

CAMDEN NATIONAL CORP  
Form 10-K  
March 02, 2012

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

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

**For the Fiscal Year Ended December 31, 2011**

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

**Commission File No. 0-28190**

**CAMDEN NATIONAL CORPORATION**

(Exact Name of Registrant As Specified in Its Charter)

Maine  
(State or Other Jurisdiction of  
Incorporation or Organization)

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

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2 Elm Street, Camden, ME

04843

(Address of Principal Executive Offices)

(Zip Code)

Registrant's Telephone Number, Including Area Code: **(207) 236-8821**

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

Title of Each Class	Name of Exchange on Which Registered
Common Stock, without par value	The NASDAQ Stock Market LLC

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 is not contained herein, and will not be contained, to the best of 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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the Registrant's most recently completed second fiscal quarter: \$228,741,739. Shares of the Registrant's common stock held by each executive officer, director and person who beneficially owns 5%

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or more of the Registrant's outstanding common stock have been excluded, in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of each of the registrant's classes of common stock, as of February 28, 2012 is:  
Common Stock: 7,666,962.

Listed hereunder are documents incorporated by reference and the relevant Part of the Form 10-K into which the document is incorporated by reference:

Certain information required in response to Items 10, 11, 12, 13 and 14 of Part III of this Form 10-K are  
(1) incorporated by reference from Camden National Corporation's Definitive Proxy Statement for the 2012 Annual Meeting of Shareholders pursuant to Regulation 14A of the General Rules and Regulations of the Commission.

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**CAMDEN NATIONAL CORPORATION  
2011 FORM 10-K ANNUAL REPORT**

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## **FORWARD-LOOKING STATEMENTS**

The discussions set forth below and in the documents we incorporate by reference herein contain certain statements that may be considered forward-looking statements under the Private Securities Litigation Reform

Act of 1995, including certain plans, exceptions, goals, projections, and statements, which are subject to numerous risks, assumptions, and uncertainties. Forward-looking statements can be identified by the use of the words believe, expect, anticipate, intend, estimate, assume, plan, target, or goal or future or such as will, may, might, should, could and other expressions which predict or indicate future events or and which do not relate to historical matters. Forward-looking statements should not be relied on, because they involve known and unknown risks, uncertainties and other factors, some of which are beyond the control of the Company. These risks, uncertainties and other factors may cause the actual results, performance or achievements of the Company to be materially different from the anticipated future results, performance or achievements expressed or implied by the forward-looking statements.

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

*continued weakness in the United States economy in general and the regional and local economies within the New England region and Maine, which could result in a deterioration of credit quality, a change in the allowance for loan losses, or a reduced demand for the Company's credit or fee-based products and services;*  
*adverse changes in the local real estate market could result in a deterioration of credit quality and an increase in the allowance for loan loss, as most of the Company's loans are concentrated in Maine, and a substantial portion of these loans have real estate as collateral;*

*changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System;*

*inflation, interest rate, market and monetary fluctuations;*  
*adverse changes in asset;*

*competitive pressures, including continued industry consolidation, the increased financial services provided by non-banks and banking reform;*

*continued volatility in the securities markets that could adversely affect the value or credit quality of the Company's assets, impairment of goodwill, the availability and terms of funding necessary to meet the Company's liquidity needs, and the Company's ability to originate loans and could lead to impairment in the value of securities in the Company's investment portfolios;*

*changes in information technology that require increased capital spending;*  
*changes in consumer spending and savings habits;*

*new laws and regulations regarding the financial services industry including but not limited to, the Dodd-Frank Wall Street Reform & Consumer Protection Act;*

*changes in laws and regulations including laws and regulations concerning taxes, banking, securities and insurance; and*

*changes in accounting policies, practices and standards, as may be adopted by the regulatory agencies as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board, and other accounting standard setters.*

You should carefully review all of these factors, and be aware that there may be other factors that could cause differences, including the risk factors listed in Part II, Item 1A, Risk Factors, beginning



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on page 12. Readers should carefully review the risk factors described therein and should not place undue reliance on our forward-looking statements.

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

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## PART I

### Item 1. Business

*Overview.* Camden National Corporation (hereafter referred to as we, our, us, or the Company) is a publicly-held bank holding company, with \$2.3 billion in assets at December 31, 2011, incorporated under the laws of the State of Maine and headquartered in Camden, Maine. The Company, as a diversified financial services provider, pursues the objective of achieving long-term sustainable growth by balancing growth opportunities against profit, while mitigating risks inherent in the financial services industry. The primary business of the Company and its subsidiaries is to attract deposits from, and to extend loans to, consumer, institutional, municipal, non-profit and commercial customers. The Company makes its commercial and consumer banking products and services available directly and indirectly through its subsidiary, Camden National Bank (the Bank), and its brokerage and insurance services through Camden Financial Consultants (Camden Financial), a division of the Bank. The Company also provides wealth management, trust and employee benefit products and services through its subsidiary, Acadia Trust, N.A. (Acadia Trust), a federally regulated, non-depository trust company headquartered in Portland, Maine. In addition to serving as a holding company, the Company provides managerial, operational, human resource, marketing, financial management, risk management and technology services to its subsidiaries. The Consolidated Financial Statements of the Company accompanying this Form 10-K include the accounts of the Company, the Bank and its divisions, and Acadia Trust. All inter-company accounts and transactions have been eliminated in consolidation.

### Descriptions of the Company and the Company's Subsidiaries

*The Company.* Following is a timeline of recent major events of the Company:

On January 3, 2008, the Company acquired Union Bankshares Company, Maine, including its principal wholly-owned subsidiary, Union Trust Company. Union Trust Company became a division of the Bank.

On February 22, 2011, the Union Trust division was merged into the Bank.

As of December 31, 2011, the Company's securities consisted of one class of common stock, no par value, of which there were 7,664,975 shares outstanding held of record by approximately 1,700 shareholders. Such number of record holders does not reflect the number of persons or entities holding stock in nominee name through banks, brokerage firms and other nominees, which is estimated to be 3,500 shareholders.

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

*Camden National Bank.* The Bank, a direct, wholly-owned subsidiary of the Company, is a national banