank's business checking account offerings include *Small BusinessPlus*, *BusinessPlus*, and *Free Small Business*, each designed to help business owners manage the varying financial aspects of their business. The Bank also offers its business customers a variety of cash management products including a *Cash Management Sweep Account*. Customers are able to automatically transfer their excess demand deposit balances, over certain thresholds established with an earnings credit rate, to interest bearing, overnight securities repurchase agreements. Business demand deposits are also generated by way of the Bank's *Merchant Credit Card Processing Program*.

NOW Accounts:

Bank offers interest bearing NOW accounts to individuals, not-for-profit organizations and sole proprietor businesses. At December 31, 2009, total NOW accounts amounted to \$74,538, compared with \$67,747 at December 31, 2008, representing an increase of \$6,791, or 10.0%.

For the year ended December 31, 2009, average NOW accounts amounted to \$70,656, compared with \$67,240 in 2008, representing an increase of \$3,416 or 5.1%.

During 2009, the Bank's most successful NOW account product continued to be *Gold Wave Checking*, a relationship product designed for its customers age 50 and above.

Savings and Money Market Deposits:

At December 31, 2009, total savings and money market accounts amounted to \$171,791, compared with \$163,780 at December 31, 2008, representing an increase of \$8,011, or 4.9%.

For the year ended December 31, 2009, average savings and money market accounts amounted to \$164,543, compared with \$167,739 in 2008, representing a decline of \$3,196 or 1.9%.

Time Deposits:

At December 31, 2009, total time deposits amounted to \$245,111, compared with \$200,206 at December 31, 2008, representing an increase of \$44,905, or 22.4%.

The 2009 increase in time deposits was largely attributed to the successful gathering of \$35,818 of out of market retail certificates of deposit, all of which were within FDIC insurance limitations at the time of origination. Excluding these out of market deposits, the Bank's total retail time deposits increased \$9,087 in 2009, or 4.5%.

Bank management believes it has exercised restraint with respect to overly aggressive deposit pricing strategies, and has sought to achieve an appropriate balance between retail deposit growth and wholesale funding levels, while considering the associated impacts on the Bank's net interest margin and liquidity position. In offering retail time deposits, the Bank generally prices these deposits on a relationship basis. At December 31, 2009, the weighted average cost of retail time deposits was 2.05% compared with 3.21% at December 31, 2008, representing a decline of 116 basis points. Given the current interest rate environment and continuing time deposit maturities, Bank management anticipates that the weighted average cost of time deposits will continue to show declines in 2010.

Brokered Time Deposits:

At December 31, 2009, total brokered time deposits amounted to \$91,990, compared with \$88,506 at December 31, 2008, representing an increase of \$3,484, or 3.9%.

Brokered deposits are generally utilized to help support the Bank's earning asset growth, while maintaining its strong on-balance-sheet liquidity position via secured borrowing lines of credit with the FHLB of Boston and the Federal Reserve Bank of Boston.

At December 31, 2009, total brokered deposits represented 14.3% of total deposits, compared with 15.3% of total deposits at December 31, 2008.

The following table summarizes the maturity distribution of brokered time deposits:

**MATURITY DISTRIBUTION  
BROKERED TIME DEPOSITS  
December 31, 2009**

Three months or less	\$ 5,127
Over three to six months	12,741
Over six to twelve months	3,588
Over twelve to twenty-four months	17,240
Over twenty-four months	53,294
	<b>\$91,990</b>

The following table summarizes the changes in the average balances of deposits during the periods indicated, including the weighted average interest rates paid for each category of deposits:

**AVERAGE DEPOSIT BALANCES BY CATEGORY OF DEPOSIT**

	2009		2008	
	Average Balance	Average Rate	Average Balance	Average Rate
Demand deposits	\$ 53,152	---	\$ 54,664	---
NOW accounts	70,656	0.43%	67,240	0.54%
Savings and money market deposits	164,543	1.05%	167,739	1.98%
Time deposits	230,669	2.40%	188,044	3.67%
Brokered time deposits	106,573	2.92%	95,679	4.60%
Total deposits	\$625,593		\$573,366	

The following table summarizes the maturity distribution of time deposits of \$100 or greater:

**MATURITY SCHEDULE  
TIME DEPOSITS \$100 OR GREATER  
DECEMBER 31, 2009**

Three months or less	\$ 25,426
Over three to six months	32,948
Over six to twelve months	28,932
Over twelve months	22,245
	<b>\$109,551</b>

Time deposits in denominations of \$100 or greater totaled \$109,551 at December 31, 2009, compared with \$65,437 at December 31, 2008, representing an increase of \$44,114, or 67.4%. In October 2008, the Emergency Economic Stabilization Act raised the basic limit on federal deposit insurance coverage from \$100 to \$250 per depositor. Company management attributes the 2009 growth in time deposits exceeding \$100, in part, to the increased insurance coverage provided by the FDIC.

#### Borrowed Funds

Borrowed funds principally consist of advances from the FHLB of Boston (the "FHLB") and, to a lesser extent, borrowings from the Federal Reserve Bank of Boston (the "Federal Reserve") and securities sold under agreements to repurchase. Advances from the FHLB of Boston are secured by stock in the FHLB of Boston, investment securities, and blanket liens on qualifying mortgage loans and home equity loans. Borrowings from the Federal Reserve Bank of Boston are principally secured by securities and liens on certain commercial loans.



## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

The Bank utilizes borrowed funds in leveraging its strong capital position and supporting its earning asset portfolios. Borrowed funds are principally utilized to support the Bank's investment securities portfolio and, to a lesser extent, fund loan growth. Borrowed funds also provide a means to help manage balance sheet interest rate risk, given the Bank's ability to select desired amounts, terms and maturities on a daily basis.

### Total Borrowings:

At December 31, 2009, total borrowings amounted to \$311,629, compared with \$323,903 at December 31, 2008, representing a decline of \$12,274, or 3.8%. The 2009 decline in borrowings was attributed to the sale of 18,751 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock to the U.S. Treasury in the first quarter of 2009, the cash proceeds from which amounted to \$18,751. The decline in 2009 borrowings was also attributed to the issuance of 800,000 shares of common stock to the public in the fourth quarter of 2009, the net cash proceeds from which amounted to \$20,412. The net cash proceeds from the foregoing transactions were deployed to pay down short-term borrowings, while largely supporting 2009 earning asset growth.

### Borrowings From the Federal Home Loan Bank:

At December 31, 2009, borrowings from the FHLB totaled \$265,986 compared with \$297,534 at December 31, 2008, representing a decline of \$31,548, or 10.6%.

At December 31, 2009, borrowings from the FHLB expressed as a percentage of total assets amounted to 24.8%, compared with 30.6% at December 31, 2008.

### Borrowings From the Federal Reserve Bank:

At December 31, 2009, borrowings from the Federal Reserve totaled \$20,000 compared with none at December 31, 2008. Borrowings from the Federal Reserve represented the lowest cost wholesale funding for the Bank and were principally utilized to help support 2009 earning asset growth as an alternative to FHLB borrowings and brokered certificates of deposit. Borrowings from the Federal Reserve are included in short-term borrowings on the Company's consolidated balance sheets.

### Securities Sold Under Agreements to Repurchase:

At December 31, 2009, securities sold under agreements to repurchase amounted to \$20,643, compared with \$21,369 at December 31, 2008, representing a decline of \$726, or 3.4%. Securities sold under agreements to repurchase are included in short-term borrowings on the Company's consolidated balance sheets.

Securities sold under agreements to repurchase were collateralized by U.S. Government-sponsored agency obligations, held in safekeeping by nonaffiliated financial institutions.

### Junior Subordinated Debentures:

In the second quarter of 2008, the Company's wholly-owned subsidiary, Bar Harbor Bank & Trust (the "Bank"), issued \$5,000 aggregate principal amount of subordinated debt securities. These securities qualify as Tier 2 capital for the Bank and the Company and were issued to help support future earning asset growth without jeopardizing the Bank's historically strong capital position. The subordinated debt securities are due in 2023, but are callable by the Bank after five years without penalty. The rate of interest on these securities is three month Libor plus 345 basis points. The subordinated debt securities are classified as borrowings on the Company's consolidated balance sheet.

### Borrowing Maturities:

Borrowing maturities are managed in concert with the Bank's asset and liability management strategy and are closely aligned with the ongoing management of balance sheet interest rate risk.

During 2009, the Bank extended the maturities on a portion of its FHLB borrowings. These actions were taken during periods of favorable market interest rates, and were consistent with the Bank's asset and liability management strategy of lessening its exposure to rising interest rates over a five year horizon.

As of December 31, 2009, total short-term borrowings, comprised of FHLB advances, Federal Reserve borrowings and all securities sold under repurchase agreements, amounted to \$91,893, compared with \$121,672 at December 31, 2008, representing a decline of \$29,779, or 24.5%. At December 31, 2009, total short-term borrowings represented 29.5% of total borrowings, compared with 37.6% at December 31, 2008.

As of December 31, 2009, total long-term borrowings (FHLB advances with a remaining term greater than one year) totaled \$214,736, compared with \$197,231 at December 31, 2008, representing an increase of \$17,505, or 8.9%. At December 31, 2009, total long-term advances represented 68.9% of total borrowings, compared with 60.9% at December 31, 2008.

### Capital Resources

Consistent with its long-term goal of operating a sound and profitable organization, during 2008 the Company maintained its strong capital position and continued to be a "well-capitalized" financial institution according to applicable regulatory standards. Management believes this to be vital in promoting depositor and investor confidence and providing a solid foundation for future growth. Historically, most of the Company's capital requirements have been provided through retained earnings and this continued to be the case during the year ended December 31, 2009.

### Capital Ratios:

The Company and the Bank are subject to the risk-based capital guidelines administered by the Company's and the Bank's principal regulators. The risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Under these guidelines, assets and off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of risk-weighted assets and off-balance sheet items. The guidelines require all banks and bank holding companies to maintain a minimum ratio of total risk-based capital to risk-weighted assets of 8%, including a minimum ratio of Tier I capital to total risk-weighted assets of 4% and a Tier I capital to average assets of 4% ("Leverage Ratio"). Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a material adverse effect on the Company's financial statements.

As of December 31, 2009 and 2008, the Company and the Bank were considered *well-capitalized* under the regulatory framework for prompt corrective action. Under the capital adequacy guidelines, a *well-capitalized* institution must maintain a minimum total risk-based capital to total risk-weighted assets ratio of at least 10.0%, a minimum Tier I capital to total risk-weighted assets ratio of at least 6.0%, and a minimum Tier I Leverage ratio of at least 5.0%.

At December 31, 2009, the Company's total risk-based capital was \$122,615 or 17.14% of risk-weighted assets, compared with \$73,191, or 11.60% of total risk-weighted assets at December 31, 2008.

At December 31, 2009, the Company's Tier I capital totaled \$109,755 or 15.34% of risk-weighted assets, compared with \$62,745, or 9.95% of total risk-weighted assets at December 31, 2008.

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

The ratio of Tier I capital to average assets, or Leverage Ratio, at December 31, 2009 was 10.35%, compared with 6.61% at December 31, 2008.

The following table sets forth the Company's regulatory capital at December 31, 2009 and 2008, under the rules applicable at that date.

	December 31, 2009		December 31, 2008	
	Amount	Ratio	Amount	Ratio
Total Capital to Risk Weighted Assets	\$122,615	17.14%	\$73,191	11.60%
Regulatory Requirement	57,241	8.00%	50,458	8.00%
Excess over "adequately capitalized"	\$ 65,374	9.14%	\$22,733	3.60%
Tier 1 Capital to Risk Weighted Assets	\$109,755	15.34%	\$62,745	9.95%
Regulatory Requirement	28,620	4.00%	25,229	4.00%
Excess over "adequately capitalized"	\$ 81,135	11.34%	\$37,516	5.95%
Tier 1 Capital to Average Assets	\$109,755	10.35%	\$62,745	6.61%
Regulatory Requirement	42,431	4.00%	37,977	4.00%
Excess over "adequately capitalized"	\$ 67,324	6.35%	\$24,768	2.61%

As more fully disclosed in Note 12 of the Consolidated Financial Statements in this Annual Report on Form 10-K, the Bank also maintained its standing as a well-capitalized institution as defined by applicable regulatory standards. At December 31, 2009, the Bank's Tier I Leverage, Tier I Risk-based and Total Risk-based capital ratios stood at 10.43%, 15.47% and 17.26%, respectively.

Series A Fixed Rate Cumulative Perpetual Preferred Stock and Warrant:

As previously reported, on January 16, 2009, as part of the Capital Purchase Program (the "CPP") established by the U.S. Department of the Treasury (the "Treasury") under the Emergency Economic Stabilization Act of 2008, the Company sold to Treasury (i) 18,751 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A, no par value, having a liquidation preference of one thousand dollars per share (the "Preferred Stock"); and (ii) a ten-year warrant to purchase up to 104,910 shares of the Company's common stock, par value two dollars per share at an initial exercise price of \$26.81 per share, for an aggregate purchase price of \$18,751 in cash. All of the proceeds from the sale were treated as Tier 1 capital for regulatory purposes.

On February 24, 2010 the Company redeemed all 18,751 shares of its Preferred Stock sold to Treasury. The Company paid \$18,774 to the Treasury to redeem the Preferred Stock, consisting of \$18,751 of principal and \$23 of accrued and unpaid dividends. The Company's redemption of the Preferred Stock is not subject to additional conditions or stipulations from the Treasury.

The preferred stock that the Company repurchased for \$18,751 had a current carrying value of \$18,255 (net of \$496 unaccreted discount) on the Company's consolidated balance sheet. As a result of the repurchase, the Company will accelerate the accretion of the \$496 discount and record a total reduction in shareholders' equity of \$18,751 in the first quarter of 2010. Additionally, the accelerated accretion of the discount will be treated in a manner consistent with that for preferred dividends in reporting net income available to common shareholders in the Company's results of operations for the first quarter of 2010, reducing diluted earnings per share by approximately \$0.13.

In the fourth quarter of 2009, the warrant received by the Treasury to purchase up to 104,910 shares of the Company's common stock was reduced by one half to 52,455 shares as a result of the Company's successful completion of a common stock offering in December 2009. The Company intends to seek agreement with the Treasury to repurchase the Warrant at its fair market value. However, there can be no assurance that the Company will reach agreement with the Treasury as to a fair market value of the Warrant, or that the Company will repurchase the Warrant.

#### Common Stock Offering:

In December 2009 the Company completed its previously announced offering of 800,000 shares of common stock to the public at \$27.50 per share. The net proceeds from this offering, after deducting underwriting discounts and estimated expenses amounted to \$20,412. As previously reported, in January 2010 the Company completed the closing of the underwriter's exercise of its over-allotment option to purchase an additional 82,021 shares of the Company's common stock at a purchase price to the public of \$27.50 per share. The Company received total net proceeds from the offering, including the exercise of the over allotment option, after deducting underwriting discounts and expenses, amounting to \$22,442. All of the net proceeds from this offering are treated as Tier 1 capital for regulatory purposes. In February 2010, the Company used \$18,751 of the net proceeds from this offering to repurchase all of its Series A preferred shares sold to the U.S. Department of the Treasury.

#### Trends, Events or Uncertainties:

There are no known trends, events or uncertainties, nor any recommendations by any regulatory authority, that are reasonably likely to have a material effect on the Company's capital resources, liquidity, or financial condition.

#### Stock Repurchase Plan:

In August 2008, the Company's Board of Directors approved a program to repurchase of up to 300,000 shares of the Company's common stock, or approximately 10.2% of the shares then currently outstanding. The new stock repurchase program became effective as of August 21, 2008 and is authorized to continue for a period of up to twenty-four consecutive months. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time, or from time to time, without prior notice and may be made in the open market or through privately negotiated transactions. As of December 31, 2009, the Company had repurchased 66,782 shares of stock under this plan, at a total cost of \$1,833 and an average price of \$27.44 per share. The Company recorded the repurchased shares as treasury stock.

The new stock repurchase program replaced the Company's stock repurchase program that had been in place since February 2004, which had authorized the repurchase of up to 310,000 or approximately 10% of the Company's outstanding shares of common stock. As of August 19, 2008, the date this program was terminated, the Company had repurchased 288,799 shares at a total cost of \$8,441,454 and an average price of \$29.23 per share.

#### Cash Dividends:

The Company has historically paid regular quarterly cash dividends on its common stock. Each quarter the Board of Directors declares the payment of regular quarterly cash dividends, subject to adjustment from time to time, based on the Company's earnings outlook, the strength of the balance sheet, its need for funds, and other relevant factors. There can be no assurance that dividends on the Company's common stock will be paid in the future.

The Company's principal source of funds to pay cash dividends and support its commitments is derived from Bank operations. During 2009, the Company declared and distributed regular cash dividends on its common stock in the aggregate amount of \$2,994, compared with \$3,004 in 2008. The Company's 2009 dividend payout ratio amounted to 32.6%, compared with 38.8% in 2008. The total regular cash dividends paid in 2009 amounted to \$1.04 per common share of stock, compared with \$1.02 in 2008, representing an increase of \$0.02 per share, or 2.0%.

In

the first quarter of 2010, the Company declared a regular cash dividend of \$0.26 per share of common stock, unchanged from the prior quarter and the same quarter in 2009. The dividend will be paid March 15, 2010 to shareholders of record as of the close of business on February 16, 2010.

### Contractual Obligations

The Company is a party to certain contractual obligations under which it is obligated to make future payments. These principally include borrowings from the FHLB, consisting of short and long-term fixed rate borrowings, and collateralized by all stock in the FHLB, a blanket lien on qualified collateral consisting primarily of loans with first and second mortgages secured by one-to-four family properties, and certain pledged investment securities. The Company has an obligation to repay all borrowings from the FHLB.

The Company is also obligated to make payments on operating leases for its branch office in Somesville and its office in Bangor, Maine.

The following table summarizes the Company's contractual obligations at December 31, 2009. Borrowings are stated at their contractual maturity due dates and do not reflect call features, or principal amortization features, on certain borrowings.

### CONTRACTUAL OBLIGATIONS

Description	Total Amount of Obligations	Payments Due By Period			
		< 1 Year	> 1-3 Years	> 3-5 Years	> 5 Years
Borrowings from Federal Home Loan Bank	\$265,986	\$51,250	\$98,266	\$97,470	\$19,000
Borrowings from Federal Reserve Bank	20,000	20,000	---	---	---
Securities sold under agreements to repurchase	20,643	20,643	---	---	---
Junior subordinated debentures	5,000	---	---	---	5,000
Operating Leases	224	116	108	---	---
Total	\$311,853	\$92,009	\$98,374	\$97,470	\$24,000

All FHLB advances are fixed-rate instruments. Advances are payable at their call dates or final maturity dates. At December 31, 2009, the Bank had \$70,000 in callable advances.

In the normal course of its banking and financial services business, and in connection with providing products and services to its customers, the Company has entered into a variety of traditional third party contracts for support services. Examples of such contractual agreements would include services providing ATM, Visa Debit Card processing, trust services accounting support, check printing, and the leasing of T-1 telecommunication lines supporting the Company's wide area technology network.

The majority of the Company's core operating systems and software applications are maintained "in-house" with traditional third party maintenance agreements of one year or less.

### Off-Balance Sheet Arrangements

The Company is, from time to time, a party to certain off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources, that may be material to

investors.

At December 31, 2009 and 2008, the Company's off-balance sheet arrangements were limited to standby letters of credit.

#### Standby Letters of Credit:

The Bank guarantees the obligations or performance of certain customers by issuing standby letters of credit to third parties. These letters of credit are sometimes issued in support of third-party debt. The risk involved in issuing standby letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same origination, portfolio maintenance and management procedures in effect to monitor other credit products. The amount of collateral obtained, if deemed necessary by the Bank upon issuance of a standby letter of credit, is based upon management's credit evaluation of the customer.

At December 31, 2009, commitments under existing standby letters of credit totaled \$372, compared with \$262 at December 31, 2008. The fair value of the standby letters of credit was not significant as of the foregoing dates.

#### Off-Balance Sheet Risk

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financial needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and certain financial derivative instruments; namely, interest rate swap agreements and interest rate floor agreements.

#### Commitments to Extend Credit:

Commitments to extend credit represent agreements by the Bank to lend to a customer provided there is no violation of any condition established in the contract. These commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee.

Since many of these commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis using the same credit policies as it does for its balance sheet instruments, such as loans. The amount of collateral obtained, if deemed necessary by the Bank upon the issuance of commitment, is based on management's credit evaluation of the customer.

The following table summarizes the Bank's commitments to extend credit as of December 31:

#### COMMITMENTS TO EXTEND CREDIT

	2009	2008
Commitments to originate loans	\$ 42,694	\$ 31,584
Unused lines of credit	78,607	70,610
Un-advanced portions of construction loans	12,565	4,284
Total	\$133,866	\$106,478

#### Financial Derivative Instruments:

As part of its overall asset and liability management strategy, the Bank periodically uses derivative instruments to minimize significant unplanned fluctuations in earnings and cash flows caused by interest rate volatility. The Bank's interest rate risk management strategy involves modifying the re-pricing characteristics of certain assets and liabilities

so that changes in interest rates do not have a significant adverse effect on net interest income. Derivative instruments that management periodically uses as part of its interest rate risk management strategy include interest rate swap agreements and interest rate floor agreements. A policy statement, approved by the Board of Directors of the Bank, governs use of derivative instruments.

At December 31, 2009, the Bank had two outstanding derivative instruments. These derivative instruments were interest rate floor agreements, with notional amounts totaling \$30,000. The notional amounts of the financial derivative instruments do not represent exposure to credit loss. The Bank is exposed to credit loss only to the extent the counter-party defaults in its responsibility to pay interest under the terms of the agreements. Management does not anticipate non-performance by the counter-parties to the agreements, and regularly reviews the credit quality of the counter-parties from which the instruments have been purchased.

The details of the Bank's financial derivative instruments as of December 31, 2009 are summarized below. The reader should also refer to Note 15 of the consolidated financial statements in Part II, Item 8 in this report on Form 10-K.

#### INTEREST RATE FLOOR AGREEMENTS

Notional Amount	Expiration Date	Prime Strike Rate	Premium Paid	Unamortized Premium at 12/31/09	Fair Value at 12/31/09	Cumulative Cash Flows Received
\$20,000	08/01/10	6.00%	\$186	\$36	\$381	\$756
\$10,000	11/01/10	6.50%	\$69	\$20	\$290	\$479

In 2005, interest rate floor agreements were purchased by the Bank to limit its exposure to falling interest rates on two pools of loans indexed to the Prime interest rate. Under the terms of the agreements, the Bank paid premiums of \$186 and \$69 for the right to receive cash flow payments if the Prime interest rate falls below the predetermined floor rates of 6.00% and 6.50%, thus effectively ensuring interest income on the pools of prime-based loans at minimum rates of 6.00% and 6.50% on the \$20,000 and \$10,000 notional amounts for the duration of the agreements, respectively. The interest rate floor agreements were designated as cash flow hedges.

#### Liquidity

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

The Bank actively manages its liquidity position through target ratios established under its Asset Liability Management Policy. Continual monitoring of these ratios, both historical and through forecasts under multiple rate and stress scenarios, allows the Bank to employ strategies necessary to maintain adequate liquidity.

The Bank uses a basic surplus model to measure its liquidity over 30 and 90-day time horizons. The relationship between liquid assets and short-term liabilities that are vulnerable to non-replacement are routinely monitored. The Bank's policy is to maintain a liquidity position of at least 5% of total assets. At December 31, 2009, liquidity, as measured by the basic surplus model, was 7.0% over the 30-day horizon and 6.0% over the 90-day horizon.

A portion of the Bank's deposit base has been historically seasonal in nature, with balances typically declining in the winter months through late spring, during which period the Bank's liquidity position tightens.

At December 31, 2009, the Bank had unused lines of credit and net unencumbered qualifying collateral availability to support its credit line with the FHLB approximating \$82,088. The Bank also had capacity to borrow funds on a secured basis utilizing the Borrower in Custody ("BIC") program at the Federal Reserve Bank of Boston. At December 31, 2009 the Bank's available secured line of credit at the Federal Reserve Bank of Boston stood at \$91,115, or 8.5% of the Company's total assets. The Bank also has access to the national brokered deposit market, and has been using this funding source to bolster its liquidity position.

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

## RESULTS OF OPERATIONS

### Net Interest Income

Net interest income is the principal component of the Company's income stream and represents the difference or spread between interest generated from earning assets and the interest expense paid on deposits and borrowed funds. Net interest income is entirely generated by the Bank. Fluctuations in market interest rates as well as volume and mix changes in earning assets and interest bearing liabilities can materially impact net interest income.

#### Total Net Interest Income:

For the year ended December 31, 2009, net interest income on a fully tax-equivalent basis amounted to \$34,786 compared with \$28,090 and \$23,558 in 2008 and 2007, representing increases of \$6,696 and \$4,532, or 23.8% and 19.2%, respectively.

The 2009 increase in tax-equivalent net interest income compared with 2008 was principally attributed to a 27 basis point improvement in the tax-equivalent net interest margin, combined with average earning asset growth of \$125,687, or 14.0%.

The 2008 increase in fully tax-equivalent net interest income compared with 2007 was principally attributed to a 22 basis point improvement in the net interest margin combined with average earning asset growth of \$87,517, or 10.8%.

Factors contributing to the changes in net interest income and the net interest margin are further enumerated in the following discussion and analysis.

#### Net Interest Income Analysis:

The following tables summarize the Company's daily average balance sheets and the components of net interest income, including a reconciliation of tax equivalent adjustments, for the years ended December 31, 2009, 2008 and 2007:

**AVERAGE BALANCE SHEET AND  
ANALYSIS OF NET INTEREST INCOME  
For the year ended December 31, 2009**

	Average Balance	Interest	Weighted Average Rate
--	--------------------	----------	-----------------------------



Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

**Interest Earning Assets:**

Loans (1,3)	\$ 655,201	\$34,936	5.33%
Taxable securities (2)	293,027	16,686	5.69%
Non-taxable securities (2,3)	57,271	4,247	7.42%
Total securities	350,298	20,933	5.98%
Federal Home Loan Bank stock	15,782	---	0.00%
Fed funds sold, money market funds, and time deposits with other banks	756	3	0.40%
<b>Total Earning Assets</b>	<b>1,022,037</b>	<b>55,872</b>	<b>5.47%</b>

**Non-Interest Earning Assets:**

Cash and due from banks	8,574		
Allowance for loan losses	(6,634)		
Other assets (2)	28,519		
<b>Total Assets</b>	<b>\$1,052,496</b>		

**Interest Bearing Liabilities:**

Deposits	\$ 572,441	\$10,724	1.87%
Borrowings	332,521	10,362	3.12%
<b>Total Interest Bearing Liabilities</b>	<b>904,962</b>	<b>21,086</b>	<b>2.33%</b>
Rate Spread			3.14%

**Non-Interest Bearing Liabilities:**

Demand and other non-interest bearing deposits	53,152		
Other liabilities	5,536		
<b>Total Liabilities</b>	<b>963,650</b>		
Shareholders' equity	88,846		
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$1,052,496</b>		
Net interest income and net interest margin (3)		34,786	3.40%
Less: Tax Equivalent adjustment		(1,505)	
<b>Net Interest Income</b>		<b>\$33,281</b>	<b>3.26%</b>

(1) For purposes of these computations, non-accrual loans are included in average loans.

(2) For purposes of these computations, unrealized gains (losses) on available-for-sale securities are recorded in other assets.

(3) For purposes of these computations, interest income is reported on a tax equivalent basis.

**AVERAGE BALANCE SHEET AND  
ANALYSIS OF NET INTEREST INCOME  
For the year ended December 31, 2008**

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

	Average Balance	Interest	Average Rate
<b>Interest Earning Assets:</b>			
Loans (1,3)	\$611,373	\$37,761	6.18%
Taxable securities (2)	231,721	13,588	5.86%
Non-taxable securities (2,3)	36,972	2,537	6.86%
Total securities	268,693	16,125	6.00%
Federal Home Loan Bank stock	13,940	526	3.77%
Fed funds sold, money market funds, and time deposits with other banks	2,344	81	3.46%
Total Earning Assets	896,350	54,493	6.08%
<b>Non-Interest Earning Assets:</b>			
Cash and due from banks	9,752		
Allowance for loan losses	(5,171)		
Other assets (2)	25,426		
Total Assets	\$926,357		
<b>Interest Bearing Liabilities:</b>			
Deposits	\$518,702	\$14,976	2.89%
Borrowings	282,954	11,427	4.04%
Total Interest Bearing Liabilities	801,656	26,403	3.29%
Rate Spread			2.79%
<b>Non-Interest Bearing Liabilities:</b>			
Demand and other non-interest bearing deposits	54,664		
Other liabilities	4,898		
Total Liabilities	861,218		
Shareholders' equity	65,139		
Total Liabilities and Shareholders' Equity	\$926,357		
Net interest income and net interest margin (3)		28,090	3.13%
Less: Tax Equivalent adjustment		(899)	
Net Interest Income		\$27,191	3.03%

(1) For purposes of these computations, non-accrual loans are included in average loans.

(2) For purposes of these computations, unrealized gains (losses) on available-for-sale securities are recorded in other assets.

(3) For purposes of these computations, interest income is reported on a tax equivalent basis.

AVERAGE BALANCE SHEET AND  
ANALYSIS OF NET INTEREST INCOME  
For the year ended December 31, 2007

	Average Balance	Interest	Average Rate
<b>Interest Earning Assets:</b>			
Loans (1,3)	\$558,795	\$38,027	6.81%
Taxable securities (2)	208,641	11,712	5.61%
Non-taxable securities (2,3)	26,728	1,804	6.75%
Total securities	235,369	13,516	5.74%
Federal Home Loan Bank stock	12,601	813	6.45%
Fed funds sold, money market funds, and time deposits with other banks	2,068	108	5.22%

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Total Earning Assets	808,833	52,464	6.49%
<b>Non-Interest Earning Assets:</b>			
Cash and due from banks	6,823		
Allowance for loan losses	(4,573)		
Other assets (2)	30,123		
Total Assets	\$841,206		
<b>Interest Bearing Liabilities:</b>			
Deposits	\$457,475	\$16,222	3.55%
Borrowings	260,640	12,684	4.87%
Total Interest Bearing Liabilities	718,115	28,906	4.03%
Rate Spread			2.46%
<b>Non-Interest Bearing Liabilities:</b>			
Demand and other non-interest bearing deposits	55,634		
Other liabilities	4,669		
Total Liabilities	778,418		
Shareholders' equity	62,788		
Total Liabilities and Shareholders' Equity	\$841,206		
Net interest income and net interest margin (3)		23,558	2.91%
Less: Tax Equivalent adjustment		(655)	
Net Interest Income		\$22,903	2.83%

(1) For purposes of these computations, non-accrual loans are included in average loans.

(2) For purposes of these computations, unrealized gains (losses) on available-for-sale securities are recorded in other assets.

(3) For purposes of these computations, interest income is reported on a tax equivalent basis.

**Net Interest Margin:**

The net interest margin, expressed on a tax-equivalent basis, represents the difference between interest and dividends earned on interest-earning assets and interest paid to depositors and other creditors, expressed as a percentage of average earning assets.

The net interest margin is determined by dividing tax-equivalent net interest income by average interest-earning assets. The interest rate spread represents the difference between the average tax-equivalent yield earned on interest earning-assets and the average rate paid on interest bearing liabilities. The net interest margin is generally higher than the interest rate spread due to the additional income earned on those assets funded by non-interest bearing liabilities, primarily demand deposits and shareholders' equity.

The Company's fully tax-equivalent net interest margin amounted to 3.40% in 2009, representing an improvement of 27 basis points compared with 2008. In 2008, the Company's fully tax-equivalent net interest margin amounted to 3.13%, representing an improvement of 22 basis points compared with 2007.

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

The following table summarizes the net interest margin components, on a quarterly basis, over the past two years. Factors contributing to the changes in the net interest margin are enumerated in the following discussion and analysis.

NET INTEREST MARGIN ANALYSIS

AVERAGE RATES	2009				2008			
	Quarter: 4	3	2	1	4	3	2	1
<b>Interest Earning Assets:</b>								
Loans (1,3)	5.16%	5.27%	5.35%	5.56%	5.93%	6.09%	6.19%	6.52%
Taxable securities (2)	5.31%	5.64%	5.86%	5.98%	5.81%	5.89%	5.88%	5.88%
Non-taxable securities (2,3)	7.53%	7.13%	7.61%	7.39%	7.02%	6.88%	6.77%	6.78%
Total securities	5.70%	5.90%	6.14%	6.18%	5.97%	6.02%	6.00%	6.02%
Federal Home Loan Bank stock	0.00%	0.00%	0.00%	0.00%	2.46%	3.00%	3.98%	5.73%
Fed Funds sold, money market funds, and time deposits with other banks	0.00%	1.33%	0.00%	0.93%	2.16%	3.13%	3.00%	4.37%
Total Earning Assets	5.26%	5.40%	5.55%	5.68%	5.88%	6.02%	6.08%	6.35%
<b>Interest Bearing Liabilities:</b>								
Deposits	1.73%	1.79%	1.84%	2.17%	2.62%	2.72%	2.92%	3.33%
Borrowings	3.34%	3.19%	2.90%	3.07%	3.67%	3.92%	4.21%	4.39%
Total Interest Bearing Liabilities	2.27%	2.29%	2.24%	2.53%	3.00%	3.14%	3.36%	3.71%
Rate Spread	2.99%	3.11%	3.31%	3.15%	2.88%	2.88%	2.72%	2.64%
Net Interest Margin (3)	3.27%	3.38%	3.54%	3.42%	3.21%	3.22%	3.07%	3.03%
Net Interest Margin without Tax Equivalent Adjustments	3.10%	3.23%	3.39%	3.30%	3.10%	3.12%	2.97%	2.92%

(1) For purposes of these computations, non-accrual loans are included in average loans.

(2) For purposes of these computations, unrealized gains (losses) on available-for-sale securities are recorded in other assets.

(3) For purposes of these computations, interest income is reported on a tax equivalent basis.

Recent data suggests that the U.S. economy is slowly emerging from a deep recession which began in December 2007, driven by sharp downturns in the nationwide housing and credit markets. Nevertheless, business activity across a wide range of industries and regions remains reduced and local governments and many businesses are in serious difficulty due to the lack of consumer spending, the lack of liquidity in the credit markets and multi-decade high unemployment rates. The Board of Governors of the Federal Reserve System (the "Federal Reserve") addressed the economic decline with changes in its monetary policy, by reducing the Federal Funds rate to historic levels. During 2008 the targeted fed funds rate fell from 4.25% to a range of 0% to 0.25% where it stayed for all of 2009. These actions favorably impacted the Bank's 2008 and 2009 net interest margins, as the total weighted average cost of funds declined faster and to a greater extent than the decline in the weighted average yield on its earning asset portfolios.

For the year ended December 31, 2009, the weighted average yield on average earning assets amounted to 5.47%, compared with 6.08% in 2008, representing a decline of 61 basis points. However, the weighted average cost of interest bearing liabilities amounted to 2.33% in 2009, compared with 3.29% in 2008, representing a decline of 96 basis points. In short, comparing 2009 with 2008, the decline in the Bank's weighted average cost of interest bearing liabilities exceeded the decline in the weighted average yield on its earning asset portfolios by 35 basis points.

For the year ended December 31, 2008, the weighted average yield on average earning assets amounted to 6.08%, compared with 6.49% in 2007, representing a decline of 41 basis points. However, the weighted average cost of interest bearing liabilities amounted to 3.29% in 2008, compared with 4.03% in 2007, representing a decline of 74 basis points. In short, comparing 2008 with 2007, the decline in the Bank's weighted average cost of interest bearing liabilities exceeded the decline in the weighted average yield on its earning asset portfolios by 33 basis points.

Should interest rates continue at current levels, Company management anticipates the improving net interest margin trend experienced in 2008 and 2009 will level off during 2010, as assets and liabilities will re-price or be replaced

more proportionally into the lower current rate environment.

The Bank's interest rate sensitivity position is more fully described in Part II, Item 7A of this Annual Report on Form 10-K, *Quantitative and Qualitative Disclosures About Market Risk*.

#### Interest Income:

For the year ended December 31, 2009, total interest income, on a tax-equivalent basis, amounted to \$55,872, compared with \$54,493 in 2008, representing an increase of \$1,379, or 2.5%.

The increase in 2009 interest income was principally attributed to average earning asset growth of \$125,687, or 14.0%, largely offset by a 61 basis point decline in the weighted average earning asset yield. The decline in the weighted average earning asset yield was principally attributed to the reduction of short-term interest rates by the Federal Reserve, the impact of which reduced the weighted average yield on the Bank's variable rate loan portfolios. To a lesser extent, the weighted average loan yields were also impacted by the renegotiation of certain fixed rate commercial loans to variable rate loans with lower prevailing interest rates.

For the year ended December 31, 2009, interest income from the loan portfolio amounted to \$34,936, representing a decline of \$2,825, or 7.5%, compared with 2008. The decline in loan interest income was attributed to an 85 basis point decline in the weighted average loan portfolio yield to 5.33%, largely offset by average loan portfolio growth of \$43,828, or 7.2%.

For the year ended December 31, 2009, interest income from the securities portfolio amounted to \$20,933, representing an increase of \$4,808, or 29.8%, compared with 2008. The increase in interest income from securities was principally attributed to average securities portfolio growth of \$81,605 or 30.4%, offset in part by a 2 basis point decline in the weighted average securities portfolio yield, which in 2009 amounted to 5.98%. Because the majority of the securities portfolio is comprised of fixed rate, non-callable securities, the decline in short-term interest rates has not had a significant impact on the portfolio's weighted average yield.

For the year ended December 31, 2009, the Bank did not record any Federal Home Loan Bank ("FHLB") stock dividends, compared with \$526 in 2008. In the first quarter of 2009, the FHLB of Boston advised its members that it is focusing on preserving capital in response to other-than-temporary impairment losses it had sustained, declining capital ratios and ongoing market volatility. Accordingly, dividend payments were suspended, and Company management believes it is unlikely that any dividends will be paid in 2010.

As depicted on the rate/volume analysis table below, the increased volume of average earning assets on the balance sheet during 2009 contributed \$7,644 to the increase in interest income compared with 2008, but this increase was largely offset by a decline of \$6,265 attributed to the impact of the lower weighted average earning asset yield.

For the year ended December 31, 2008, total interest income, on a fully tax-equivalent basis, amounted to \$54,493, compared with \$52,464 in 2007, representing an increase of \$2,029, or 3.9%. The increase in 2008 interest income was principally attributed to average earning asset growth of \$87,517, or 10.8%, largely offset by a 41 basis point decline in the weighted average earning asset yield. The decline in the weighted average earning asset yield was principally attributed to the reduction of short-term interest rates by the Federal Reserve, the impact of which reduced the weighted average yield on the Bank's variable rate loan portfolios. To a lesser extent, the weighted average loan yields were also impacted by the renegotiation of certain fixed rate loans to variable rate loans with lower prevailing interest rates.

For the year ended December 31, 2008 interest income from the loan portfolio amounted to \$37,761, representing a decline of \$266, or 0.7%, compared with 2007. The decline in 2008 loan interest income was attributed to a 63 basis point decline in the weighted average loan portfolio yield to 6.18%, offset by average loan portfolio growth of

\$52,578, or 9.4%.

For the year ended December 31, 2008, interest income from the Bank's securities portfolio amounted to \$16,125, representing an increase of \$2,609, or 19.3%, compared with 2007. The increase in interest income from securities was principally attributed to average securities portfolio growth of \$33,324 or 14.2%, combined with a 26 basis point improvement in the weighted average securities portfolio yield, which in 2008 amounted to 6.00%. The improved yield on the securities portfolio reflected, in part, the restructuring of a portion of the portfolio in 2007. In addition, because the majority of the securities portfolio is comprised of fixed rate, non-callable securities, the decline in short-term interest rates had minimal impact on the portfolio's weighted average yield.

As depicted on the rate/volume analysis table below, the increased volume of average earning assets on the balance sheet during 2008 contributed \$5,483 to the increase in interest income compared with 2007, but this increase was largely offset by a decline of \$3,454 attributed to the impact of the lower weighted average earning asset yield.

#### Interest Expense:

For the year ended December 31, 2009, total interest expense amounted to \$21,086, compared with \$26,403 in 2008, representing a decline of \$5,317, or 20.1%. The 2009 decline in total interest expense compared with 2008 was principally attributed to a 96 basis point decline in the weighted average interest rate paid on interest bearing liabilities, largely offset by a \$103,306 or 12.9% increase in average interest bearing liabilities.

For the year ended December 31, 2009, the weighted average cost of borrowed funds declined 92 basis points to 3.12%, while the weighted average cost of interest bearing deposits declined 102 basis points to 1.87%, compared with 2008. The foregoing declines principally resulted from lower market interest rates in 2009 compared with 2008, combined with maturing time deposits and borrowings being replaced at lower prevailing interest rates.

As depicted on the rate/volume analysis table below, the impact of the lower weighted average rate paid on interest bearing liabilities contributed \$8,888 to the 2009 decline in interest expense, but this was largely offset by an increase of \$3,571 attributed to the impact of the increased volume of average interest bearing liabilities compared with 2008.

For the year ended December 31, 2008, total interest expense amounted to \$26,403, compared with \$28,906 in 2007, representing a decline of \$2,503, or 8.7%. The 2008 decline in total interest expense compared with 2007 was principally attributed to a 74 basis point decline in the weighted average interest rate paid on interest bearing liabilities, largely offset by \$83,541 or 11.6% increase in average interest bearing liabilities.

For the year ended December 31, 2008, the weighted average cost of borrowed funds declined 83 basis points to 3.29%, while the weighted average cost of interest bearing deposits declined 66 basis points to 2.89%, compared with 2007. The foregoing declines principally resulted from lower market interest rates in 2008 compared with 2007. The decline in the weighted average cost of borrowed funds outpaced the decline in the weighted average cost of interest bearing deposits, reflecting the shorter maturities of the Bank's borrowing base as rates began declining, combined with highly competitive market pricing pressures for deposits in the markets served by the Bank.

As depicted on the rate/volume analysis table below, the impact of the lower weighted average rate paid on interest bearing liabilities contributed \$5,772 to the 2008 decline in interest expense, but this was largely offset by an increase of \$3,269 attributed to the impact of the increased volume of average interest bearing liabilities compared with 2007.

#### Rate/Volume Analysis:

The following tables set forth a summary analysis of the relative impact on net interest income of changes in the average volume of interest earning assets and interest bearing liabilities, and changes in average rates on such assets and liabilities. The income from tax-exempt assets has been adjusted to a fully tax equivalent basis, thereby allowing

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

uniform comparisons to be made. Because of the numerous simultaneous volume and rate changes during the periods analyzed, it is not possible to precisely allocate changes to volume or rate. For presentation purposes, changes which are not solely due to volume changes or rate changes have been allocated to these categories in proportion to the relationships of the absolute dollar amounts of the change in each.

ANALYSIS OF VOLUME AND RATE CHANGES ON NET INTEREST INCOME  
FOR THE YEAR ENDED DECEMBER 31, 2009 VERSUS DECEMBER 31, 2008  
INCREASES (DECREASES) DUE TO:

	Average Volume	Average Rate	Total Change
Loans (1,3)	\$2,711	\$(5,536)	\$(2,825)
Taxable securities (2)	3,594	(496)	3,098
Non-taxable securities (2,3)	1,394	316	1,710
Investment in Federal Home Loan Bank stock	---	(526)	(526)
Fed funds sold, money market funds, and time deposits with other banks	(55)	(23)	(78)
<b>TOTAL EARNING ASSETS</b>	<b>\$7,644</b>	<b>\$(6,265)</b>	<b>\$ 1,379</b>
Interest bearing deposits	1,554	(5,806)	(4,252)
Borrowings	2,017	(3,082)	(1,065)
<b>TOTAL INTEREST BEARING LIABILITIES</b>	<b>\$3,571</b>	<b>\$(8,888)</b>	<b>\$(5,317)</b>
<b>NET CHANGE IN NET INTEREST INCOME</b>	<b>\$4,073</b>	<b>\$ 2,623</b>	<b>\$ 6,696</b>

(1) For purposes of these computations, non-accrual loans are included in average loans.

(2) For purposes of these computations, unrealized gains (losses) on available-for-sale securities are recorded in other assets.

(3) For purposes of these computations, interest income is reported on a tax equivalent basis.

ANALYSIS OF VOLUME AND RATE CHANGES ON NET INTEREST INCOME  
FOR THE YEAR ENDED DECEMBER 31, 2008 VERSUS DECEMBER 31, 2007  
INCREASES (DECREASES) DUE TO:

	Average Volume	Average Rate	Total Change
<b>ASSETS</b>			
Loans (1,3)	\$3,395	\$(3,661)	\$ (266)
Taxable securities (2)	1,296	580	1,876
Non-taxable securities (2,3)	692	41	733
Investment in Federal Home Loan Bank stock	86	(373)	(287)
Fed funds sold, money market funds, and time deposits with other banks	14	(41)	(27)
Total Earning Assets	5,483	(3,454)	2,029
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>			
Interest bearing deposits	2,181	(3,427)	(1,246)
Borrowings	1,088	(2,345)	(1,257)
Total Interest Bearing Liabilities	3,269	(5,772)	(2,503)
Net Change In Net Interest Income (3)	\$2,214	\$ 2,318	\$ 4,532

(1) For purposes of these computations, non-accrual loans are included in average loans.

(2) For purposes of these computations, unrealized gains (losses) on available-for-sale securities are recorded in other assets.

(3) For purposes of these computations, interest income is reported on a tax equivalent basis.

## Provision for Loan Losses

The provision for loan losses reflects the amount necessary to maintain the allowance for loan losses (the "allowance") at a level that, in management's judgment, is appropriate for the amount of inherent risk of probable loss in the Bank's current loan portfolio.

For the year ended December 31, 2009, the Bank recorded a provision for loan losses ("provision") of \$3,207, compared with \$1,995 in 2008, representing an increase of \$1,212, or 60.8%. The increase in the provision was largely attributed to deterioration in overall credit quality, growth in the loan portfolio, and depressed economic conditions, including elevated unemployment levels and declining real estate values in the markets served by the Bank.

During 2009 the Bank's non-performing loans trended upward, ending the year at \$9,176 and representing 1.37% of total loans, compared with \$4,404 or 0.70% of total loans at December 31, 2008. The allowance expressed as a percentage of non-performing loans stood at 85.2% at December 30, 2009, compared with 123.7% at December 31, 2008.

Net loan charge-offs amounted to \$839 in 2009 compared with \$1,292 in 2008, representing a decline of \$453, or 35.1%. Total net loan charge-offs to average loans outstanding amounted to 0.13% in 2009, compared with 0.21% in 2008, representing an improvement of 8 basis points.

For the year ended December 31, 2008, the Bank recorded a provision of \$1,995, compared with \$456 in 2007, representing an increase of \$1,539, or 337.5%. The increase in the provision was largely attributed to the increases in net loan charge-offs and non-performing loans, growth in the loan portfolio and generally declining economic conditions and real estate values in much of the Bank's market area.

The Bank's non-performing loans stood at relatively low levels at December 31, 2008, representing \$4,404 or 0.70% of total loans, compared with \$2,062 or 0.36% of total loans at December 31, 2007. The allowance expressed as a percentage of non-performing loans stood at 123.7% at December 30, 2008, compared with 230.0% at December 31, 2007.

Net charge-offs amounted to \$1,292 in 2008, or net charge-offs to average loans outstanding of 0.21%, compared with \$238, or net charge-offs to average loans outstanding of 0.04%, in 2007. Two problem loans were accountable for \$1,094, or 84.7%, of the 2008 net loan charge-offs.

Refer to Part II, Item 7, *Allowance for Loan Losses*, in this Annual Report on Form 10-K for further discussion and analysis regarding the provision for loan losses.

## Non-Interest Income

In addition to net interest income, non-interest income is a significant source of revenue for the Company and an important factor in its results of operations. In 2009, non-interest income represented 15.3% of total net interest income and non-interest income, compared with 19.1% in 2008.

For the year ended December 31, 2009, total non-interest income amounted to \$6,022, compared with \$6,432 in 2008, representing a decline of \$410 or 6.4%.

For the year ended December 31, 2008, total non-interest income amounted to \$6,432, compared with \$5,929 in 2007, representing an increase of \$503, or 8.5%.



Factors contributing to the 2009 and 2008 changes in non-interest income are enumerated in the following discussion and analysis:

#### Trust and Financial Services Income:

Income from trust and financial services represented 40.6% of the Company's total non-interest income in 2009, compared with 39.1% and 39.4% in 2008 and 2007, respectively.

Income from trust and financial services is principally derived from fee income based on a percentage of the market value of client assets under management and held in custody and, to a lesser extent, revenue from brokerage services conducted through Bar Harbor Financial Services, an independent third-party broker.

For the year ended December 31, 2009, income generated from trust and financial services amounted to \$2,444, compared with \$2,513 in 2008, representing a decline of \$69, or 2.7%.

The decline in trust and other financial services fees was principally attributed to declining revenue from trust and investment management activities, largely reflecting lower average fair values of assets under management during 2009 compared with 2008. The decline in revenue from trust and investment management activities was partially offset by a moderate increase in revenue generated from third party brokerage activities, which was principally attributed to increased staff capacity and new client relationships.

Following a recovery in the equity markets, the fair value of assets under management at December 31, 2009 rose to \$270,115, representing an increase of \$39,892 or 17.3% compared with December 31, 2008.

For the year ended December 31, 2008, income from trust and financial services amounted to \$2,513, compared with \$2,335 in 2007, representing an increase of \$178, or 7.6%. Revenue generated from third party brokerage activities posted meaningful increases in 2008, attributed to staff additions and new client relationships. Revenue from trust and investment management activities posted moderate declines in 2008, principally reflecting declining market values of assets under management.

At December 31, 2008, the fair value of total assets under management at Trust Services stood at \$230,223, compared with \$278,227 at December 31, 2007, representing a decline of \$48,004 or 17.3%. The decline in assets under management was principally reflective of the broad declines experienced by the equity markets in general during 2008, offset in part by new managed asset accounts.

#### Mortgage Banking Activities:

This income is principally derived from gains on sales of residential mortgage loans into the secondary market and, to a lesser extent, ongoing retained mortgage loan servicing fees. Income from mortgage banking activities represented 8.1% of total 2009 non-interest income, compared with 0.2% and 0.3% in 2008 and 2007, respectively.

For the year ended December 31, 2009, income from mortgage banking activities amounted to \$490, compared with \$15 and \$20 in 2008 and 2007, respectively. The increase in 2009 mortgage origination and servicing income was attributed to the sale of \$29,842 of residential real estate mortgage loans into the secondary market with servicing retained, whereas in 2008 and 2007 all mortgage loan originations were held in the Bank's loan portfolio.

#### Service Charges on Deposit Accounts:

This income is principally derived from monthly deposit account maintenance and activity fees, overdraft fees, automated teller machine ("ATM") fees and a variety of other deposit account related fees. Income from service charges on deposit accounts represented 23.4% of total 2009 non-interest income, compared with 24.8% and 27.4% in

2008 and 2007, respectively.

For the year ended December 31, 2009, income generated from service charges on deposit accounts amounted to \$1,412, compared with \$1,594 in 2008, representing a decline of \$182, or 11.4%. For the year ended December 31, 2008, income generated from service charges on deposit accounts amounted to \$1,594, compared with \$1,624 in 2007, representing a decline of \$30, or 1.8%.

The foregoing declines in service charges on deposit accounts were principally attributed to declines in deposit account overdraft activity. Additionally, the Bank has not increased its deposit account fee amounts charged to customers since early 2007.

#### Credit and Debit Card Service Charges and Fees:

This income is principally derived from the Bank's Visa debit card product, merchant credit card processing fees and fees associated with Visa credit cards. As previously reported, in the fourth quarter of 2008 the Bank sold its merchant processing and Visa credit card portfolios. In connection with the sale of these portfolios, the Bank entered into certain future referral, marketing and revenue-sharing agreements, which are expected to provide future revenue streams from these lines of business.

Income from credit and debit card service charges and fees represented 12.9% of total 2009 non-interest income, compared with 31.8% and 35.4% in 2008 and 2007, respectively.

For the year ended December 31, 2009, income generated from credit and debit card service charges and fees amounted to \$779, compared with \$2,044 in 2008, representing a decline of \$1,265, or 61.9%. The 2009 decline in credit and debit card service charges and fees principally reflected the Bank's sale of its merchant credit card processing portfolio and its Visa credit card portfolio in the fourth quarter of 2008. The 2009 decline in credit and debit card service charges and fees were offset by comparable declines in debit and credit card expenses, which are included in non-interest expense in the Company's consolidated statements of income.

For the year ended December 31, 2008, income generated from credit and debit card service charges and fees amounted to \$2,044, compared with \$2,100 in 2007, representing a decline of \$56, or 2.7%. The 2008 decline in credit and debit card service charges and fees principally reflected the Bank's sale of its merchant credit card processing portfolio and its Visa credit card portfolio in the fourth quarter in the fourth quarter of 2008.

#### Net Securities Gains (Losses):

For the year ended December 31, 2009, net securities gains amounted to \$1,521, compared with net securities losses of \$831 in 2008. The \$1,521 in net securities gains were comprised of realized gains on the sale of securities amounting to \$2,528, largely offset by other-than-temporary securities impairment ("OTTI") losses of \$1,007.

In the first quarter of 2009 the Company recorded \$1,007 of OTTI losses as a component of net securities gains (losses). The Company concluded that unrealized losses on certain available-for-sale, non-agency mortgage-backed securities were other-than-temporarily impaired, because the Company could no longer conclude it was probable it would recover all of the principal and interest on these securities. Because these securities were being carried at fair value, estimated losses on these securities, net of tax, were previously recorded in unrealized losses on securities available-for-sale within accumulated other comprehensive loss, a component of total shareholders equity on the Company's consolidated balance sheet. This OTTI was recorded prior to the Company's adoption of a new accounting standard, which became effective April 1, 2009.

For the year ended December 31, 2008 net securities losses amounted to \$831, compared with net securities losses of \$671 in 2007, representing an increase in net securities losses of \$160, or 23.8%. The \$831 in 2008 net securities

losses were comprised of other-than-temporary securities impairment losses of \$1,435, largely offset by realized gains on the sale of securities amounting to \$604.

Further information regarding 2009 and 2008 securities gains and losses and OTTI losses is incorporated by reference to Part II, Item 8, Notes 1 and 2 of the Consolidated Financial Statements in this Annual Report on Form 10-K.

#### Net OTTI Losses Recognized in Earnings:

For the year ended December 31, 2009, net OTTI losses recognized in earnings amounted to \$1,454, compared with none during the same periods in 2008.

During 2009 the Company determined that unrealized losses on certain available-for-sale, 1-4 family non-agency mortgage-backed securities were other-than-temporarily impaired, because the Company could no longer conclude that it was probable it would recover all of the principal and interest on these securities. Because these securities were being carried at fair value, estimated losses on these securities, net of taxes, were previously recorded in unrealized gains or losses on securities available-for-sale within accumulated other comprehensive income or loss, a component of total shareholders' equity on the Company's consolidated balance sheet. The total 2009 OTTI losses amounted to \$2,773, of which \$1,454 represented estimated credit losses on the collateral underlying the security. The \$1,454 in estimated credit losses were recorded in earnings, with the \$1,319 non-credit portion of the unrealized losses recorded within accumulated other comprehensive income, net of taxes.

Further information regarding impaired securities, other-than-temporarily impaired securities and evaluation of securities for impairment is incorporated by reference to Part II, Item 8, Notes 1 and 2 of the Consolidated Financial Statements in this Annual Report on Form 10-K.

#### Other Operating Income:

Other operating income represented 13.8% of total 2009 non-interest income, compared with 17.1% and 8.8% in 2008 and 2007, respectively.

For the year ended December 31, 2009, other operating income amounted to \$830, compared with \$1,097 in 2008, representing a decline of \$267, or 24.3%.

The decline in 2009 other operating income was principally attributed to a \$313 gain recorded in 2008 representing the proceeds from shares redeemed in connection with the Visa, Inc. initial public offering. As previously reported in connection with the Bank's merchant services and Visa credit card business, prior to September 2007 the Bank was a member of Visa U.S.A. Inc. Card Association. As a part of the Visa Inc. reorganization in 2007, (the "Visa Reorganization"), the Bank received its proportionate number of Class U.S.A. shares of Visa Inc. common stock, or 20,187 shares.

In connection with the Visa Inc. initial public offering that occurred in March of 2008, the Bank's Class U.S.A. shares were converted to 18,949 shares of Visa Inc. Class B Common Stock, of which 7,326 shares were immediately redeemed. The proceeds from this redemption amounted to \$313 and were recorded in other operating income in the Company's consolidated statement of income. The 11,623 post redemption non-marketable shares owned by the Bank are convertible to Class A Visa Inc. shares three years after the initial public offering, or upon settlement of certain litigation between Visa Inc. and other third parties, whichever is later.

For the year ended December 31, 2008, total other operating income amounted to \$1,097, compared with \$521 in 2007, representing an increase of \$576, or 110.6%. The increase in 2008 non-interest income compared with 2007 was principally attributed to the non-recurring \$313 gain recorded in 2008 representing the proceeds from shares redeemed in connection with the Visa, Inc. public offering, as more fully discussed above. The increase in 2008 non-interest

income was also attributed to \$214 of non-recurring gains from the sale of the Bank's merchant credit card processing portfolio and the net gains from the sale of the Bank's Visa credit card portfolio.

In 2009 and 2008, other operating income also included income from bank-owned life insurance ("BOLI") representing increases in the cash surrender value of life insurance policies on the lives of certain retired employees who had provided positive consent allowing the Bank to be the beneficiary of such policies.

#### Non-interest Expense

For the year ended December 31, 2009, total non-interest expense amounted to \$21,754, compared with \$20,513 in 2008, representing an increase of \$1,241, or 6.0%.

For the year ended December 31, 2008, total non-interest expense amounted to \$20,513, compared with \$18,201 in 2007, representing an increase of \$2,312, or 12.7%.

Factors contributing to the changes in non-interest expense are enumerated in the following discussion and analysis.

#### Salaries and Employee Benefits:

For the year ended December 31, 2009, total salaries and employee benefit expenses amounted to \$11,594, compared with \$10,827 in 2008, representing an increase of \$767, or 7.1%. The 2009 increase in salaries and employee benefits was principally attributed to increases in employee health insurance premiums, normal increases in base salaries, as well as changes in staffing levels and mix.

For the year ended December 31, 2008, total salaries and employee benefit expenses amounted to \$10,827, compared with \$9,368 in 2007, representing an increase of \$1,459, or 15.6%. The 2008 increase in salaries and employee benefits was attributed to a variety of factors including strategic additions to staff, normal increases in base salaries, increased employee benefit costs, higher levels of incentive compensation, and certain employee severance payments.

#### Postretirement Plan Settlement:

In 2007, the Company settled its limited postretirement benefit program, which funded medical coverage and life insurance benefits to a closed group of active and retired employees who met minimum age and service requirements. The Company voluntarily paid out \$699 to plan participants. This payment fully settled all Company obligations related to this program. In connection with the settlement of the postretirement program, in 2007 the Company recorded a reduction in non-interest expense of \$832, representing the remaining accrued benefit obligation and the actuarial gain related to the program.

#### Occupancy Expense:

For the year ended December 31, 2009, total occupancy expense amounted to \$1,329, compared with \$1,387 in 2008, representing a decline of \$58, or 4.2%. The decline in occupancy expense was largely attributed to lower utilities costs associated with declining fuel prices during 2009 compared with 2008.

For the year ended December 31, 2008, total occupancy expense amounted to \$1,387, compared with \$1,275 in 2007, representing an increase of \$112, or 8.8%. The increase in occupancy expense was principally attributed higher fuel and utilities prices during 2008 compared with 2007. Groundskeeping and snow removal expenses at the Bank's twelve branch office locations also posted moderate increases in 2008 compared with 2007.

#### Furniture and Equipment Expense:

## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

For the year ended December 31, 2009, total furniture and equipment expense amounted to \$1,378, compared with \$1,539 in 2008, representing a decline of \$161, or 10.5%. The 2009 decline in furniture and equipment expense was attributed to declines in a variety of expense categories including depreciation expense, maintenance contract expenses, miscellaneous equipment purchases and repairs, and personal property taxes.

For the year ended December 31, 2008, total furniture and equipment expense amounted to \$1,539, compared with \$1,718 in 2007, representing a decline of \$179, or 10.4%. The decline in 2008 furniture and equipment expenses compared with 2007 was principally attributed to declines in depreciation expense, maintenance contract expenses, and personal property taxes.

### Credit and Debit Card Expenses:

These expenses principally relate to the Bank's Visa debit card processing activities. In 2008 and prior years, these expenses also included merchant credit card processing fees and processing fees associated with Visa credit cards.

For the year ended December 31, 2009, credit and debit card expenses amounted to \$332, compared with \$1,416 in 2008, representing a decline of \$1,084 or 76.6%. The decline in credit and debit card expenses was principally attributed to the previously reported sale of the merchant credit card processing and Visa credit card portfolios in the fourth quarter of 2008. The 2009 decline in credit and debit card expenses were essentially offset by a like decline in credit and debit card income, which is included in non-interest income in the Company's consolidated statements of income.

For the year ended December 31, 2008, total credit and debit card expenses amounted to \$1,416, compared with \$1,469 in 2007, representing a decline of \$53, or 3.6%. The 2008 decline in credit and debit card expenses compared with 2007 principally reflected the Bank's sale of its merchant credit card processing portfolio and its Visa credit card portfolio in the fourth quarter of 2008. This decline was offset in part by a 2008 increase in debit card expenses, principally reflecting the ongoing growth in the Bank's demand deposits accounts base, combined with a new program introduced in 2007 that offers rewards for certain debit card transactions. Credit and debit card expenses also included the costs incurred during the first half of 2008 associated with the voluntary re-issuance of a large number of credit and debit cards that were compromised in the widely-publicized Hannaford Bros. Supermarket data breach.

### FDIC Insurance Assessments:

For the year ended December 31, 2009, FDIC insurance assessments amounted to \$1,420, compared with \$134 in 2008, representing an increase of \$1,286, or 959.7%.

During 2009, the FDIC's Deposit Insurance Fund ("DIF") posted record losses, causing the reserve ratio to fall well below 1.15%. A reserve ratio below 1.15% triggers the need for a DIF restoration plan in accordance with the FDI Reform Act of 2005 and conforming amendments. Pursuant to the Act, the FDIC must bring the reserve ratio back to 1.15% within five years. Deposit insurance premiums for all FDIC insured banks have increased as a result of the FDIC's plan to reestablish the Deposit Insurance Fund to levels.

Included in 2009 FDIC insurance assessments expense was a special FDIC deposit insurance assessment amounting to \$492. In the second quarter of 2009 the FDIC levied a special emergency assessment on all FDIC insured financial institutions. The special assessment represented five basis points on the Bank's total assets, less Tier I Capital, as of June 30, 2009. The special assessment was in addition to the normal second quarter 2009 assessment.

The increases in the Bank's 2009 FDIC insurance assessment premiums were also attributed to historical insurance assessment credits recorded during 2008 amounting to \$147. In this regard, the FDI Reform Act required the FDIC to establish a one-time historical assessment credit that provided banks with a credit that could be used to offset insurance assessments in 2007 and 2008. This one-time, historical assessment credit was established to benefit banks

that had funded deposit insurance funds prior to December 31, 1996.

#### Other Operating Expense:

For the year ended December 31, 2009, total other operating expense amounted to \$5,701, compared with \$5,210 in 2008, representing an increase of \$491, or 9.4%. The increase in 2009 other operating expense compared with 2008 was principally attributed to \$281 in write-downs of certain non-marketable venture capital equity investment funds considered other-than-temporarily impaired, compared with \$68 in 2008. These investment funds, which generally qualify for Community Reinvestment Act ("CRA") credit, represent socially responsible venture capital investments in small businesses throughout Maine and New England. These write-downs principally reflected the impact current economic conditions have had on these funds.

The increase in 2009 other operating expenses compared with 2008 was also attributed to loan collection and foreclosure expenses. Reflecting increased loan collection and foreclosure activity, the Bank's loan collection and foreclosure expenses increased \$185 in 2009, or 250.7%, compared with 2008.

For the year ended December 31, 2008, total other operating expense amounted to \$5,210, compared with \$5,144 in 2007, representing an increase of \$66, or 1.3%. The increase in 2008 other operating expenses compared with 2007 was attributed to a variety of factors including increases in charitable contributions, professional services, marketing expenses, staff development costs and regulatory examination expenses. These increases were largely offset by declines in courier services, and telecommunications costs. The decline in courier services was principally attributed to the mid 2007 implementation of remote image item capture technology in all of the Bank's branch office locations.

Also included in 2008 other operating expense was a \$128 reduction in the Company's liability related to the Visa Reorganization and the Visa Inc. initial public offering. As previously reported, as a former member of Visa, the Bank has an obligation to indemnify Visa U.S.A. under its bylaws and Visa Inc. under a retrospective responsibility plan, approved as part of the Visa Reorganization, for contingent losses in connection with covered litigation (the "Visa Indemnification") disclosed in Visa Inc.'s public filings with the SEC, based on its membership proportion. The Bank is not a party to the lawsuits brought against Visa U.S.A. In 2007 the Bank recorded a \$243 liability in connection with the Visa Indemnification. The Company recognizes its portion of the Visa Indemnification at the estimated fair value of such obligation in accordance with a FASB accounting standard interpretation covering Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.

#### Income Taxes

For the year ended December 31, 2009, total income taxes amounted to \$3,992, compared with \$3,384 in 2008, representing an increase of \$608, or 18.0%.

For the year ended December 31, 2008, total income taxes amounted to \$3,384, compared with \$3,020 in 2007, representing an increase of \$364, or 12.1%.

The Company's effective income tax rate in 2009 amounted to 27.8%, compared with 30.4% and 29.7% in 2008 and 2007, respectively. The income tax provisions for these periods were less than the expense that would result from applying the federal statutory rate of 35% to income before income taxes, principally because of the impact of tax-exempt income on certain investment securities, loans and bank owned life insurance.

Fluctuations in the Company's effective tax rate are generally attributed to changes in the relationship between non-taxable income and non-deductible expense, and income before income taxes, during any given reporting period.

#### Impact of Inflation and Changing Prices

The Consolidated Financial Statements and the accompanying Notes to the Consolidated Financial Statements presented elsewhere in this report have been prepared in accordance with U.S. generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

Unlike many industrial companies, substantially all of the assets and virtually all of the liabilities of the Company are monetary in nature. As a result, interest rates have a more significant impact on the Company's performance than the general level of inflation. Over short periods of time, interest rates and the U.S. Treasury yield curve may not necessarily move in the same direction or in the same magnitude as inflation.

While the financial nature of the Company's consolidated balance sheets and statements of income is more clearly affected by changes in interest rates than by inflation, inflation does affect the Company because as prices increase the money supply tends to increase, the size of loans requested tends to increase, total Company assets increase, and interest rates are affected by inflationary expectations. In addition, operating expenses tend to increase without a corresponding increase in productivity. There is no precise method, however, to measure the effect of inflation on the Company's financial statements. Accordingly, any examination or analysis of the financial statements should take into consideration the possible effects of inflation.

#### Recent Accounting Developments

The following information addresses new or proposed accounting standards that could have an impact on the Company's financial condition or results of operations.

#### Fair Value Measurements and Disclosures:

In January 2010, the FASB amended fair value measurement and disclosure guidance to require disclosure of significant transfers in and out of Level 1 and Level 2 fair value measurements and the reasons for the transfers and to require separate presentation of information about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. The amended guidance also clarifies existing requirements that (i) fair value measurement disclosures should be disaggregated for each class of asset and liability and (ii) disclosures about valuation techniques and inputs for both recurring and nonrecurring Level 2 and Level 3 fair value measurements should be provided. The guidance is effective for interim and annual periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those years. The adoption of this guidance is not expected to impact the Company's consolidated financial position or results of operations.

#### Determining the Primary Beneficiary of a Variable Interest Entity:

In June 2009, the FASB amended accounting guidance relating to the consolidation of variable interest entities to eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity. The amended guidance instead requires a reporting entity to qualitatively assess the determination of the primary beneficiary of a variable interest entity based on whether the reporting entity has the power to direct the activities that most significantly impact the variable interest entity's economic performance and has the obligation to absorb losses or the right to receive benefits of the variable interest entity that could potentially be significant to the variable interest entity. The amended guidance requires ongoing reassessments of whether the reporting entity is the primary beneficiary of a variable interest entity. The amended guidance is effective as of the beginning of the first annual reporting period that begins after November 15, 2009 (January 1, 2010 for the Company), for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier adoption is prohibited. The adoption of this accounting standard is not expected to impact the Company's consolidated results of operation or financial condition.

Accounting for transfers of Financial Assets:

In June 2009, the FASB issued amended accounting guidance relating to accounting for transfers of financial assets to eliminate the exceptions for qualifying special purpose entities from the consolidation guidance and an exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred assets. The amended guidance is effective as of the beginning of the first annual reporting period that begins after November 15, 2009 (January 1, 2010 for the Company), for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier adoption is prohibited. The recognition and measurement provisions of the amended guidance should be applied to transfers that occur on or after the effective date. Additionally, on and after the effective date, the concept of a qualifying special-purpose entity will no longer be relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities will be evaluated for consolidation on and after the effective date in accordance with applicable consolidation guidance, including the new accounting guidance relating to the consolidation of variable interest entities discussed in the previous paragraph. The adoption of this accounting standard is not expected to impact the Company's consolidated results of operation or financial condition.

ITEM 7A. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

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

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

Interest Rate Risk:

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

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

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



Interest rate risk is monitored through the use of two complementary measures: static gap analysis ("gap") and interest rate sensitivity modeling. While each measurement may have its limitations, taken together they form a reasonably comprehensive view of the magnitude of the Bank's interest rate risk, the level of risk over time, and the quantification of exposure to changes in certain interest rate relationships.

Static Gap Analysis:

Interest rate gap analysis provides a static view of the maturity and re-pricing characteristics of the Bank's on- and off-balance sheet positions. Gap is defined as the difference between assets and liabilities re-pricing or maturing within specified periods. An asset-sensitive position, or "positive gap," indicates that there are more rate sensitive assets than rate-sensitive liabilities re-pricing or maturing within a specified time period, which would imply a favorable impact on net interest income during periods of rising interest rates. Conversely, a liability-sensitive position, or "negative gap," generally implies a favorable impact on net interest income during periods of falling interest rates.

The Bank's static interest rate sensitivity gap is summarized below:

INTEREST RATE RISK  
CUMULATIVE STATIC GAP POSITION  
DECEMBER 31, 2009, AND 2008

	One Day To Six Months	Over Six Months To One Year	Over One Year
December 31, 2009	\$144,793	\$163,934	\$(166,793)
December 31, 2008	\$ 79,467	\$133,823	\$ 194,616
Change (\$)	\$ 65,326	\$ 30,111	\$(361,409)

The Bank's December 31, 2009 cumulative interest rate risk sensitivity static gap position indicated that the Bank's balance sheet was asset sensitive over the twelve-month horizon and beyond.

Comparing December 31, 2009 with December 31, 2008, the asset sensitivity of the Bank's balance increased. Changes in the Bank's cumulative static gap position from the prior year principally reflected higher levels of longer term funding, higher levels of variable rate earning assets, and overall changes in the maturity and re-pricing mix of earning assets and interest bearing liabilities. Pursuant to the Bank's asset and liability management strategy, management extended the maturities on a portion of its wholesale funding base during 2009, in order to lessen the Bank's exposure to rising interest rates. While this strategy pressures net interest income in the near term, Company management believes the long-term risks of funding the balance sheet short far outweigh the short-term rewards.

There are certain limitations inherent in static gap analysis. These limitations include the fact that it is a static measurement and it does not reflect the degrees to which interest earning assets and interest bearing liabilities may respond non-proportionally to changes in market interest rates. Although ALCO reviews all data used in the model in detail, assets and liabilities do not always have clear re-pricing dates, and re-pricing may occur earlier or later than assumed in the model.

Interest Rate Sensitivity Modeling:

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

The interest rate risk sensitivity model requires that assets and liabilities be broken down into components as to fixed, variable, and adjustable interest rates, as well as other homogeneous groupings, which are segregated as to maturity and type of instrument. The model includes assumptions about how the balance sheet is likely to evolve through time and in different interest rate environments. The model uses contractual re-pricing dates for variable products, contractual maturities for fixed rate products, and product specific assumptions for deposit accounts, such as money market accounts, that are subject to re-pricing based on current market conditions. Re-pricing margins are also determined for adjustable rate assets and incorporated in the model. Investment securities and borrowings with call provisions are examined on an individual basis in each rate environment to estimate the likelihood of a call. Prepayment assumptions for mortgage loans and mortgage-backed securities are developed from industry median estimates of prepayment speeds, based upon similar coupon ranges and degree of seasoning. Cash flows and maturities are then determined, and for certain assets, prepayment assumptions are estimated under different interest rate scenarios. Interest income and interest expense are then simulated under several hypothetical interest rate conditions including:

- A flat interest rate scenario in which current prevailing rates are locked in and the only balance sheet fluctuations that occur are due to cash flows, maturities, new volumes, and re-pricing volumes consistent with this flat rate assumption;
- A 200 basis point rise or decline in interest rates applied against a parallel shift in the yield curve over a twelve-month horizon together with a dynamic balance sheet anticipated to be consistent with such interest rate changes;
- Various non-parallel shifts in the yield curve, including changes in either short-term or long-term rates over a twelve-month horizon, together with a dynamic balance sheet anticipated to be consistent with such interest rate changes; and
- An extension of the foregoing simulations to each of two, three, four and five year horizons to determine the interest rate risk with the level of interest rates stabilizing in years two through five. Even though rates remain stable during this two to five year time period, re-pricing opportunities driven by maturities, cash flow, and adjustable rate products will continue to change the balance sheet profile for each of the interest rate conditions.

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

The following table summarizes the Bank's net interest income sensitivity analysis as of December 31, 2009, over one and two year horizons and under different interest rate scenarios. In light of the prevailing Federal Funds rate of 0.00% to 0.25%, and the two-year U.S. Treasury note of 1.14% at December 31, 2009, the analysis incorporates a declining interest rate scenario of 100 basis points, rather than the 200 basis points as would traditionally be the case. The table also summarizes net interest income sensitivity under a non-parallel shift in the yield curve, whereby short term rates increase by 500 basis points.

**INTEREST RATE RISK**  
**CHANGE IN NET INTEREST INCOME FROM THE FLAT RATE SCENARIO**  
**DECEMBER 31, 2009**

	-100 Basis Points Parallel Yield Curve Shift	+200 Basis Points Parallel Yield Curve Shift	+500 Basis Points Short-term Rates
Year 1			
Net interest income	(\$248)	\$208	(\$438)
% change	(0.72%)	0.60%	(1.27%)
Year 2			
Net interest income	(\$792)	\$2,407	\$126
% change	(2.29%)	6.96%	0.36%

During 2009, the interest rate risk profile of the Bank's balance sheet became less liability sensitive than exhibited over the past few years. This was principally attributed to the extension of FHLB borrowings into longer-term maturities out to five years, as well as adding longer-term brokered certificates of deposit to the Bank's balance sheet. These actions were taken to protect the Bank's net interest margin and net interest income in a rising rate environment, at times when borrowing costs were at cyclical lows. Also impacting the liability sensitivity of the Bank's December 31, 2009 balance sheet was the renegotiation of certain fixed rate loans to variable rate, combined with a proportionately higher level of new variable rate loans added to the balance sheet during 2009.

As more fully discussed below, the December 31, 2009 interest rate sensitivity modeling results indicate that the Bank's balance sheet is about evenly matched over the one-year horizon and is favorably positioned for parallel increases in short-term and or long-term interest rates over the two-year horizon.

Assuming interest rates remain at or near their current levels and the Bank's balance sheet structure and size remain at current levels, the interest rate sensitivity simulation model suggests that net interest income will remain stable over the one year horizon and then begin to trend upward over the two year horizon and beyond. The upward trend over the two year horizon and beyond principally results from funding costs rolling over at lower prevailing rates while earning asset yields remain relatively stable.

Assuming short-term and long-term interest rates decline 100 basis points from current levels (i.e., a parallel yield curve shift) and the Bank's balance sheet structure and size remain at current levels, management believes net interest income will remain relatively stable over the one year horizon as reductions to funding costs essentially keep pace declining earning asset yields. Over the two year horizon, the interest rate sensitivity simulation model suggests the net interest margin will be pressured by accelerated cash flows on earning assets and the re-pricing of the Bank's earning asset base, resulting in a slow downward trend in net interest income. Should the yield curve steepen as rates fall, the model suggests that accelerated earning asset prepayments will slow, resulting in a more stabilized level of net interest income. Management anticipates that continued earning asset growth will be needed to meaningfully increase the Bank's current level of net interest income should both long-term and short-term interest rates decline in parallel.

Assuming the Bank's balance sheet structure and size remain at current levels and the Federal Reserve increases short-term interest rates by 200 basis points with the balance of the yield curve shifting in parallel with these increases, management believes net interest income will remain relatively stable over the twelve month horizon, then begin a strong and steady recovery over the two year horizon and beyond. The interest rate sensitivity simulation model suggests that as interest rates rise, the Bank's funding costs will re-price slightly faster than its earning asset portfolios, causing a small increase in net interest income. As funding costs begin to stabilize late in the first year of the simulation, the model suggests that the earning asset portfolios will continue to re-price at prevailing interest rate levels and cash flows from earning asset portfolios will be reinvested into higher yielding earning assets, resulting in a widening of spreads and improving levels of net interest income over the two year horizon and beyond. Management believes continued earning asset growth will be necessary to meaningfully increase the current level of net interest income over the one year horizon should short-term and long-term interest rates rise in parallel. Over the two year horizon and beyond, management believes low to moderate earning asset growth will be necessary to meaningfully increase the current level of net interest income.

The interest rate sensitivity model is used to evaluate the impact on net interest income given certain non-parallel shifts in the yield curve, including changes in either short-term or long-term interest rates. The Federal Reserve addressed the current economic recession with changes in its monetary policy, by reducing the Federal Funds rate to historic levels. During 2007 and 2008 the targeted fed funds rate fell from 5.25% to a range of 0% to 0.25% where it stayed for all of 2009, whereas the 10 year U.S. Treasury note has remained essentially unchanged since 2007. Accordingly, management modeled a non-parallel shift in the yield curve assuming a 500 basis point increase in the short-term Federal Funds interest rate with the balance of the yield curve remaining unchanged. Using this future interest rate scenario, the interest rate sensitivity model suggests that net interest income will post a small to moderate

decline over the twelve month horizon as funding costs re-price more quickly than earning asset yields. However, over the two year horizon and beyond net interest income will stabilize at a level that is slightly better than the current base case scenario.

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

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

The Bank engages an independent consultant to periodically review its interest rate risk position and the reasonableness of assumptions used, with periodic reports provided to the Bank's Board of Directors. At December 31, 2009, there were no significant differences between the views of the independent consultant and management regarding the Bank's interest rate risk exposure.

The following table summarizes the Bank's net interest income sensitivity analysis that was prepared as of December 31, 2008, over one and two-year horizons assuming 200 basis point parallel shifts in the yield curve. The table also summarized net interest income sensitivity under a non-parallel shift in the yield curve, whereby short-term rates increased by 200 basis points.

INTEREST RATE RISK			
CHANGES IN NET INTEREST INCOME FROM THE FLAT RATE SCENARIO			
DECEMBER 31, 2008			
	-100 Basis Points Parallel Yield Curve Shift	+200 Basis Points Parallel Yield Curve Shift	+200 Basis Points Short-term Rates
Year 1			
Net interest income	\$88	(\$298)	(\$1,239)
% change	0.29%	(0.99%)	(4.12%)
Year 2			
Net interest income	(\$887)	\$1,629	(\$1,998)
% change	(2.95%)	5.42%	(6.64%)

During 2009, the short-term Federal Funds interest rate remained unchanged at 0.00% to 0.25%, with yields on three month to two year Treasury notes also remaining essentially unchanged. As had been largely anticipated by management through use of the interest rate sensitivity model, the Bank's net interest margin increased 27 basis points in 2009, as the cost of interest bearing liabilities declined faster and to a greater degree than the decline in earning asset yields.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders  
Bar Harbor Bankshares:

We have audited the accompanying consolidated balance sheets of Bar Harbor Bankshares and subsidiaries (the "Company") as of December 31, 2009 and 2008, and the related consolidated statements of income, changes in shareholders' equity, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2009. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Bar Harbor Bankshares and subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2009, in conformity with U. S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 15, 2010 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Albany, New York  
March 15, 2010

BAR HARBOR BANKSHARES AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
DECEMBER 31, 2009 AND 2008  
(in thousands, except share data)

	December 31, 2009	December 31, 2008
Assets		
Cash and due from banks	\$ 9,831	\$ 9,041
Overnight interest bearing money market funds	1	1
Total cash and cash equivalents	9,832	9,042
Securities available for sale, at fair value	347,026	290,502

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Federal Home Loan Bank stock	16,068	14,796
Loans	669,492	633,603
Allowance for loan losses	(7,814)	(5,446)
Loans, net of allowance for loan losses	661,678	628,157
Premises and equipment, net	11,927	10,854
Goodwill	3,158	3,158
Bank owned life insurance	6,846	6,573
Other assets	15,846	9,206
<b>TOTAL ASSETS</b>	<b>\$1,072,381</b>	<b>\$972,288</b>
Liabilities		
Deposits:		
Demand and other non-interest bearing deposits	\$ 57,743	\$ 57,954
NOW accounts	74,538	67,747
Savings and money market deposits	171,791	163,780
Time deposits	245,111	200,206
Brokered time deposits	91,990	88,506
Total deposits	641,173	578,193
Short-term borrowings	91,893	121,672
Long-term advances from Federal Home Loan Bank	214,736	197,231
Junior subordinated debentures	5,000	5,000
Other liabilities	6,065	4,747
<b>TOTAL LIABILITIES</b>	<b>958,867</b>	<b>906,843</b>
Shareholders' equity		
Capital stock, par value \$2.00; authorized 10,000,000 shares; issued 4,443,614 shares at December 31, 2009 and 3,643,614 shares at December 31, 2008	8,887	7,287
Preferred stock, par value \$0; authorized 1,000,000 shares; issued 18,751 shares at December 31, 2009	18,358	---
Surplus	24,360	4,903
Retained earnings	75,001	67,908
Accumulated other comprehensive income (loss):		
Prior service cost and unamortized net actuarial losses on employee benefit plans, net of tax of (\$56) and (\$59), at December 31, 2009 and December 31, 2008, respectively	(109)	(115)
Net unrealized appreciation (depreciation) on securities available for sale, net of tax of \$1,074 and (\$573), at December 31, 2009 and December 31, 2008, respectively	2,084	(1,149)
Portion of OTTI attributable to non-credit losses, net of tax of \$931 and \$0, at December 31, 2009 and 2008, respectively	(1,808)	---
Net unrealized appreciation on derivative instruments, net of tax of \$209 and \$382 at December 31, 2009 and December 31, 2008, respectively	406	740
Total accumulated other comprehensive income (loss)	573	(524)
Less: cost of 752,431 and 769,635 shares of treasury stock at December 31, 2009 and December 31, 2008, respectively	(13,665)	(14,129)
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>113,514</b>	<b>65,445</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$1,072,381</b>	<b>\$972,288</b>

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME  
YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007  
(in thousands, except share data)

	2009	2008	2007
Interest and dividend income:			
Interest and fees on loans	\$ 34,797	\$ 37,653	\$ 37,923
Interest on securities	19,570	15,415	13,073
Dividends on FHLB stock	---	526	813

## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Total interest and dividend income	54,367	53,594	51,809
Interest expense:			
Deposits	10,724	14,976	16,222
Short-term borrowings	602	1,421	5,967
Long-term debt	9,760	10,006	6,717
Total interest expense	21,086	26,403	28,906
Net interest income	33,281	27,191	22,903
Provision for loan losses	3,207	1,995	456
Net interest income after provision for loan losses	30,074	25,196	22,447
Non-interest income:			
Trust and other financial services	2,444	2,513	2,335
Service charges on deposit accounts	1,412	1,594	1,624
Mortgage banking activities	490	15	20
Credit and debit card service charges and fees	779	2,044	2,100
Net securities gains (losses)	1,521	(831)	(671)
Total other-than-temporary impairment ("OTTI") losses	(2,773)	---	---
Non-credit portion of OTTI losses (before taxes) (1)	1,319	---	---
Net OTTI losses recognized in earnings	(1,454)	---	---
Other operating income	830	1,097	521
Total non-interest income	6,022	6,432	5,929
Non-interest expense:			
Salaries and employee benefits	11,594	10,827	9,368
Postretirement plan settlement	---	---	(832)
Occupancy expense	1,329	1,387	1,275
Furniture and equipment expense	1,378	1,539	1,718
Credit and debit card expenses	332	1,416	1,469
FDIC insurance assessments	1,420	134	59
Other operating expense	5,701	5,210	5,144
Total non-interest expense	21,754	20,513	18,201
Income before income taxes	14,342	11,115	10,175
Income taxes	3,992	3,384	3,020
Net income	\$ 10,350	\$ 7,731	\$ 7,155
Preferred stock dividends and accretion of discount	1,034	---	---
Net income available to common shareholders	\$ 9,316	\$ 7,731	\$ 7,155

### **Computation of Earnings Per Share:**

Weighted average number of capital stock shares outstanding			
Basic	2,916,643	2,943,694	3,037,074
Effect of dilutive employee stock options	57,182	63,555	75,662
Effect of dilutive warrants	9,604	---	---
Diluted	2,983,429	3,007,249	3,112,736

### **Per Common Share Data:**

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Basic Earnings Per Share	\$ 3.19	\$ 2.63	\$ 2.36
Diluted Earnings Per Share	\$ 3.12	\$ 2.57	\$ 2.30

(1) Included in other comprehensive income (loss), net of taxes

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007  
(in thousands, except share data)

	Capital Stock	Preferred Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive income (loss)	Treasury Stock	Total Shareholders' Equity
<b>Balance December 31, 2006</b>	\$7,287	\$ ---	\$ 4,365	\$59,339	\$ (953)	\$ (8,987)	\$ 61,051
Net income	---	---	---	7,155	---	---	7,155
Total other comprehensive income	---	---	---	---	2,071	---	2,071
Cash dividends declared (\$0.955 per share)	---	---	---	(2,899)	---	---	(2,899)
Purchase of treasury stock (67,599 shares)	---	---	---	---	---	(2,118)	(2,118)
Stock options exercised (22,817 shares), including related tax effects	---	---	99	(303)	---	714	510
Recognition of stock option expense	---	---	204	---	---	---	204
<b>Balance December 31, 2007</b>	\$7,287	\$ ---	\$ 4,668	\$63,292	\$ 1,118	\$ (10,391)	\$ 65,974
<b>Balance December 31, 2007</b>	\$7,287	\$ ---	\$ 4,668	\$63,292	\$ 1,118	\$ (10,391)	\$ 65,974
Net income	---	---	---	7,731	---	---	7,731
Total other comprehensive loss	---	---	---	---	(1,642)	---	(1,642)
Cash dividends declared (\$1.02 per share)	---	---	---	(3,004)	---	---	(3,004)
Purchase of treasury stock (138,409 shares)	---	---	---	---	---	(4,028)	(4,028)
Stock options exercised (9,725 shares), including related tax effects	---	---	31	(111)	---	290	210
Recognition of stock option expense	---	---	204	---	---	---	204
<b>Balance December 31, 2008</b>	\$ 7,287	\$ ---	\$ 4,903	\$67,908	\$ (524)	\$ (14,129)	\$ 65,445
<b>Balance December 31, 2008</b>	\$7,287	\$ ---	\$ 4,903	\$67,908	\$ (524)	\$ (14,129)	\$ 65,445
Net income	---	---	---	10,350	---	---	10,350
Cumulative effect adjustment for the adoption of FSP FAS 115-2	---	---	---	937	(937)	---	---
Total other comprehensive income	---	---	---	---	2,034	---	2,034
Dividend declared:						---	
Common stock (\$1.04 per share)	---	---	---	(2,994)	---	---	(2,994)
Preferred stock	---	---	---	(790)	---	---	(790)



Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Issuance of common stock (800,000 shares)	1,600	---	18,812	---	---	---	20,412
Issuance of preferred stock (18,751 shares)	---	18,114	(232)	---	---	---	17,882
Issuance of stock warrants	---	---	638	---	---	---	638
Purchase of treasury stock (5,571 shares)	---	---	---	---	---	(144)	(144)
Stock options exercised (22,775 shares), including related tax effects	---	---	110	(166)	---	608	552
Recognition of stock option expense	---	---	129	---	---	---	129
Cumulative dividends on preferred stock	---	122	---	(122)	---	---	---
Accretion of discount	---	122	---	(122)	---	---	---
<b>Balance December 31, 2009</b>	<b>\$8,887</b>	<b>\$18,358</b>	<b>\$24,360</b>	<b>\$75,001</b>	<b>\$ 573</b>	<b>\$(13,665)</b>	<b>\$113,514</b>

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007  
(in thousands)

	2009	2008	2007
Net income	\$10,350	\$ 7,731	\$7,155
Net unrealized appreciation (depreciation) on securities available for sale, net of tax of \$1,670, (\$1,472) and \$739 respectively	3,277	(2,893)	1,433
Less reclassification adjustment for net (gains) losses related to securities available for sale included in net income, net of tax of (\$517), \$283 and \$228, respectively	(1,004)	548	443
Add other-than-temporary adjustment, net of tax of \$494	960	---	---
Add non-credit portion of other-than-temporary losses, net of tax of \$448	(871)	---	---
Net unrealized (depreciation) appreciation and other amounts for interest rate derivatives, net of tax of (\$173), \$358 and \$245, respectively	(334)	694	475
Reversal of actuarial gain upon postretirement plan settlement, net of tax of \$0, \$0, and \$151, respectively	---	---	(289)
Amortization of actuarial gain for supplemental executive retirement plan, net of related tax of \$3, \$5 and \$7, respectively	6	9	9
Total other comprehensive income (loss)	2,034	(1,642)	2,071
Total comprehensive income	\$12,384	\$ 6,089	\$9,226

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007  
(in thousands)

	2009	2008	2007
Cash flows from operating activities:			
Net income	\$ 10,350	\$ 7,731	\$ 7,155
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization of premises and equipment	914	1,004	1,211
Amortization of core deposit intangible	67	67	67
Provision for loan losses	3,207	1,995	456
Net securities (gains) losses	(1,521)	831	671
Other-than-temporary impairment	1,454	---	---
Net (accretion) amortization of bond discounts and premiums	(965)	(748)	93
Deferred tax (benefit) expense	(1,742)	(714)	374
Recognition of stock option expense	129	204	204
Postretirement plan settlement	---	---	(832)
Gain on sale of credit card processing business	---	(111)	---

## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Gain on sale of merchant processing business	---	(103)	---
Proceeds from sale of mortgages	29,898	---	---
Origination of mortgage loans held for sale	(29,842)	---	---
Net gains on sale of mortgages held for sale	(490)	---	---
Net change in other assets	(6,003)	1,536	(1,087)
Net change in other liabilities	1,327	(768)	(138)
Net cash provided by operating activities	6,783	10,924	8,174
Cash flows from investing activities:			
Purchases of securities available for sale	(184,554)	(100,222)	(154,501)
Proceeds from maturities, calls and principal paydowns of mortgage-backed securities	70,266	49,656	50,702
Proceeds from sales of securities available for sale	62,357	21,064	54,513
Net increase in Federal Home Loan Bank stock	(1,272)	(1,640)	(1,307)
Proceeds from sale of student loan portfolio	---	---	2,539
Proceeds from sale of credit card processing business	---	2,284	---
Net loans made to customers	(37,148)	(57,337)	(27,729)
Proceeds from sale of other real estate owned	83	340	---
Capital expenditures	(1,987)	(1,063)	(638)
Net cash used in investing activities	(92,255)	(86,918)	(76,421)
Cash flows from financing activities:			
Net increase in deposits	62,980	39,077	42,797
Net (decrease) increase in securities sold under repurchase agreements and fed funds purchased	(726)	(1,177)	7,619
Proceeds from Federal Reserve borrowings	20,000	---	---
Proceeds from Federal Home Loan Bank advances	47,490	97,180	101,000
Repayments of Federal Home Loan Bank advances	(79,038)	(55,953)	(90,478)
Proceeds from issuance of junior subordinated debentures	---	5,000	---
Proceeds from issuance of common stock	20,412	---	---
Net proceeds from issuance of preferred stock and stock warrants	18,520	---	---
Purchases of treasury stock	(144)	(4,028)	(2,118)
Proceeds from stock option exercises, including excess tax benefits	552	210	510
Payments of dividends	(3,784)	(3,004)	(2,899)
Net cash provided by financing activities	86,262	77,305	56,431
Net increase (decrease) in cash and cash equivalents	790	1,311	(11,816)
Cash and cash equivalents at beginning of year	9,042	7,731	19,547
Cash and cash equivalents at end of year	\$ 9,832	\$ 9,042	\$ 7,731
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Interest	\$ 21,191	\$ 26,667	\$ 28,194
Income taxes	5,954	3,427	2,712
Schedule of noncash investing activities:			
Transfers from loans to other real estate owned	\$ 854	\$ 83	\$ 340

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### BAR HARBOR BANKSHARES AND SUBSIDIARIES

(All dollar amounts expressed in thousands, except per share data)

#### Note 1: Summary of Significant Accounting Policies

The accounting and reporting policies of Bar Harbor Bankshares (the "Company") and its wholly-owned operating subsidiary, Bar Harbor Bank & Trust (the "Bank"), conform to U.S. generally accepted accounting principles and to general practice within the banking industry.

The Company's principal business activity is retail and commercial banking and, to a lesser extent, financial services including trust, financial planning, investment management and third-party brokerage services. The Company's business is conducted through the Company's twelve banking offices located throughout downeast and midcoast

Maine.

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, and is subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve System. The Company is also 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. The Bank is subject to the supervision, regulation, and examination of the FDIC and the Maine Bureau of Financial Institutions.

Financial Statement Presentation:

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles.

The consolidated financial statements include the accounts of Bar Harbor Bankshares and its wholly-owned subsidiary, Bar Harbor Bank & Trust. All significant inter-company balances and transactions have been eliminated in consolidation. Whenever necessary, amounts in the prior years' financial statements are reclassified to conform to current presentation. Assets held in a fiduciary capacity are not assets of the Company and, accordingly, are not included in the consolidated balance sheets.

In preparing financial statements in conformity with U.S. generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to change in the near term relate to the determination of the allowance for loan losses, reviews of goodwill and intangible assets for impairment, accounting for postretirement plans, and income taxes.

Cash and Cash Equivalents:

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, federal funds sold and other short-term investments with maturities less than 90 days.

The Bank is required to maintain an average reserve balance with the Federal Reserve Bank or maintain such reserve balance in the form of cash on hand. The required reserve balance at December 31, 2009, and 2008 was \$0 and \$394, respectively, and was met by holding cash on hand. The Bank's clearing balance requirement was \$150 at December 31, 2009, and 2008.

In the normal course of business, the Bank has funds on deposit at other financial institutions in amounts in excess of the \$250 that is insured by the Federal Deposit Insurance Corporation.

Investment Securities:

Investments in debt securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" ("HTM") and reflected at amortized cost. Securities not classified as "held-to-maturity" are classified as "available-for-sale" ("AFS"). All securities held at December 31, 2009 and 2008 were classified as AFS. Securities AFS primarily consist of debt securities and mortgage-backed securities, and are carried at estimated fair value. Changes in estimated fair value of AFS securities, net of applicable income taxes, are reported in accumulated other comprehensive income (loss) as a separate component of shareholders' equity. The Bank does not have a securities trading portfolio or securities held to maturity.

Premiums and discounts on securities are amortized and accreted over the term of the securities using the interest method. Gains and losses on the sale of securities are recognized at the trade date using the specific-identification

method and are shown separately in the consolidated statements of income.

#### Other-Than-Temporary Impairments on Investment Securities

: One of the significant estimates relating to securities is the evaluation of other-than-temporary impairment. If a decline in the fair value of a debt security is judged to be other-than-temporary, and management does not intend to sell the security and believes it is more-likely-than-not the Company will not be required to sell the security prior to recovery of cost or amortized cost, the portion of the total impairment attributable to the credit loss is recognized in earnings, and the remaining difference between the security's amortized cost basis and its fair value is included in other comprehensive income.

For impaired available-for-sale debt securities that management intends to sell, or where management believes it is more-likely-than-not that the Company will be required to sell, an other-than-temporary impairment charge is recognized in earnings equal to the difference between fair value and cost or amortized cost basis of the security. The fair value of the other-than-temporarily impaired security becomes its new cost basis.

The evaluation of securities for impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of securities should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition and/or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period of unrealized losses. The Company has a security monitoring process that identifies securities that, due to certain characteristics, as described below, are subjected to an enhanced analysis on a quarterly basis.

Securities that are in an unrealized loss position, are reviewed at least quarterly to determine if an other-than-temporary impairment is present based on certain quantitative and qualitative factors and measures. The primary factors considered in evaluating whether a decline in value of securities is other-than-temporary include: (a) the cause of the impairment; (b) the financial condition, credit rating and future prospects of the issuer; (c) whether the debtor is current on contractually obligated interest and principal payments; (d) the volatility of the securities' fair value; (e) performance indicators of the underlying assets in the security including default rates, delinquency rates, percentage of nonperforming assets, loan to collateral value ratios, third party guarantees, current levels of subordination, vintage, and geographic concentration and; (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of the receipt of all principal and interest due.

For securitized financial assets with contractual cash flows, such as private label mortgage-backed securities, the Company periodically updates its best estimate of cash flows over the life of the security. The Company's best estimate of cash flows is based upon assumptions consistent with the current economic recession, similar to those the Company believes market participants would use. If the fair value of a securitized financial asset is less than its cost or amortized cost and there has been an adverse change in timing or amount of anticipated future cash flows since the last revised estimate to the extent that the Company does not expect to receive the entire amount of future contractual principal and interest, an other-than-temporary impairment charge is recognized in earnings representing the estimated credit loss if management does not intend to sell the security and believes it is more-likely-than-not the Company will not be required to sell the security prior to recovery of cost or amortized cost. Estimating future cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain assumptions and judgments regarding the future performance of the underlying collateral. In addition, projections of expected future cash flows may change based upon new information regarding the performance of the underlying collateral.

Federal Home Loan Bank Stock

: The Bank is a member of the Federal Home Loan Bank ("FHLB") of Boston. The FHLB of Boston is a cooperatively owned wholesale bank for housing and finance in the six New England States. As a requirement of membership in the FHLB of Boston, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. The Bank uses the FHLB of Boston for most of its wholesale funding needs.

FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value. Shares held in excess of the minimum required amount are generally redeemable at par value; however, the FHLB recently announced a moratorium on such redemptions in order to preserve its capital in response to current market conditions. The minimum required shares are redeemable, subject to certain limitations, five years following termination of FHLB membership. The Bank has no intention of terminating its FHLB membership. The investment in FHLB of Boston stock is periodically evaluated for impairment based on, among other things, the capital adequacy of the FHLB of Boston and its overall financial condition. No impairment losses have been recorded through December 31, 2009.

#### Loans:

Loans are carried at the principal amounts outstanding adjusted by partial charge-offs and net deferred loan origination costs or fees.

Interest on loans is accrued and credited to income based on the principal amount of loans outstanding. Residential real estate loans are generally placed on non-accrual status when reaching 90 days past due, or in process of foreclosure, or sooner if judged appropriate by management. All consumer loans are generally placed on non-accrual when reaching 90 days or more past due, or sooner if judged appropriate by management, and any equity line in the process of foreclosure is generally placed on non-accrual status, or sooner if judged appropriate by management. Secured consumer loans are written down to realizable value and unsecured consumer loans are charged-off upon reaching 120 days past due. Commercial real estate loans and commercial business loans that are 90 days or more past due are generally placed on non-accrual status, unless secured by sufficient cash or other assets immediately convertible to cash, and the loan is in the process of collection. Commercial real estate and commercial business loans may be placed on non-accrual status prior to the 90 days delinquency date if considered appropriate by management. When a loan has been placed on non-accrual status, previously accrued and uncollected interest is reversed against interest on loans. A loan can be returned to accrual status when collectibility of principal is reasonably assured and the loan has performed for a period of time, generally six months.

Commercial real estate and commercial business loans are considered impaired when it becomes probable the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status and collateral value.

Loan origination and commitment fees and direct loan origination costs are deferred, and the net amount is amortized as an adjustment of the related loans yield, using the level yield method over the estimated lives of the related loans.

#### Allowance for Loan Losses:

The allowance for loan losses (the "allowance") is a significant accounting estimate used in the preparation of the Company's consolidated financial statements. The allowance is available to absorb losses on loans and is maintained at a level that, in management's judgment, is appropriate for the amount of risk inherent in the loan portfolio, given past and present conditions. The allowance is increased by provisions charged to operating expense and by recoveries on loans previously charged off, and is decreased by loans charged off as uncollectible.

Arriving at an appropriate level of allowance for loan losses involves a high degree of judgment. The determination of the adequacy of the allowance and provisioning for estimated losses is evaluated regularly based on review of loans, with particular emphasis on non-performing and other loans that management believes warrant special consideration.

The ongoing evaluation process includes a formal analysis, which considers among other factors: the character and size of the loan portfolio, business and economic conditions, real estate market conditions, collateral values, changes in product offerings or loan terms, changes in underwriting and/or collection policies, loan growth, previous charge-off experience, delinquency trends, nonperforming loan trends, the performance of individual loans in relation to contract terms, and estimated fair values of collateral.

The allowance for loan losses consists of allowances established for specific loans including impaired loans; allowances for pools of loans based on historical charge-offs by loan types; and supplemental allowances that adjust historical loss experience to reflect current economic conditions, industry specific risks, and other observable data.

While management uses available information to recognize losses on loans, changing economic conditions and the economic prospects of the borrowers may necessitate future additions or reductions to the allowance. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance, which also may necessitate future additions or reductions to the allowance, based on information available to them at the time of their examination.

#### Premises and Equipment:

Premises and equipment and related improvements are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of related assets; generally 25 to 40 years for premises and 3 to 7 years for furniture and equipment.

#### Goodwill and Identifiable Intangible Assets:

In connection with acquisitions, the Company generally records as assets on its consolidated financial statements both goodwill and identifiable intangible assets, such as core deposit intangibles.

The Company evaluates whether the carrying value of its goodwill has become impaired, in which case the value is reduced through a charge to its earnings. Goodwill is evaluated for impairment at least annually, or upon a triggering event, using certain fair value techniques. Goodwill impairment testing is performed at the segment (or "reporting unit") level. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to the reporting units, it no longer retains its association with a particular acquisition, and all if the activities within a reporting unit, whether acquired or organically grown, are available to support the value of the goodwill.

The goodwill impairment analysis is a two-step test. The first steps used to identify potential impairment, involves comparing each unit's fair value to its carrying value including goodwill. If the fair value of a reporting unit exceeds its carrying value, applicable goodwill is considered not to be impaired. If the carrying value exceeds fair value, there is an indication of impairment and the second step is to measure the amount of impairment.

At December 31, 2009, the Company did not have any identifiable intangible assets on its consolidated balance sheet. At December 31, 2008, identifiable intangible assets included in other assets on the consolidated balance sheet consisted of core deposit intangibles amortized over their estimated useful lives on a straight-line method, which approximated the amount of economic benefits to Company. These assets became fully amortized during 2009. The determination of which intangible assets have finite lives is subjective, as is the determination of the amortization period for such intangible assets.

Any changes in the estimates used by the Company to determine the carrying value of its goodwill and identifiable intangible assets, or which otherwise adversely affect their value or estimated lives, would adversely affect the Company's consolidated results of operations.

#### Bank-Owned Life Insurance:

Bank-owned life insurance ("BOLI") represents life insurance on the lives of certain retired employees who had provided positive consent allowing the Bank to be the beneficiary of such policies. Increases in the cash value of the policies, as well as insurance proceeds received in excess of the cash value, are recorded in other non-interest income, and are not subject to income taxes. The cash surrender value is included in other assets on the Company's consolidated balance sheet. The Company reviews the financial strength of the insurance carrier prior to the purchase of BOLI and annually thereafter.

#### Mortgage Servicing Rights

: Mortgage servicing rights are recognized as separate assets when purchased or when retained in a sale of financial assets. Capitalized servicing rights are reported in other assets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance to the extent that fair value is less than the carrying value of the rights.

#### Other Real Estate Owned

: Real estate acquired in satisfaction of a loan is reported in other assets. Properties acquired by foreclosure or deed in lieu of foreclosure are transferred to other real estate owned and recorded at the lower of cost or fair market value less estimated costs to sell based on appraised value at the date actually or constructively received. Loan losses arising from the acquisition of such property are charged against the allowance for loan losses. Subsequent reductions in market value below the carrying value are charged to other operating expenses.

#### Derivative Financial Instruments:

The Company recognizes all derivative instruments on the consolidated balance sheet at fair value. On the date the derivative instrument is entered into, the Company designates whether the derivative is part of a hedging relationship (i.e., cash flow or fair value hedge). The Company formally documents relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking hedge transactions. The Company also assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives used in hedging transactions are highly effective in offsetting the changes in cash flows or fair values of hedged items.

Changes in fair value of derivative instruments that are highly effective and qualify as a cash flow hedge are recorded in other comprehensive income or loss. Any ineffective portion is recorded in earnings. For fair value hedges that are highly effective, the gain or loss on the derivative and the loss or gain on the hedged item attributable to the hedged risk are both recognized in earnings, with the differences (if any) representing hedge ineffectiveness. The Company discontinues hedge accounting when it is determined that the derivative is no longer highly effective in offsetting changes of the hedged risk on the hedged item, or management determines that the designation of the derivative as a hedging instrument is no longer appropriate.

#### Off-Balance Sheet Financial Instruments

: In the ordinary course of business the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit, and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

#### Stock Based Compensation:

The Company has a stock option plan, which is described more fully in Note 13. The Company expenses the grant date fair value of options granted. The expense is recognized over the vesting periods of the grants.

Accounting for Defined Benefit Pension and Retirement Benefit Plans:

The Company has non-qualified supplemental executive retirement agreements with certain retired officers. The agreements provide supplemental retirement benefits payable in installments over a period of years upon retirement or death. The Company recognized the net present value of payments associated with the agreements over the service periods of the participating officers. Interest costs continue to be recognized on the benefit obligations. The Company also has supplemental executive retirement agreements with certain current executive officers. These agreements provide a stream of future payments in accordance with individually defined vesting schedules upon retirement, termination, or in the event that the participating executive leaves the Company following a change of control event. The Company recognizes the net present value of payments associated with these agreements over the service periods of the participating executive officers. Upon retirement, interest costs will continue to be recognized on the benefit obligation.

Prior to the first quarter of 2007, the Company sponsored a limited postretirement benefit program, which funded medical coverage and life insurance benefits to a closed group of active and retired employees who met minimum age and service requirements. It was the Company's policy to record the cost of postretirement health care and life insurance plans based on actuarial estimates, which were dependent on claims and premiums paid. The cost of providing these benefits was accrued during the active service period of the employee.

In the first quarter of 2007, the Company settled its limited postretirement benefit program. The Company voluntarily paid out \$699 to plan participants, representing 64% of the accrued post retirement benefit obligation. This payment fully settled all Company obligations related to this program. In connection with the settlement of the postretirement program, the Company recorded a reduction in non-interest expense of \$832 in the first quarter of 2007, representing the elimination of the \$390 remaining accrued benefit obligation included in other liabilities on the consolidated balance sheet, and the \$442 actuarial gain (\$291, net of tax) related to the program. The actuarial gain was previously included in accumulated other comprehensive income, net of tax effect of \$151.

The Company recognizes the over-funded or under-funded status of defined benefit pension and other postretirement benefit plans as an asset or liability on the balance sheet and recognizes changes in that funded status through other comprehensive income. Gains and losses, prior service costs and credits, and any remaining transition amounts that have not yet been recognized through net periodic benefit costs are recognized in accumulated other comprehensive income (loss), net of tax effects, until they are amortized as a component of net periodic cost. The measurement date, which is the date at which the benefit obligation and plan assets are measured, is the Company's fiscal year end.

Income Taxes:

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information indicates that it is more likely than not that deferred tax assets will not be realized, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company performs an analysis of its tax positions and has not identified any uncertain tax positions for which tax benefits should not be recognized as of December 31, 2009. The Company's policy is to report interest and penalties, if any, related to unrecognized tax benefits in income tax expense in the consolidated statements of income.



Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

The Company's income tax returns are currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2005 through 2008.

Earnings Per Share:

Basic earnings per share exclude dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company, such as the Company's dilutive stock options.

Segment Reporting:

An operating segment is defined as a component of a business for which separate financial information is available that is evaluated regularly by the chief operating decision-maker in deciding how to allocate resources and evaluate performance. The Company has determined that its operations are solely in the community banking industry and include traditional community banking services, including lending activities, acceptance of demand, savings and time deposits, business services, investment management, trust and third-party brokerage services. These products and services have similar distribution methods, types of customers and regulatory responsibilities. Accordingly, disaggregated segment information is not presented in the notes to the consolidated financial statements.

Note 2: Securities Available For Sale

A summary of the amortized cost and market values of securities available for sale follows:

	December 31, 2009			
	Amortized Cost*	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Available for Sale:</b>				
Obligations of US Government-sponsored enterprises	\$ 2,770	\$ 13	\$ 227	\$ 2,556
Mortgage-backed securities:				
US Government-sponsored enterprises	226,740	7,613	3	234,350
US Government agency	21,522	606	21	22,107
Private label	31,754	27	5,428	26,353
Obligations of states and political subdivisions thereof	63,821	1,674	3,835	61,660
Total	\$346,607	\$9,933	\$9,514	\$347,026

\*includes the cumulative write-down of securities considered to be other-than-temporarily impaired at December 31, 2009, with impairment write-downs totaling \$2,475; all related to private label mortgage backed securities

	December 31, 2008			
	Amortized Cost*	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Available for Sale:</b>				
Obligations of US Government-sponsored enterprises	\$ 700	\$ 1	\$ ---	\$ 701
Mortgage-backed securities:				
US Government-sponsored enterprises	172,661	4,874	10	177,525
US Government agency	32,750	961	26	33,685
Private-label	43,579	172	4,193	39,558
Obligations of states and political subdivisions thereof	42,534	166	3,667	39,033
Total	\$292,224	\$6,174	\$7,896	\$290,502

\*Includes the write-down of securities considered to be other-than-temporarily impaired at December 31, 2008, with impairment write-downs totaling \$1,435.

Securities Impairment:

As a part of the Company's ongoing security monitoring process, the Company identifies securities in an unrealized loss position that could potentially be other-than-temporarily impaired.

Effective April 1, 2009, the Company adopted FSP FAS 115-2, *Recognition and Presentation of Other-than-Temporary Impairments*, now included in the *FASB Accounting Standards Codification* as part of FASB ASC 320-10-65, *Investments - Debt and Equity Securities*. This new accounting standard amended the OTTI guidance included in GAAP for debt securities, which among other things clarified the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired and changed the presentation and calculation of OTTI on debt securities in the financial statements. Additionally, when adopting this accounting standard, an entity is required to record a cumulative-effect adjustment as of the beginning of the period of adoption to reclassify the non-credit component of a previously recognized other-than-temporary impairment from retained earnings to accumulated other comprehensive income (loss) if the entity does not intend to sell the security and it is not likely that the entity will be required to sell the security before recovery of its amortized cost. Upon the adoption of this accounting standard the Company recognized the effect of applying it as a change in accounting principle. The Company recognized a \$937 cumulative effect of initially applying this standard as an adjustment to retained earnings as of April 1, 2009, with a corresponding adjustment to accumulated other comprehensive income (loss).

Prior to the adoption of the new accounting standard, in the first quarter of 2009 the Company recorded other-than-temporary impairment losses of \$1,007 related to five available-for-sale, 1-4 family non-agency mortgage-backed securities because the Company could no longer conclude it was probable that it would recover all of the principal and interest on these securities. This charge represented the total amount of unrealized losses on these securities at March 31, 2009 and was recorded within net securities gains in the Company's consolidated statement of income.

For the year ended December 31, 2009, the Company recorded total OTTI losses amounting to \$2,773 (before taxes), related to twelve, available-for-sale, 1-4 family non-agency mortgage backed securities. Of the \$2,773 in total OTTI losses, \$1,454 (before taxes) represented estimated credit losses on the collateral underlying the securities, while \$1,319 (before taxes) represented unrealized losses for the same securities resulting from factors other than credit. The \$1,454 in estimated credit losses were recorded in earnings (before taxes), with the \$1,319 non-credit portion of the unrealized losses recorded within accumulated other comprehensive income, net of taxes.

The \$1,454 in 2009 OTTI losses recognized in earnings represented management's best estimate of credit losses inherent in the securities based on discounted, bond-specific future cash flow projections using assumptions about cash flows associated with the pools of loans underlying each security. In estimating those cash flows the Company considered loan level credit characteristics, current delinquency and nonperforming loan rates, current levels of subordination and credit support, recent default rates and future constant default rate estimates, loan to collateral value ratios, recent collateral loss severities and future collateral loss severity estimates, recent prepayment rates and future prepayment rate assumptions, and other estimates of future collateral performance.

For the year ended December 31, 2008, the Company recorded OTTI losses of \$1,435 related to three available-for-sale, 1-4 family non-agency mortgage-backed securities because the Company could no longer conclude it was probable it would recover all of the principal and interest on these securities. This charge represented the total amount of unrealized losses on these securities at December 31, 2008 and was recorded within net securities losses in the Company's consolidated statement of income.

Despite some rising levels of delinquencies, defaults and losses in the underlying residential mortgage loan collateral, given credit enhancements resulting from the structures of the individual securities, the Company expects that as of December, 2009 it will recover the amortized cost basis of its private label mortgage-backed securities as depicted in the table below and has therefore concluded that such securities were not other-than-temporarily impaired as of that

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

date. Nevertheless, given recent market conditions, it is possible that adverse changes in repayment performance and fair value could occur in future periods that could impact the Company's current best estimates.

The following table displays the beginning balance of OTTI related to credit losses on debt securities held by the Company at the beginning of the current reporting period for which the other than credit related portion of the OTTI was included in accumulated other comprehensive income (net of tax), as well as changes in credit losses recognized in pre-tax earnings for the quarter ended December 31, 2009.

Estimated credit losses as of April 1, 2009	\$1,021
Additional credit losses for securities on which OTTI had been previously recognized	987
Additions for credit losses for securities on which OTTI had not been previously recognized	467
Estimated credit losses as of December 31, 2009	\$2,475

As of December 31, 2009, the total OTTI losses included in accumulated other comprehensive income amounted to \$1,808, net of tax, compared with none at December 31, 2008. These OTTI losses related to twelve private label mortgage-backed securities, with a total unamortized cost of \$7,693 at December 31, 2009.

As of December 31, 2009, based on a review of each of the remaining securities in the securities portfolio, the Company concluded that it expects to recover its amortized cost basis for such securities. This conclusion was based on the issuers' continued satisfaction of the securities obligations in accordance with their contractual terms and the expectation that they will continue to do so through the maturity of the security, the expectation that the Company will receive the entire amount of future contractual cash flows, as well as the evaluation of the fundamentals of the issuers' financial condition and other objective evidence. Accordingly, the Company concluded that the declines in the values of those securities were temporary and that any additional other-than-temporary impairment charges were not appropriate at December 31, 2009. As of that date, the Company did not intend to sell nor believed it is more likely than not that it would be required to sell any of its impaired securities, that is, where fair value is less than the cost basis of the security.

The following tables summarize the fair value of securities with continuous unrealized losses for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer as of December 31, 2009 and 2008. All securities referenced are debt securities. At December 31, 2009 and 2008, the Company did not hold any common stock or other equity securities in its securities portfolio.

2009	Less than 12 months			12 months or longer			Total		
	Estimated Fair Value	Number of Investments	Unrealized Losses	Estimated Fair Value	Number of Investments	Unrealized Losses	Estimated Fair Value	Number of Investments	Unrealized Losses
<b>Description of Securities:</b>									
Obligations of U.S. Government-									
Sponsored enterprises	\$ 1,543	2	\$ 227	\$ ---	---	\$ ---	\$ 1,543	2	\$ 227
Mortgage-backed securities:									
US									
Government-sponsored enterprises	954	1	2	21	1	1	975	2	3
US Government Agency	2,855	2	14	843	14	7	3,698	16	21
Private Label	3,346	11	1,852	18,489	45	3,576	21,835	56	5,428
Obligations of states and political subdivisions thereof									
subdivisions thereof	15,287	36	744	10,943	50	3,091	26,230	86	3,835
<b>Total</b>	<b>\$23,985</b>	<b>52</b>	<b>\$2,839</b>	<b>\$30,296</b>	<b>110</b>	<b>\$6,675</b>	<b>\$54,281</b>	<b>162</b>	<b>\$9,514</b>

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

2008	Less than 12 months			12 months or longer			Total		
	Estimated Fair Value	Number of Investments	Unrealized Losses	Estimated Fair Value	Number of Investments	Unrealized Losses	Estimated Fair Value	Number of Investments	Unrealized Losses
Mortgage-backed securities:									
US Government-sponsored enterprises	\$ 2,423	3	\$ 7	\$ 451	3	\$ 3	\$ 2,874	6	\$ 10
US Government agency	1,660	16	19	230	7	7	1,890	23	26
Private-label Obligations of states of the U.S. and political subdivisions thereof	27,140	37	3,560	6,620	23	633	33,760	60	4,193
	25,975	79	2,330	3,928	18	1,337	29,903	97	3,667
Total	\$57,198	135	\$5,916	\$11,229	51	\$1,980	\$68,427	186	\$7,896

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

- Debt obligations of U.S. Government-sponsored enterprises:

As of December 31, 2009, the total unrealized losses on these securities amounted to \$227, compared with none at December 31, 2008. All of these securities were credit rated "AAA" by the major credit rating agencies. Management's analysis indicated that these securities have minimal credit risk, as these enterprises play a vital role in the nation's financial markets. Company management believes that the unrealized losses at December 31, 2009 were attributed to changes in current market yields and pricing spreads for similar securities since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at December 31, 2009.

- Mortgage-backed securities issued by U.S. Government-sponsored enterprises

: As of December 31, 2009, the total unrealized losses on these securities amounted to \$3, compared with \$10 at December 31, 2008. All of these securities were credit rated "AAA" by the major credit rating agencies. Company management believes these securities have minimal credit risk, as these enterprises play a vital role in the nation's financial markets. Management's analysis indicates that that the unrealized losses at December 31, 2009 were attributed to changes in current market yields and pricing spreads for similar securities since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at December 31, 2009.

- Mortgage-backed securities issued by U.S. Government agencies:

As of December 31, 2009, the total unrealized losses on these securities amounted to \$21, compared with \$26 at December 31, 2008. All of these securities were credit rated "AAA" by the major credit rating agencies. Management's analysis indicates that these securities bear no credit risk because they are backed by the full faith and credit of the United States. The Company attributes the unrealized losses at December 31, 2009 to changes in current market yields and pricing spreads for similar securities since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at December 31, 2009.

- Private label mortgage-backed securities

: As of December 31, 2009, the total unrealized losses on the Bank's private label mortgage-backed securities amounted to \$5,428, compared with \$4,193 at December 31 2008. The Company attributes the unrealized losses at December 31, 2009 to the current market environment for non-agency mortgage-backed securities, a seriously declining housing market, risk related market pricing discounts for non-agency mortgage-backed

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

securities and credit rating downgrades on certain private label MBS owned by the Company. Based upon the foregoing considerations and the expectation that the Company will receive all of the future contractual cash flows on these securities, the Company does not consider these securities to be other-than-temporarily impaired at December 31, 2009.

- Obligations of states of the U.S. and political subdivisions thereof

: As of December 31, 2009, the total unrealized losses on the Bank's municipal securities amounted to \$3,835, compared with \$3,667 at December 31, 2008. The Bank's municipal securities are supported by the general taxing authority of the municipality and in the cases of school districts, are supported by state aid. At December 31, 2009, all municipal bond issuers were current on contractually obligated interest and principal payments. At December 31, 2009, the Bank's municipal bond portfolio did not contain any below investment grade securities as reported by major credit rating agencies. The Company attributes the unrealized losses at December 31, 2009 to changes in prevailing market yields and pricing spreads since the date the underlying securities were purchased, driven in part by current market concerns about the prolonged economic recession and the impact it might have on the future financial stability of municipalities throughout the country. Accordingly, The Company does not consider these municipal securities to be other-than-temporarily impaired at December 31, 2009.

At December 31, 2009, the Company had no intent to sell nor believed it is more likely than not that it would be required to sell any of its impaired securities as identified and discussed immediately above, and therefore did not consider these securities to be other-than-temporarily impaired as of that date.

**Maturity Distribution:**

The following table summarizes the maturity distribution of the amortized cost and estimated fair value of securities available for sale as of December 31, 2009. Actual maturities may differ from the final contractual maturities noted below because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities are allocated among the maturity groupings based on their final maturity dates.

	December 31, 2009	
	Amortized Cost	Estimated Fair Value
<b>Securities Available for Sale</b>		
Due in one year or less	\$ 162	\$ 164
Due after one year through five years	1,619	1,657
Due after five years through ten years	17,002	17,045
Due after ten years	327,824	328,160
	\$346,607	\$347,026

\*includes the cumulative write-down of securities considered to be other-than-temporarily impaired at December 31, 2009 with impairment write-downs totaling \$2,475.

**Realized Securities Gains and Losses:**

The following table summarizes realized gains and losses and other than temporary impairment losses on securities available for sale for the years ended December 31, 2009, 2008 and 2007.

	Proceeds from Sale of Securities Available for Sale	Realized Gains	Realized Losses	Other Than Temporary Impairment Losses	Net
2009	\$62,357	\$2,528	\$ ---	\$2,461	\$ 67

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

2008	\$21,064	\$ 604	\$ ---	\$1,435	\$(831)
2007	\$54,513	\$ 641	\$150	\$1,162	\$(671)

Pledged Securities:

At December 31, 2009 and 2008, securities available for sale, at fair value, totaling \$32,826 and \$43,922, respectively, were pledged as collateral for securities sold under repurchase agreements and for other purposes required by law.

Note 3: Loans

The Company's lending activities are principally conducted in downeast and midcoast Maine. The following table summarizes the composition of the loan portfolio as of December 31, 2009 and 2008:

	2009	2008
Commercial real estate mortgages	\$269,776	\$236,674
Commercial and industrial loans	77,284	65,717
Agricultural and other loans to farmers	22,192	19,390
Total commercial loans	369,252	321,781
Residential real estate mortgages	225,750	249,543
Home equity loans	54,889	51,095
Consumer loans	4,665	4,773
Total consumer loans	285,304	305,411
Tax exempt loans	14,138	5,358
Deferred origination costs, net	798	1,053
Total loans	669,492	633,603
Allowance for loan losses	(7,814)	(5,446)
Total loans net of allowance for loan losses	\$661,678	\$628,157

Non-performing Loans:

The following table sets forth information regarding non-accruing loans and accruing loans 90 days or more overdue at December 31, 2009, 2008 and 2007.

	2009	2008	2007
Commercial real estate mortgages	\$3,096	\$1,645	\$1,519
Commercial construction and development	392	---	---
Commercial and industrial loans	237	294	---
Agricultural and other loans to farmers	1,848	199	79
Total commercial loans	5,573	2,138	1,598
Residential real estate mortgages	2,498	1,696	377
Home equity loans	304	26	73
Residential construction and development	24	25	---
Consumer loans	5	16	5
Total consumer loans	2,831	1,763	455
Total non-accrual loans	8,404	3,901	2,053
Accruing loans contractually past due 90 days or more	772	503	9
Total non-performing loans	\$9,176	\$4,404	\$2,062

During the years ended December 31, 2009, 2008 and 2007, the foregone interest on non-accrual loans amounted to \$382, \$263, and \$99, respectively.

At December 31, 2009, the Bank had \$854 of other real estate owned, compared with \$83 at December 31, 2008.

Loan Concentrations:

Because of the Company's proximity to Acadia National Park, a large part of the economic activity in the Bank's area is generated from the hospitality business associated with tourism. At December 31, 2009 and 2008, loans to the lodging

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

industry amounted to approximately \$70,846 and \$54,855, respectively.

**Loans to Related Parties:** In the ordinary course of business, the Bank has made loans at prevailing rates and terms to directors, officers and other related parties. In management's opinion, such loans do not present more than the normal risk of collectibility or incorporate other unfavorable features, and were made under terms that are consistent with the Company's lending policies.

Loans to related parties at December 31 are summarized below. Balances have been adjusted to reflect changes in status of directors and officers for each year presented.

	2009	2008
Beginning balance	\$ 7,560	\$8,057
New loans	1,239	---
Less: repayments	(1,178)	(497)
Ending balance	\$ 7,621	\$7,560

As of December 31, 2009, and 2008, there were no non-performing loans to related parties.

Note 4: Allowance For Loan Losses

A summary of changes in the allowance for loan losses for each of the three years ended December 31 follows:

	2009	2008	2007
Balance, beginning of year	\$5,446	\$ 4,743	\$4,525
Provision for loan losses	3,207	1,995	456
Less: Loans charged off	(995)	(1,336)	(303)
Recoveries on loans previously charged off	156	44	65
Net loans charged off	(839)	(1,292)	(238)
Balance, end of year	\$7,814	\$ 5,446	\$4,743

Impaired Loans:

Impaired loans are commercial and commercial real estate loans for which the Company believes it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement, as well as all loans restructured in a troubled debt restructuring, if any. Allowances for losses on impaired loans are determined by the lower of the present value of the expected cash flows related to the loan, using the original contractual interest rate, and its recorded value, or in the case of collateral dependant loans, the lower of the fair value of the collateral, less costs to dispose, and the recorded amount of the loans. When foreclosure is probable, impairment is measured based on the fair value of the collateral less cost to sell.

Information pertaining to impaired loans at December 31, 2009, 2008 and 2007 follows:

	2009	2008	2007
Investment in impaired loans	\$5,573	\$2,138	\$1,598
Portion of impaired loan balance for which an allowance for loan losses is allocated	\$4,416	\$1,328	\$1,397
Portion of impaired loan losses allocated to the impaired loan balance	\$ 702	\$ 176	\$ 280
Interest not recorded on impaired loans at year end	\$ 382	\$ 263	\$ 111

## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

During the years ended December 31, 2009, 2008 and 2007, the total average balance of impaired loans amounted to approximately \$3,861, \$1,956, and \$830, respectively.

There was significant disruption and volatility in the financial and capital markets during the second half of 2008 and these conditions largely continued throughout 2009. Turmoil in the mortgage market has adversely impacted both domestic and global markets, and has led to a significant credit and liquidity problems in many domestic markets. These market conditions were attributable to a variety of factors, in particular the fallout associated with the subprime mortgage loans (a type of lending the Company has never pursued). This disruption has been exacerbated by the continued decline of the real estate housing market. While the Bank continues to adhere to prudent underwriting standards, as a lender, it may be adversely impacted by general economic weaknesses and, in particular, a continued downturn in the housing market nationally. Decreases in real estate values could adversely affect the value of property used as collateral for the Bank's loans. Adverse changes in the economy may have a negative effect on the ability of the Bank's borrowers to make timely loan payments, which would have an adverse impact on the Company's earnings. A further increase in loan delinquencies would decrease the Company's net interest income and adversely impact the Company's loan loss experience, causing increases in the Bank's provision for loan losses.

### Note 5: Mortgage Loan Servicing

Residential real estate mortgages are originated by the Company both for portfolio and for sale into the secondary market. The Company may sell its loans to institutional investors such as Freddie Mac. Under loan sale and servicing agreements with the investor, the Company continues to service the residential real estate mortgages. The Company pays the investor an agreed-upon rate on the loan, which is less than the interest rate the Company receives from the borrower. The Company retains the difference as a fee for servicing the residential real estate mortgages. The Company capitalizes mortgage servicing rights at their fair value upon sale of the related loans, amortizes the asset over the estimated life of the serviced loan, and periodically assesses the asset for impairment.

The balance of capitalized mortgage servicing rights, net of a valuation allowance, included in other assets at December 31, 2009 was \$278 compared with none at December 31, 2008. In evaluating the reasonableness of the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. The model utilizes a variety of assumptions, the most significant of which are loan prepayment assumptions and the discount rate used to discount future cash flows. Prepayment assumptions, which are impacted by loan rates and terms, are calculated using a three-month moving average of weekly prepayment data and modeled against the serviced loan portfolio by the third party valuation specialist. The discount rate is the quarterly average 10-year US Treasury rate plus 4.22%, rounded up to the nearest 25 basis points. Other assumptions include delinquency rates, foreclosure rates, servicing cost inflation, and annual unit loan cost. All assumptions are adjusted periodically to reflect current circumstances. Amortization of the mortgage servicing rights, as well as write-offs of capitalized rights due to prepayments of the related mortgage loans, are recorded as a charge against mortgage servicing fee income.

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets of the Company and amounted to \$32,810 and \$4,575 at December 31, 2009 and 2008, respectively.

### Note 6: Premises and Equipment

The detail of premises and equipment as of December 31 follows:

	2009	2008
Land	\$ 2,267	\$ 2,056
Buildings and improvements	14,689	13,844
Furniture and equipment	10,207	9,649
Less: accumulated depreciation	(15,236)	(14,695)



Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Total	\$ 11,927	\$ 10,854
-------	-----------	-----------

Depreciation expense amounted to \$914, \$1,004 and \$1,211 in 2009, 2008 and 2007, respectively.

Note 7: Goodwill and Other Intangible Assets

Goodwill totaled \$3,158 at December 31, 2009 and 2008, and there were no additions or impairments recorded during the years ended December 31, 2009, 2008 or 2007.

Core Deposit Intangible Asset:

At December 31, 2008 Company had a finite-lived intangible asset capitalized on its consolidated balance sheet in the form of a core deposit intangible asset related to the Bank's acquisition of a branch office in Rockland, Maine. The core deposit intangible asset was being amortized over an estimated useful life of six years, and was included in other assets on the Company's consolidated balance sheet. During 2009 the core deposit intangible asset became fully amortized.

A summary of the core deposit intangible asset as of December 31 follows:

	December 31, 2009	December 31, 2008
Core deposit intangibles:		
Gross carrying amount	\$391	\$391
Less: accumulated amortization	391	324
Net carrying amount	\$ ---	\$ 67

Note 8: Income Taxes

The following table summarizes the current and deferred components of income tax expense (benefit) for each of the three years ended December 31:

	2009	2008	2007
Current			
Federal	\$5,544	\$3,943	\$2,503
State	190	155	143
	5,734	4,098	2,646
Deferred	(1,742)	(714)	374
	\$3,992	\$3,384	\$3,020

The following table reconciles the expected federal income tax expense (computed by applying the federal statutory tax rate of 35% to income before taxes in 2009 and 34% in 2008 and 2007) to recorded income tax expense, for each of the three years ended December 31:

	2009	2008	2007
Computed tax expense	\$5,020	\$3,779	\$3,459
Increase (reduction) in income			
taxes resulting from:			
Officers' life insurance	(91)	(74)	(71)
Tax exempt interest	(1,052)	(590)	(416)
State taxes, net of federal benefit	123	102	94
Other	(8)	167	(46)

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

\$3,992      \$3,384      \$3,020

The tax effects of temporary differences that give rise to deferred tax assets and deferred tax liabilities at December 31, 2009 and 2008 are summarized below. The net deferred tax asset, which is included in other assets, amounted to \$3,575 at December 31, 2009 and \$2,379 at December 31, 2008.

	2009		2008	
	Asset	Liability	Asset	Liability
Allowance for losses on loans and other real estate owned	\$2,751	\$ ---	\$1,852	\$ ---
Deferred compensation	997	---	989	---
Unrealized gain or loss on securities available for sale	---	143	573	---
Unrealized gain or loss on derivatives	---	209	---	382
Unfunded retirement benefits	56	---	59	---
Depreciation	---	323	---	171
Deferred loan origination costs	---	596	---	770
Write down of impaired investments	1,363	---	488	---
Other	213	534	224	483
	\$5,380	\$1,805	\$ 4,185	\$1,806

The Company has determined that a valuation allowance is not required for its net deferred tax asset since it is more likely than not that this asset is realizable principally through the ability to carry-back to taxable income in prior years, future reversals of existing taxable temporary differences, and future taxable income.

Note 9: Deposits

The aggregate amount of jumbo time deposits, each with a minimum denomination of \$100, was \$101,265 and \$65,437 at December 31, 2009 and 2008, respectively. At December 31, 2009, the scheduled maturities of jumbo certificates of deposit were as follows:

Three months or less	\$ 25,426
Over three to six months	32,948
Over six to twelve months	28,932
Over twelve months	22,245
	\$109,551

At December 31, 2009, the scheduled maturities of total time deposits were as follows:

2010	\$190,090
2011	40,892
2012	25,219
2013	33,359
2014	34,025
2015 & thereafter	13,516
	\$337,101

## Note 10: Short-term Borrowings

The Company's short-term borrowings consist of borrowings from the Federal Home Loan Bank (the "FHLB"), borrowings from the Federal Reserve Bank ("FRB") and securities sold under agreements to repurchase. The following table summarizes short-term borrowings at December 31, 2009 and 2008.

	2009		2008	
	Total Principal	Weighted Average Rate	Total Principal	Weighted Average Rate
Federal Home Loan Bank Advances	\$51,250	2.70%	\$100,303	1.80%
Federal Reserve Bank	20,000	0.37%	---	1.25%
Securities sold under agreements to repurchase	20,643	1.22%	21,369	2.55%
Total short-term borrowings	\$91,893		\$121,672	

## Federal Home Loan Bank Borrowings:

Information concerning short-term Federal Home Loan Bank borrowings for 2009 and 2008 is summarized below:

	2009	2008
Average daily balance during the year	\$ 78,415	\$ 73,697
Maximum month-end balance during the year	\$128,776	\$100,303
Amount outstanding at end of year	\$ 51,250	\$100,303

All short-term FHLB advances are fixed-rate instruments. Pursuant to an agreement with the FHLB, advances are collateralized by stock in the FHLB, investment securities and a blanket lien on qualified collateral, consisting primarily of loans with first mortgages secured by one to four family properties, and other qualifying assets. All short-term advances are payable at their maturity dates.

## Federal Reserve Bank Borrowings:

Information concerning short-term Federal Reserve Bank borrowings for 2009 and 2008 is summarized below:

	2009	2008
Average daily balance during the year	\$20,241	\$ 204
Average interest rate during the year	0.37%	1.25%
Maximum month-end balance during the year	\$30,000	\$ ---
Amount outstanding at end of year	\$20,000	\$ ---

## Securities Sold Under Agreements to Repurchase:

Securities sold under agreements to repurchase generally mature within one to four days from the transaction date. Information concerning securities sold under agreements to repurchase for 2009 and 2008 is summarized below:

	2009	2008
Average daily balance during the year	\$18,062	\$18,445
Average interest rate during the year	1.64%	2.83%

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Maximum month-end balance during the year	\$22,025	\$24,178
Amount outstanding at end of year	\$20,643	\$21,369

Securities collateralizing repurchase agreements, which are held in safekeeping by nonaffiliated financial institutions and not under the Bank's control, were as follows at December 31:

	2009	2008
Amortized cost	\$31,373	\$42,635
Estimated fair value	\$32,826	\$43,922

Note 11: Long-term Debt

A summary of long-term debt by contractual maturity is as follows:

December 31, 2009					
	Maturity	Total Principal	Rate	Range of Interest Rates	
	2011	\$ 58,147	4.08%	2.75%	to 5.30%
	2012	\$ 40,119	4.02%	2.99%	to 5.07%
	2013	\$ 43,480	3.66%	2.77%	to 4.39%
	2014	\$ 53,990	3.24%	2.73%	to 4.80%
	2015 and thereafter	\$ 19,000	4.00%	2.25%	to 4.70%
	Total	\$214,736			

December 31, 2008					
	Maturity	Total Principal	Rate	Range of Interest Rates	
	2010	\$ 29,000	4.62%	2.84% to 5.95%	
	2011	\$ 58,699	4.08%	2.75% to 5.30%	
	2012	\$ 40,552	4.03%	2.99% to 5.07%	
	2013	\$ 37,980	3.77%	3.02% to 4.39%	
	2014	\$ 12,000	4.07%	3.35% to 4.33%	
	2015 and thereafter	\$ 19,000	4.00%	2.25% to 4.70%	
	Total long-term debt	\$197,231			

All of the long-term debt represents advances from the FHLB. All FHLB advances are fixed-rate instruments. Pursuant to an agreement with the FHLB, advances are collateralized by stock in the FHLB, investment securities and a blanket lien on qualified collateral, consisting primarily of loans with first mortgages secured by one to four family properties, and other qualifying assets. Advances are payable at their call dates or final maturity.

The maturity distribution of the long-term debt with callable features was as follows:

December 31, 2009			
	Maturity	Total Principal	Weighted Average Interest Rate
	2011	\$10,500	5.20%

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

2012	21,000	4.60%
2013	7,500	3.79%
2014	12,000	4.11%
2015 and thereafter	19,000	4.00%
Total long-term debt	\$70,000	

December 31, 2008

Maturity	Total Principal	Weighted Average Interest Rate
2010	\$12,000	5.34%
2011	10,500	5.20%
2012	21,000	4.60%
2013	7,500	3.73%
2014 and thereafter	31,000	4.03%
Total	\$82,000	

At December 31, 2009, and 2008, the Company had \$50,500 and \$35,000 of long-term debt that was currently callable, respectively. The remaining callable debt has call dates ranging from January 2010 to November 2102.

Junior Subordinated Debentures:

In April 2008, the Company's wholly-owned subsidiary, Bar Harbor Bank & Trust (the "Bank"), issued \$5,000 aggregate principal amount of subordinated debentures. These debt securities qualify as Tier 2 capital for the Company and the Bank. The subordinated debt securities are due in 2023, but are callable by the Bank after five years without penalty. The rate of interest on these debt securities is three month LIBOR plus 345 basis points. The subordinated debt securities are classified as borrowings on the Company's consolidated balance sheet. The Company incurred \$197 in costs to issue the securities and these costs are being amortized over 15 years using the interest method.

Note 12: Shareholders' Equity

Regulatory Capital Requirements:

The Company and Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory frameworks for prompt corrective action, the Company and Bank must meet specific capital guidelines that involve quantitative measures of the Company's and Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's and Bank's capital amounts and classification are also subject to qualitative judgment by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital to risk-weighted assets and average assets. As of December 31, 2009, the Company and the Bank exceed all capital adequacy requirements to which they are subject. As of December 31, 2009, the most recent notification from the federal regulators categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

well-capitalized, the Company and Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Bank's or the Company's category.

The following table sets forth the Company's and the Bank's regulatory capital at December 31, 2009, under the rules applicable at that date.

	<b>Consolidated</b>		<b>For Capital Adequacy Purposes Required</b>		<b>To be well Capitalized under Prompt corrective Action provisions Required</b>	
	<b>Actual Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
<b>As of December 31, 2009</b>						
Total Capital (To Risk-Weighted Assets)						
Consolidated	\$122,615	17.14%	\$57,241	8.0%	N/A	
Bank	\$123,383	17.26%	\$57,175	8.0%	\$71,469	10.0%
Tier 1 Capital (To Risk-Weighted Assets)						
Consolidated	\$109,755	15.34%	\$28,620	4.0%	N/A	
Bank	\$110,569	15.47%	\$28,587	4.0%	\$42,881	6.0%
Tier 1 Capital (To Average Assets)						
Consolidated	\$109,755	10.35%	\$42,431	4.0%	N/A	
Bank	\$110,569	10.43%	\$42,395	4.0%	\$52,993	5.0%

The following table sets forth the Company's and the Bank's regulatory capital at December 31, 2008, under the rules applicable at that date.

	<b>Consolidated</b>		<b>For Capital Adequacy Purposes Required</b>		<b>To be well Capitalized under Prompt corrective Action provisions Required</b>	
	<b>Actual Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
<b>As of December 31, 2008</b>						
Total Capital (To Risk-Weighted Assets)						
Consolidated	\$73,191	11.60%	\$50,458	8.0%	N/A	
Bank	\$73,540	11.69%	\$50,333	8.0%	\$62,917	10.0%
Tier 1 Capital (To Risk-Weighted Assets)						
Consolidated	\$62,745	9.95%	\$25,229	4.0%	N/A	
Bank	\$63,094	10.03%	\$25,167	4.0%	\$37,750	6.00%
Tier 1 Capital (To Average Assets)						
Consolidated	\$62,745	6.61%	\$37,977	4.0%	N/A	
Bank	\$63,094	6.65%	\$37,944	4.0%	\$47,430	5.0%

Dividend Limitations:

Dividends paid by the Bank are the primary source of funds available to the Company for payment of dividends to its shareholders. The Bank is subject to certain requirements imposed by federal banking laws and regulations. These requirements, among other things, establish minimum levels of capital and restrict the amount of dividends that may be distributed by the Bank to the Company. At December 31, 2009, the Bank had \$51,914 available for dividends that could be paid without prior regulatory approval.

**Series A Fixed Rate Cumulative Perpetual Preferred Stock and Warrant:**

As previously reported, on January 16, 2009, as part of the Capital Purchase Program (the "CPP") established by the U.S. Department of the Treasury (the "Treasury") under the Emergency Economic Stabilization Act of 2008, the Company sold to Treasury (i) 18,751 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A, no par value, having a liquidation preference of one thousand dollars per share (the "Preferred Stock"); and (ii) a ten-year warrant to purchase up to 104,910 shares of the Company's common stock, par value two dollars per share at an initial exercise price of \$26.81 per share, for an aggregate purchase price of \$18,751 in cash. All of the proceeds from the sale were treated as Tier 1 capital for regulatory purposes.

On February 24, 2010 the Company redeemed all 18,751 shares of its Preferred Stock sold to Treasury. The Company paid \$18,774 to the Treasury to redeem the Preferred Stock, consisting of \$18,751 of principal and \$23 of accrued and unpaid dividends. The Company and the Bank received approvals from their respective regulators to redeem the Preferred Stock. The Company's redemption of the Preferred Stock is not subject to additional conditions or stipulations from the Treasury.

The preferred stock that the Company repurchased for \$18,751 had a current carrying value of \$18,255 (net of \$496 unaccreted discount) on the Company's consolidated balance sheet. As a result of the repurchase, the Company will accelerate the accretion of the \$496 discount and record a total reduction in shareholders' equity of \$18,751.

In the fourth quarter of 2009, the warrant received by the Treasury to purchase up to 104,910 shares of the Company's common stock was reduced by one half to 52,455 shares as a result of the Company's successful completion of a common stock offering in December 2009.

**Common Stock Offering:**

In December 2009 the Company completed its previously announced offering of 800,000 shares of common stock to the public at \$27.50 per share. The net proceeds from this offering, after deducting underwriting discounts and estimated expenses amounted to \$20,412. As previously reported, in January 2010 the Company completed the closing of the underwriter's exercise of its over-allotment option to purchase an additional 82,021 shares of the Company's common stock at a purchase price to the public of \$27.50 per share. The Company received total net proceeds from the offering, including the exercise of the over allotment option, after deducting underwriting discounts and expenses, amounting to \$22,442. All of the net proceeds from this offering are treated as Tier 1 capital for regulatory purposes. In February 2010, the Company used \$18,751 of the net proceeds from this offering to repurchase all of its Series A preferred shares sold to the U.S. Department of the Treasury.

**Stock Repurchase Plan:**

In August 2008, the Company's Board of Directors approved a program to repurchase up to 300,000 shares of the Company's common stock, or approximately 10.2% of the shares currently outstanding. The new stock repurchase program became effective as of August 21, 2008 and is authorized to continue for a period of up to twenty-four consecutive months. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time, or from time to time, without prior notice and may be made in the open market or through privately negotiated transactions. As of December 31, 2009, the Company had repurchased 66,782 shares of stock under this plan, at a total cost of \$1,833 and an average price of \$27.44 per share. The Company recorded the

repurchased shares as treasury stock.

The new stock repurchase program replaced the Company's stock repurchase program that had been in place since February 2004, which had authorized the repurchase of up to 310,000 or approximately 10% of the Company's outstanding shares of common stock. As of August 19, 2008, the date this program was terminated, the Company had repurchased 288,799 shares at a total cost of \$8,441 and an average price of \$29.23 per share.

Note 13: Stock-Based Compensation Plans:

On October 3, 2000, the shareholders of the Company approved the Bar Harbor Bankshares and Subsidiaries Incentive Stock Option Plan of 2000 ("ISOP") for its officers and employees, which provides for the issuance of up to 450,000 shares of common stock. At December 31, 2009, 15,829 shares are still available for future stock option grants. The purchase price of the stock covered by each option shall be at least 100% of the trading value on the date such option is granted. Vesting terms range from three to seven years. No option shall be granted after October 3, 2010, ten years after the effective date of the ISOP.

In May, 2009, the shareholders of the Company approved the adoption of the 2009 Bar Harbor Bankshares and Subsidiaries Equity Incentive Plan (the "2009 Plan") for employees and directors of the Company and its subsidiaries. Subject to adjustment for stock splits, stock dividends, and similar events, the total number of shares of common stock that can be issued under the 2009 Plan over the 10 year period in which the plan will be in place is 175,000 shares of common stock, provided that no more than 75,000 shares of such stock can be awarded in the form of restricted stock or restricted stock units, as further described in the 2009 Plan. The 2009 Plan is to be administered by the Company's Compensation Committee. All employees and directors of the Company and its subsidiaries are eligible to participate in the 2009 Plan, subject to the discretion of the Administrator and the terms of the 2009 Plan. No grants have been made with respect to the shares of common stock reserved for issuance under the 2009 Plan as of December 31, 2009 and as of the filing of this Report. The maximum stock award granted to one individual may not exceed 20,000 shares of common stock (subject to adjustment for stock splits, and similar events) for any calendar year.

In 2009 and 2008, the Company recognized \$129 and \$204, respectively, of share-based compensation in salaries and employee benefits expense.

For the years ended December 31, 2009, 2008, and 2007, the total anti-dilutive stock options amounted to 135, 138, and 72 thousand shares, respectively.

The fair value of options was estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for stock option grants during the years ended December 31:

	2009	2008	2007
Risk free interest rate	2.94%	3.08%	4.64%
Expected market volatility factor for the Company's stock	22.69%	18.82%	18.86%
Dividend yield	3.85%	3.41%	2.99%
Expected life of the options (years)	7.0	7.0	6.5
Options granted	11,500	27,000	40,700
Estimated fair value of options granted	\$ 4.25	\$ 4.61	\$ 6.27

The expected market price volatility for the grants during 2009 was determined by using the Company's historical stock price volatility on a daily basis during the 3-7 year periods ending December 31, 2009, consistent with the expected life of the 2009 options.

Stock Option Activity:



Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

A summary status of the ISOP as of December 31, 2009, and changes during the year then ended is presented below:

	Number of Stock Options Outstanding	Exercise Price Range		Weighted Average Exercise Price	Intrinsic Value	Aggregate Intrinsic Value
		From	To			
		Outstanding at January 1, 2009	288,572			
Granted	11,500	\$21.82	\$34.65	\$26.07		
Exercised	(22,775)	\$15.40	\$32.20	\$18.90		
Forfeited	(3,500)	\$26.60	\$31.00	\$27.23		
Outstanding at December 31, 2009	273,797	\$15.40	\$34.65	\$22.80	\$5.82	\$1,593
Ending vested and expected to vest December 31, 2009	261,747	\$15.40	\$34.65	\$22.50	\$6.06	\$1,587
Exercisable at December 31, 2009	196,821	\$15.40	\$33.00	\$20.19	\$7.90	\$1,554

The intrinsic value of the options exercised and cash received by the Company for options exercised for the years ended December 31, 2009, 2008, and 2007, was approximately \$195 and \$430, \$72 and \$179 and \$306 and \$411, respectively.

The tax benefit received related to the exercise of options in 2009, 2008 and 2007, was \$52, \$31 and \$99, respectively.

The Company's policy for fulfilling option exercises is to release shares from treasury stock.

As of December 31, 2009, there was approximately \$345 of unrecognized compensation cost related to unvested stock option awards, net of estimated forfeitures. This amount is expected to be recognized as expense over the next seven years, with a weighted average recognition period of 3.85 years.

Stock Options Outstanding:

The following table summarizes stock options outstanding and exercisable by exercise price range at December 31, 2009:

Range of Exercise Prices		Options Outstanding			Options Exercisable		
		Number Outstanding As of 12/31/09	Weighted Average Remaining Contractual Term (years)	Weighted Average Exercise Price	Number Exercisable As of 12/31/09	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
\$15.40	\$15.80	23,027		\$15.44	23,027	\$15.44	
\$16.05	\$16.05	90,000		\$16.05	90,000	\$16.05	
\$18.09	\$27.00	64,253		\$22.95	47,660	\$22.18	
\$27.02	\$31.16	62,897		\$29.75	19,159	\$29.31	
\$31.50	\$34.65	33,620		\$32.61	16,975	\$32.73	
\$15.40	\$34.65	273,797	4.37	\$22.80	196,821	\$20.19	3.24

Note 14: Retirement Benefit Plans

Prior to the first quarter of 2007, the Company sponsored a limited postretirement benefit program, which funded medical coverage and life insurance benefits to a closed group of active and retired employees who met minimum age

and service requirements.

In the first quarter of 2007, the Company settled its limited postretirement benefit program. The Company voluntarily paid out \$699 to plan participants, representing 64% of the accrued post retirement benefit obligation. This payment fully settled all Company obligations related to this program. In connection with the settlement of the postretirement program, the Company recorded a reduction in non-interest expense of \$832, representing the elimination of the \$390 remaining accrued benefit obligation included in other liabilities on the consolidated balance sheet, and the \$442 actuarial gain (\$291, net of tax) related to the program. The actuarial gain was previously included in accumulated other comprehensive income, net of tax.

The Company also has non-qualified supplemental executive retirement agreements with certain retired officers. The agreements provide supplemental retirement benefits payable in installments over a period of years upon retirement or death. The Company also has supplemental executive retirement agreements with certain current executive officers. These agreements provide a stream of future payments in accordance with individually defined vesting schedules upon retirement, termination, or in the event that the participating executive leaves the Company following a change of control event.

The after tax components of accumulated other comprehensive income (loss), which have not yet been recognized in net periodic benefit cost, related to postretirement benefits are net actuarial losses related to supplemental retirement plans of \$109 and \$115, as of December 31, 2009 and 2008, respectively.

A December 31 measurement date is used for the supplemental executive retirement plans. The following table sets forth changes in benefit obligation, changes in plan assets, and the funded status of the plans as of and for the years ended December 31:

	Supplemental Executive Retirement Plans Fiscal Year Ending	
	2009	2008
<b>Obligations and Funded Status</b>		
<b>Change in Benefit Obligation</b>		
Benefit obligation at beginning of year	\$ 3,107	\$ 2,950
Service cost	222	209
Interest cost	179	170
Benefits paid	(222)	(222)
Benefit obligation at end of year	\$ 3,286	\$ 3,107
<b>Change in plan assets</b>		
Fair value of plan assets at beginning of year	\$ ---	\$ ---
Employer contributions	222	222
Benefits paid	(222)	(222)
Fair value of plan assets at end of year	\$ ---	\$ ---
Under funded status at end of year	\$(3,286)	\$(3,107)

As of December 31, 2009 and 2008, the Company had recognized liabilities of \$3,286 and \$3,107, respectively, for the supplemental executive retirement plans. These amounts are reported within other liabilities on the consolidated balance sheets.

The following table summarizes the assumptions used to determine the benefit obligations at December 31, 2009, 2008, and 2007, and net periodic benefit costs for the years ended December 31, 2009, 2008, and 2007:

Supplemental  
Executive  
Retirement Plans

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Assumptions	Fiscal Year Ending		
	2009	2008	2007
<b>Weighted-average assumptions used to determine benefit obligations at December 31:</b>			
Discount rate	6.00%	6.00%	6.00%
<b>Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31:</b>			
Discount rate	6.00%	6.00%	5.75%

The net periodic benefit cost for the years ended December 31 included the following components:

Components of Net Periodic Benefit Cost and Other Amounts	Supplemental Executive Retirement Plans		
	Fiscal Year Ending		
	2009	2008	2007
<b>Recognized in the Consolidated Income Statements</b>			
Service cost	\$222	\$209	\$197
Interest cost	179	170	162
Amortization of prior service cost	---	---	---
Recognition of net actuarial gain (loss)	9	14	16
Postretirement settlement	---	---	---
Total recognized in the consolidated income statements	\$410	\$393	\$375
<b>Other Changes and Benefit Obligations Recognized in Other Comprehensive Income (pre-tax)</b>			
Recognition of net actuarial (gain) loss	(9)	(14)	(16)
Amortization of prior service cost	---	---	---
Total recognized in other comprehensive income (pre-tax)	(9)	(14)	(16)
Total recognized in the consolidated income statements and other comprehensive income (pre-tax)	\$401	\$379	\$359

The estimated net actuarial loss for the supplemental executive retirement plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is (\$9).

The Company expects to contribute the following amounts to fund benefit payments under the supplemental executive retirement plans:

2010	\$ 242
2011	340
2012	340
2013	340
2014	340
2015 and thereafter	5,196

401(k) Plan:

The Company maintains a Section 401(k) savings plan for substantially all of its employees. Employees are eligible to participate in the 401(k) Plan on the first day of any quarter following their date of hire. Under the plan, the Company makes a matching contribution of a portion of the amount contributed by each participating employee, up to a percentage of the employee's annual salary. The plan allows for supplementary profit sharing contributions by the Company, at its discretion, for the benefit of participating employees. The total expense for this plan in 2009, 2008 and 2007 was \$276, \$265, and \$245, respectively.

## Note 15: Financial Derivative Instruments

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

At December 31, 2009, the Bank had two outstanding, off-balance sheet, derivative instruments. These derivative instruments were interest rate floor agreements, with notional principal amounts totaling \$30,000. The details are summarized as follows:

## Interest Rate Floor Agreements

Notional Amount	Termination Date	Prime Strike Rate	Premium Paid	Unamortized Premium at 12/31/09	Fair Value 12/31/09	Cumulative Cash Flows Received
\$20,000	08/01/10	6.00%	\$186	\$36	\$381	\$756
\$10,000	11/01/10	6.50%	\$69	\$20	\$290	\$479

During 2005, interest rate floor agreements were purchased to limit the Bank's exposure to falling interest rates on two pools of loans indexed to the Prime interest rate. Under the terms of the agreements, the Bank paid premiums of \$186 and \$69 for the right to receive cash flow payments if the Prime interest rate falls below the floors of 6.00% and 6.50%, thus effectively ensuring interest income on the pools of prime-based loans at minimum rates of 6.00% and 6.50% for the duration of the agreements. The interest rate floor agreements were designated as cash flow hedges.

At December 31, 2009, the total fair market value of the interest rate floor agreements was \$671 compared with \$1,229 at December 31, 2008. The fair market values of the interest rate floor agreements are included in other assets on the Company's consolidated balance sheets. Changes in the fair value, representing unrealized gains or losses, are recorded in accumulated other comprehensive income (loss).

The premiums paid on the interest rate floor agreements are being recognized as reductions of interest income over the duration of the agreements using the floorlet method. During 2009, 2008, and 2007, \$74, \$63, and \$42 of the premiums were recognized as reductions of interest income, respectively. At December 31, 2009, the remaining unamortized premiums, net of tax, totaled \$37, compared with \$87 at December 31, 2008.

At December 31, 2009 and 2008, the following amounts were recorded in accumulated other comprehensive income (loss) on the consolidated balance sheets:

	December 31, 2009		December 31, 2008	
	Gross	Net of Tax	Gross	Net of Tax
Unrealized gain on interest rate floors	\$671	\$443	\$1,229	\$811
Unrealized gain on interest rate swaps	---	---	23	16
Unamortized premium on interest rate floors	(56)	(37)	(130)	(87)
Total	\$615	\$406	\$1,122	\$740

## Note 16: Commitments and Contingent Liabilities

The Bank is a party to financial instruments in the normal course of business to meet financing needs of its customers. These financial instruments include commitments to extend credit, unused lines of credit, and standby letters of credit.

Commitments to originate loans, including unused lines of credit, are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank uses the same credit policy to make such commitments as it uses for on-balance-sheet items, such as loans. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower.

The Bank guarantees the obligations or performance of customers by issuing standby letters of credit to third parties. These standby letters of credit are primarily issued in support of third party debt or obligations. The risk involved in issuing standby letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same credit origination, portfolio maintenance and management procedures in effect to monitor other credit and off-balance sheet instruments. Exposure to credit loss in the event of nonperformance by the counter-party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. Typically, these standby letters of credit have terms of five years or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements.

The following table summarizes the contractual amounts of commitments and contingent liabilities as of December 31, 2009 and 2008.

	December 31, 2009	December 31, 2008
Commitments to originate loans	\$ 42,694	\$ 31,584
Unused lines of credit	78,607	70,610
Un-advanced portions of construction loans	12,565	4,284
Total	\$133,866	\$106,478
Standby letters of credit	\$ 372	\$ 262

As of December 31, 2009 and 2008, the fair values of the standby letters of credit were not significant to the Company's consolidated financial statements.

#### Operating Lease Obligations

The Company leases certain properties used in operations under terms of operating leases, which include renewal options. The following table sets forth the approximate future lease payments over the remaining terms of the non-cancelable leases as of December 31, 2009.

2010	\$116
2011	\$ 71
2012	\$ 37

In connection the foregoing lease obligations, in 2009, 2008 and 2007, the Company recorded \$92, \$88, and \$87 in rent expense, respectively, which is included in occupancy expense in the consolidated statements of income.

#### Note 17: Fair Value Measurements

The Company measures fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact, and (iv) willing to transact.

The Company's fair value measurements employ valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The Company uses a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets (Level 1 measurements) for identical assets or liabilities and the lowest priority to unobservable inputs (Level 3 measurements). The fair value hierarchy is as follows:

- Level 1

Valuation is based on unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

- Level 2

Valuation is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and model-based techniques for which all significant assumptions are observable in the market.

- Level 3

Valuation is principally generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates that market participants would use in pricing the asset or liability. Valuation techniques include use of discounted cash flow models and similar techniques.

The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

The most significant instruments that the Company values are securities, all of which fall into Level 2 in the fair value hierarchy. The securities in the available for sale portfolio are priced by independent providers. In obtaining such valuation information from third parties, the Company has evaluated their valuation methodologies used to develop the fair values in order to determine whether valuations are appropriately placed within the fair value hierarchy and whether the valuations are representative of an exit price in the Company's principal markets. The Company's principal markets for its securities portfolios are the secondary institutional markets, with an exit price that is predominantly reflective of bid level pricing in those markets. Additionally, the Company periodically tests the reasonableness of the prices provided by these third parties by obtaining fair values from other independent providers and by obtaining desk

bids from a variety of institutional brokers.

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.

- Securities Available for Sale:

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

- Derivative Instruments:

Derivative instruments are reported at fair value utilizing Level 2 inputs. The Company obtains independent dealer market price estimates to value its Prime interest rate floors. Derivative instruments are priced by independent providers using observable market data and assumptions with adjustments based on widely accepted valuation techniques. A discounted cash flow analysis on the expected cash flows of each derivative reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves, implied volatilities, transaction size, custom tailored features, counterparty credit quality, and the estimated current replacement cost of the derivative instrument.

The foregoing valuation methodologies may produce fair value calculations that may not be fully indicative of net realizable value or reflective of future fair values. While Company management believes these valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of December 31, 2009, and December 31, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

December 2009	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Securities available for sale:				
Obligations of US Government-sponsored enterprises	\$ ---	\$ 2,556	\$ ---	\$ 2,556
Mortgage-backed securities:				
US Government-sponsored enterprises	\$ ---	\$234,350	\$ ---	\$234,350
US Government agencies	\$ ---	\$ 22,107	\$ ---	\$ 22,107
Private label	\$ ---	\$ 26,353	\$ ---	\$ 26,353
Obligations of states and political subdivisions thereof	\$ ---	\$ 61,660	\$ ---	\$ 61,660
Derivative assets	\$ ---	\$ 671	\$ ---	\$ 671

December 2008

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Securities available for sale:				
Obligations of US Government-sponsored enterprises	\$ ---	\$ 701	\$ ---	\$ 701
Mortgage-backed securities:				
US Government-sponsored enterprises	\$ ---	\$177,525	\$ ---	\$177,525
US Government agencies	\$ ---	\$ 33,685	\$ ---	\$ 33,685
Private label	\$ ---	\$ 39,558	\$ ---	\$ 39,558
Obligations of states and political subdivisions thereof	\$ ---	\$ 39,033	\$ ---	\$ 39,033
Derivative assets	\$ ---	\$ 1,252	\$ ---	\$ 1,252

The Company also makes fair value measurements on a non-recurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

The following table summarizes financial assets and financial liabilities measured at fair value on a non-recurring basis as of December 31, 2009, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value.

	Principal Balance as of 12/31/09	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Fair Value as of 12/31/09
Mortgage servicing rights	\$ 282	\$ ---	\$282	\$ ---	\$ 278
Collateral dependent impaired loans	\$2,871	\$ ---	\$ ---	\$2,871	\$2,433

The Company had collateral dependent impaired loans with a carrying value of approximately \$2,871 which had specific reserves included in the allowance of \$438 at December 31, 2009.

Mortgage servicing rights represent the value associated with servicing residential mortgage loans. Servicing assets and servicing liabilities are reported using the fair value measurement method. In evaluating the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. As such, the Company classified mortgage servicing rights as nonrecurring measurements using Level 2 inputs.

#### Note 18: Fair Value of Financial Instruments

The Company discloses fair value information about financial instruments for which it is practicable to estimate fair value. Fair value estimates are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. Where available, quoted market prices are used. In other cases, fair values are based on estimates using present value or other valuation techniques. These techniques involve uncertainties and are significantly affected by the assumptions used and judgments made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experience and other factors. Changes in assumptions could significantly affect these estimates. Derived fair value estimates cannot be substantiated by comparison to independent markets and, in certain cases, could not be realized in an immediate sale of the instrument.

Fair value estimates are based on existing financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Accordingly, the aggregate fair value amounts presented do not purport to represent the underlying market value of the Company.



## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

The following describes the methods and significant assumptions used by the Company in estimating the fair values of significant financial instruments:

**Cash and cash equivalents:** For cash and cash equivalents, including cash and due from banks and other short-term investments with maturities of 90 days or less, the carrying amounts reported on the consolidated balance sheet approximate fair values.

**Loans:** For variable rate loans that re-price 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.

**Deposits:** The fair value of deposits with no stated maturity is equal to the carrying amount. The fair value of time deposits is based on the discounted value of contractual cash flows, applying interest rates currently being offered on wholesale funding products of similar maturities. The fair value estimates for deposits do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of alternative forms of funding ("deposit base intangibles").

**Borrowings:** For borrowings that mature or re-price in 90 days or less, carrying value approximates fair value. The fair value of the Company's remaining borrowings is estimated by using discounted cash flows based on current rates available for similar types of borrowing arrangements taking into account any optionality.

**Accrued interest receivable and payable:** The carrying amounts of accrued interest receivable and payable approximate their fair values.

### Off-balance sheet financial instruments

The Company's off-balance sheet instruments consist of loan commitments and standby letters of credit. Fair values for standby letters of credit and loan commitments were insignificant.

A summary of the carrying values and estimated fair values of the Company's significant financial instruments at December 31, 2009 and 2008 follows:

	2009		2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 9,832	\$ 9,832	\$ 9,042	\$ 9,042
Loans, net	661,678	663,717	628,157	629,587
Interest receivable	4,441	4,441	3,999	3,999
Securities available for sale	346,607	347,026	292,224	290,502
Derivative instruments	671	671	1,229	1,229
<b>Financial liabilities:</b>				
Deposits (with no stated maturity)	304,072	304,072	289,481	289,481
Time deposits	337,101	340,242	288,712	293,741
Securities sold under repurchase agreements	20,643	20,640	21,369	21,369
Borrowings	290,986	298,576	302,534	313,575
Interest payable	1,246	1,246	1,351	1,351

### Note 19: Legal Contingencies

The Company and its subsidiaries are parties to certain ordinary routine litigation incidental to the normal conduct of their respective businesses, which in the opinion of management based upon currently available information will have

no material effect on the Company's consolidated financial statements.

Note 20: Condensed Financial Information Parent Company Only

The condensed financial statements of Bar Harbor Bankshares as of December 31, 2009 and 2008, and for the years ended December 31, 2009, 2008 and 2007 are presented below:

BALANCE SHEETS

December 31

	2009	2008
Cash	\$ 196	\$ 475
Investment in subsidiaries	114,328	65,867
Premises	750	767
Other assets	28	6
Total assets	\$115,302	\$67,115
Liabilities		
Total liabilities	\$ 1,788	\$ 1,670
Shareholders' equity		
Total shareholders' equity	113,514	65,445
Liabilities and Shareholders' equity	\$115,302	\$67,115

STATEMENTS OF INCOME

Years Ended December 31

	2009	2008	2007
Dividend income from subsidiaries	\$ 3,691	\$7,249	\$4,229
Equity in undistributed earnings of subsidiaries	7,459	1,242	3,580
Bankshares expenses	(1,083)	(1,046)	(885)
Tax benefit	283	286	231
Net income	\$10,350	\$7,731	\$7,155

STATEMENTS OF CASH FLOWS

Years Ended December 31

	2009	2008	2007
Cash flows from operating activities:			
Net income	\$10,350	\$ 7,731	\$ 7,155
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation	25	14	11
Recognition of stock option expense	129	204	204
Net decrease in other assets	(58)	13	(128)
Net increase in other liabilities	118	498	297
Equity in undistributed earnings of subsidiaries	(7,459)	(1,242)	(3,580)
Net cash provided by operating activities	3,105	7,218	3,959
Cash flows from investing activities:			
Additional investments in subsidiaries	(38,932)	---	---

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

Capital expenditures	(8)	(52)	(9)
Net cash used in investing activities	(38,940)	(52)	(9)
Cash flows from financing activities:			
Purchases of treasury stock	(144)	(4,028)	(2,118)
Proceeds from issuance of equity instruments	38,932	---	---
Proceeds from stock option exercises	552	210	510
Dividend paid	(3,784)	(3,004)	(2,899)
Net cash used in financing activities	35,556	(6,822)	(4,507)
Net (decrease) increase in cash	(279)	344	(557)
Cash and cash equivalents, beginning of year	475	131	688
Cash and cash equivalents, end of year	\$ 196	\$ 475	\$ 131

**Note 21: Selected Quarterly Financial Data (Unaudited)**

Year 2009	Quarter				Total
	1	2	3	4	
Interest and dividend income	\$13,364	\$14,065	\$13,705	\$13,233	\$54,367
Interest expense	5,424	5,222	5,273	5,167	21,086
Net interest income	7,940	8,843	8,432	8,066	33,281
Provision for loan losses	665	835	1,057	650	3,207
Non-interest income	1,604	1,369	1,931	1,118	6,022
Non-interest expense	5,164	5,552	4,982	6,056	21,754
Income before income taxes	3,715	3,825	4,324	2,478	14,342
Income taxes	1,090	1,069	1,219	614	3,992
Net income	\$ 2,625	\$ 2,756	\$ 3,105	\$ 1,864	\$10,350
Preferred stock dividends and accretion of discount	222	268	272	272	1,034
Net income available to common shareholders	\$ 2,403	\$ 2,488	\$ 2,833	\$ 1,592	\$ 9,316
<b><u>Per common share data:</u></b>					
Basic earnings per share	\$ 0.84	\$ 0.87	\$ 0.98	\$ 0.52	\$ 3.19
Diluted earnings per share	\$ 0.82	\$ 0.85	\$ 0.95	\$ 0.51	\$ 3.12

Year 2008	Quarter				Total
	1	2	3	4	
Interest and dividend income	\$13,430	\$13,165	\$13,515	\$13,484	\$53,594
Interest expense	7,138	6,633	6,387	6,245	26,403
Net interest income	6,292	6,532	7,128	7,239	27,191
Provision for loan losses	512	297	860	326	1,995
Non-interest income	2,049	1,932	2,224	227	6,432
Non-interest expense	4,988	5,234	5,112	5,179	20,513
Income before income taxes	2,841	2,933	3,380	1,961	11,115
Income taxes	889	904	1,047	544	3,384
Net income	\$ 1,952	\$ 2,029	\$ 2,333	\$ 1,417	\$ 7,731
Earnings per share:					
Basic	\$ 0.65	\$ 0.69	\$ 0.80	\$ 0.49	\$ 2.63
Diluted	\$ 0.64	\$ 0.67	\$ 0.78	\$ 0.48	\$ 2.57

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

#### Evaluation of Disclosure Controls and Procedures

: The Company carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are designed to ensure that the information required to be disclosed by us in our reports filed or submitted 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 and are operating in an effective manner.

#### Management Report on Internal Control over Financial Reporting:

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2009. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control-Integrated Framework*.

Based on its assessment, management believes that as of December 31, 2009, the Company's internal control over financial reporting is effective, based on the criteria set forth by COSO in *Internal Control - Integrated Framework*.

The Company's independent registered public accounting firm has issued an audit report on the effectiveness of the Company's internal control over financial reporting. This report appears within Item 9A of this report on Form 10-K.

#### Changes in Internal Control Over Financial Reporting:

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Attestation Report of the Company's Registered Public Accounting Firm

#### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Bar Harbor Bankshares:

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

We have audited Bar Harbor Bankshares (the "Company") internal control over financial reporting as of December 31, 2009, based on criteria established in

*Internal Control -- Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control -- Integrated Framework* issued by COSO.

We also have audited in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Bar Harbor Bankshares and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, changes in shareholders' equity, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2009, and our report dated March 15, 2010 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Albany, New York  
March 15, 2010

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE OF THE REGISTRANT

Directors and Executive Officers

: Information required by Item 401 of Regulation S-K with respect to the directors and executive officers will appear under the heading "DIRECTORS AND EXECUTIVE OFFICERS" in the Company's definitive Proxy Statement for the 2010 Annual Meeting of Shareholders, which the Company intends to file with the Commission within 120 days of the end of the Company's 2009 fiscal year (hereinafter the "Proxy") and is incorporated herein by reference.

Compliance with Section 16(a) of the Securities Exchange Act of 1934:

Information required by Item 405 of Regulation S-K with respect to Compliance with Section 16(a) of the Securities Exchange Act of 1934 will appear under the heading "SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE" in the Company's Proxy and is incorporated herein by reference.

Stockholder Nominees to Board of Directors:

There have been no material changes to the procedures by which security holders may recommend nominees to the Company's Board of Directors. Those procedures will be set forth in the Proxy under the headings entitled "CORPORATE GOVERNANCE" "Governance Committee" and "OTHER MATTERS" "Nominations by Stockholders" and are incorporated herein by reference.

Audit Committee:

Information required by Items 407(d)(4) of Regulation S-K will appear under the heading "CORPORATE GOVERNANCE" "Audit Committee" in the Company's Proxy, and is incorporated herein by reference. Information required by Item 407(d)(5) of Regulation S-K will appear under "Appendix A" Report of the Audit Committee, contained in the Company's Proxy and is incorporated herein by reference.

Code of Ethics:

Information required by Item 406 of Regulation S-K will appear under the heading "OTHER MATTERS" "Code of Ethics" contained in the Company's Proxy and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 402 of Regulation S-K will appear under the heading "COMPENSATION OF DIRECTORS AND EXECUTIVE OFFICERS-COMPENSATION OF EXECUTIVE OFFICERS," in the Company's Proxy, which information is incorporated herein by reference.

The information required by Item 407(e)(4) of Regulation S-K will appear under the heading "*Compensation Committee Interlocks and Insider Participation*" in the Company's Proxy, which information is incorporated herein by reference.

The information required by Item 407(e)(5) of Regulation S-K will appear under the heading "Report of the Compensation and Human Resources Committee" in the Company's Proxy, which information is incorporated herein by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The Information required by Item 201(d) of Regulation S-K appears in this Report as Part II, Item 5, under the heading "Market for Registrant's Common Stock, Related Shareholder Matters and Issuer Purchases of Equity Securities" "Incentive Stock Option Plan," which information is incorporated herein by reference.

Information required by Item 403 of Regulation S-K will appear under the heading "VOTING SECURITIES AND PRINCIPAL HOLDERS THEREOF" in the Company's Proxy, which information is incorporated herein by reference.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

Information required by Item 404 of Regulation S-K will appear under the heading "CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS" in the Company's Proxy, which information is incorporated herein by reference.

Information required by Section 407(a) of Regulation S-K will appear under the headings "Directors and Nominees" and "CORPORATE GOVERNANCE"- "Board of Directors" in the Company's Proxy, which information is incorporated herein by reference.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

Information required by this item will appear under the heading "INDEPENDENT REGISTERED ACCOUNTANTS," in the Company's Proxy, which information is incorporated herein by reference.

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

**(a) 1. All Financial Statements**

The consolidated financial statements of the Company and report of the Company's independent registered public accounting firm incorporated herein are included in Item 8 of this Report as follows:

<b>Item</b>	<b>Page</b>
Report of Independent Registered Public Accounting Firm	89
Consolidated Balance Sheets	90
Consolidated Statements of Income	91
Consolidated Statements of Changes in Shareholders' Equity	92
Consolidated Statements of Comprehensive Income	93
Consolidated Statements of Cash Flows	94
Notes to Consolidated Financial Statements	95

2. Financial Statement Schedules. Schedules have been omitted because they are not applicable or are not required under the instructions contained in Regulation S-X or because the information required to be set forth therein is included in the consolidated financial statements or notes thereto.

3. Exhibits. A list of exhibits to this Form 10-K is set forth on the Exhibit Index immediately preceding such exhibits and is incorporated herein by reference.

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

(b) Exhibits to this Form 10-K are attached or incorporated herein by reference as stated above.

(c) There are no other financial statements and financial statement schedules, which were excluded from this report, which are required to be included herein.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

March 16, 2010 BAR HARBOR BANKSHARES  
(Registrant)

/s/ Joseph M. Murphy

Joseph M. Murphy  
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, the following persons have signed this report in the capacities indicated on behalf of the Registrant.

/s/ Peter Dodge Peter Dodge Chairman, Board of Directors	/s/ Joseph M. Murphy Joseph M. Murphy, Director President and Chief Executive Officer
/s/ Thomas A. Colwell Thomas A. Colwell Vice Chairman, Board of Directors	/s/ Robert M. Phillips Robert M. Phillips, Director
/s/ Robert C. Carter Robert C. Carter, Director	/s/ Gerald Shencavitz Gerald Shencavitz EVP, Chief Financial Officer, & Principal Accounting Officer
/s/ Martha Tod Dudman Martha Tod Dudman, Director	/s/ Kenneth E. Smith Kenneth E. Smith, Director
/s/ Jacquelyn S. Dearborn Jacquelyn S. Dearborn, Director	/s/ Constance C. Shea Constance C. Shea, Director
/s/ Lauri E. Fernald Lauri E. Fernald, Director	/s/ Scott G. Toothaker Scott G. Toothaker, Director



Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

/s/ Gregg S. Hannah Gregg S. Hannah, Director	/s/ David B. Woodside David B. Woodside, Director
/s/ Clyde H. Lewis Clyde H. Lewis, Director	

EXHIBIT INDEX

The following exhibits are included as part of this Form 10-K.

EXHIBIT  
NUMBER

3	Articles of Incorporation and Bylaws	
3.1	Articles of Incorporation, as amended to date	Incorporated herein by reference to Form 10-K, Part IV, Item 15, Exhibit 3.1, filed with the commission on March 16, 2009
3.2	Bylaws, as amended to date	Incorporated herein by reference to Form 8-K, Exhibit 3, filed with the Commission on December 17, 2008
4	Instruments Defining Rights of Security Holders	
4.1	Certificate of Designations, Fixed Rate Cumulative Perpetual Preferred Stock, series A	Incorporated herein by reference to Form 8-K, Exhibit 3.1, filed with the Commission on January 21, 2009
4.2	Form of Specimen Stock Certificate for Series A Preferred Sock	Incorporated by reference to Form 8-K, Exhibit 4.1, filed with the Commission on January 21, 2009
4.3	Letter Agreement with U. S. Treasury for purchase of Series A Preferred Stock	Incorporated by reference to Form 8-K, Exhibit 10.1, filed with the Commission on January 21, 2009
4.4	Warrant to Purchase Shares of Company Common Stock issued to U.S. Treasury	Incorporated by reference to Form 8-K, Exhibit 4.2, filed with the Commission on January 21, 2009
4.5	Debt Securities Purchase Agreement	Incorporated herein by reference to Form 10-K, Part IV, Item 15, Exhibit 4.5, filed with the commission on March 16, 2009.

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

4.6	Form of Subordinated Debt Security of Bar Harbor Bank & Trust	Incorporated herein by reference to Form 10-K, Part IV, Item 15, Exhibit 4.6, filed with the commission on March 16, 2009.
10	Material Contracts	
10.1	Deferred Compensation Plans	Incorporated by reference to Form 10-K filed with the Commission March 31, 1987 (Commission Number 0-13666)
10.2	Supplemental Executive Retirement Plan  Adopted by the Board of Directors on September 16, 2003, and effective as of January 1, 2003, providing Joseph M. Murphy, President and CEO of the Company, Gerald Shencavitz, the Company's Chief Financial Officer, and Dean S. Read, former President of the Bank, with certain defined retirement benefits (the "2003 SERP")	Incorporated by reference to Form 10-Q, Part II, Item 6, Exhibit 10.2, filed with the Commission November 13, 2003 (Commission File Number 001-13349)
10.3	Amendment No. 1 to the 2003 SERP	Incorporated by reference to Form 8-K, Exhibit 10.6, filed with the Commission on November 24, 2008
10.4	Joseph M. Murphy  Amended and Restated Employment Contract	Incorporated by reference to Form 8-K, Exhibit 10.10, filed with the Commission on November 24, 2008
10.5	Change in Control, Confidentiality, and Non-competition Agreement between the Company and Joseph M. Murphy	Incorporated by reference to Form 8-K, Exhibit 10.6, filed with the Commission on November 24, 2008
10.6	Supplemental Executive Retirement Plan, Section 409A	Incorporated by reference to Form 8-K, Exhibit 10.7, filed with the Commission on November 24, 2008
10.7	Incentive Stock Option Plan of 2000	Incorporated by reference to Form 10-K, Item 14(a)(3), Exhibit 10.2, filed with the Commission March 28, 2002 (Commission File Number 001-13349)
10.8	Amended and Restated Change in Control, Confidentiality, and Non-competition Agreement between the Company and Gerald Shencavitz	Incorporated by reference to Form 8-K, Exhibit 10.9, filed with the Commission on November 24, 2008

## Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

10.9	Amended and Restated Change in Control, Confidentiality, and Non-competition Agreements between the Company and Daniel A. Hurley III, Senior Vice President of the Bank and President of Bar Harbor Trust Services; Michael W. Bonsey, Senior Vice President of the Bank Credit Administration; Gregory W. Dalton, Senior Vice President of the Bank Business Banking	Incorporated by reference to Form 8-K, Exhibit 10.8, "Specimen 409A Change in Control Confidentiality and Non-competition Agreement" filed with the Commission on November 24, 2008
10.10	Change in Control, Confidentiality, and Non-competition Agreement between the Company and Marsha C. Sawyer, Senior Vice President Human Resources	Incorporated by reference to Form 8-K, filed with the Commission on November 24, 2008, and Form 8-K/A, Exhibit 10.1, filed with the Commission on November 26, 2008
10.11	Change in Control, Confidentiality, and Non-competition Agreement between the Company and Cheryl D. Curtis, Senior Vice President Marketing and Community Relations	Incorporated by reference to Form 8-K, Exhibit 10.2, filed with the Commission on November 24, 2008
10.12	Change in Control, Confidentiality, and Non-competition Agreement between the Company and Craig Worcester, Managing Director Bar Harbor Financial Services	Incorporated by reference to Form 8-K, Exhibit 10.3, filed with the Commission on November 24, 2008
10.13	Change in Control, Confidentiality, and Non-competition Agreement between the Company and Joshua A. Radel, Chief Investment Officer, Bar Harbor Trust Services	Incorporated by reference to Form 8-K, Exhibit 10.4, filed with the Commission on November 24, 2008
10.14	Change in Control, Confidentiality, and Non-competition Agreement between the Company and David W. Thibault, Senior Vice President Operations and Information Systems	Incorporated by reference to Form 8-K, Exhibit 10.5, filed with the Commission on November 24, 2008
10.15	Purchase and Assumption Agreement between Bar Harbor Banking and Trust Company and Androscoggin Savings Bank, dated October 24, 2003	Incorporated by reference to Form 10-Q, Part II, Item 6, Exhibit 10.1, filled with the Commission November 13, 2003 (Commission File Number 001-13349)
10.16	Summary of the 2008 Annual Incentive Plan not pursuant to a written plan or agreement	Incorporated by reference to Form 10-Q, Exhibit 10.1, filed with the Commission on August 11, 2008
10.17	Infinex Agreement third party brokerage services	Incorporated by reference to Form 10-K, Part III, Item 15(a), Exhibit 10.10, filed with the Commission on March 16, 2005 (Commission File Number 001-13349)
10.18	Somesville Bank Branch Lease dated October 27, 2005	Incorporated by reference to Form 10-K, Part III, Item 15(a), Exhibit 10.13, filed with the Commission on March 16, 2006 (Commission File Number 001-13349)

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

10.19	Merchant Portfolio Purchase Agreement between Bar Harbor Bank & Trust and TransFirst, LLC ("TransFirst") and Columbus Bank and Trust Company, dated September 30, 2008	Incorporated by reference to Form 10-Q, Exhibit 10.1, filed with the Commission on November 10, 2008
10.20	Merchant Portfolio Assignment and Assumption Agreement	Incorporated by reference to Form 10-Q, Exhibit 10.2, filed with the Commission on November 10, 2008
10.21	Referral and Sales Agreement between Bar Harbor Bank & Trust and TransFirst dated September 30, 2008	Incorporated by reference to Form 10-Q, Exhibit 10.3, filed with the Commission on November 10, 2008
10.22	Credit Card Account Purchase Agreement between Bar Harbor Bank & Trust and U. S. Bank National Association D/B/A Elan Financial Services	Incorporated by reference to Form 10-K, Exhibit 10.22, filed with the Commission on March 16, 2009
10.23	Letter Agreement (including the Securities Purchase Agreement Standard Terms incorporated by reference therein (the "Purchase Agreement")), between the Company and the U. S. Treasury pursuant to which the Company issued and sold to Treasury (i) 18,751 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A, no par value, having a liquidation preference of \$1,000 per share and (ii) a ten-year warrant to purchase up to 104,910 shares of the Company's common stock, par value \$2.00 per share, at an initial exercise price of \$26.81 per share (the "Warrant"), for an aggregate purchase price of \$18,751	Incorporated by reference to Form 8-K, Exhibits 4.2 and 10.1, filed with the Commission on January 21, 2009
10.24	2009 Annual Incentive Plan for certain executive officers of the Company	Filed herewith
10.25	2010 Annual Incentive Plan for certain executive officers of the Company	Filed herewith
10.26	Bar Harbor Bankshares and Subsidiaries Equity Incentive Plan of 2009	Incorporated by reference to Appendix "C" to the Company's Definitive Proxy Statement (DEF 14A) filed with the commission on April 7, 2009
11.1	Statement re computation of per share earnings	Statement re computation of per share earnings is provided in Note 1 to the Notes to Consolidated Financial Statements in this Report).
13	Annual Report to Shareholders	Furnished herewith
21	Subsidiaries of the Registrant	Incorporated by reference to Form 10-K, Exhibit 21, filed with the commission on

Edgar Filing: BAR HARBOR BANKSHARES - Form 10-K

March 16, 2009

23	Consent of Independent Registered Public Accounting Firm	Filed herewith
31.1	Certification of Chief Executive Officer under Rule 13a-14(a)/15d-14(a)	Filed herewith.
31.2	Certification of Chief Financial Officer under Rule 13a-14(a)/15d-14(a)	Filed herewith.
32.1	Certification of Chief Executive Officer under 18 U.S.C. Sec. 1350.	Filed herewith.
32.2	Certification of Chief Financial Officer under 18 U.S.C. Sec. 1350.	Filed herewith.
99.1	Certification of Chief Executive Officer pursuant to Section 111(b)(4) of the Economic Stabilization Act of 2008	Filed herewith
99.2	Certification of Chief Financial Officer pursuant to Section 111(b)(4) of the Economic Stabilization Act of 2008	Filed herewith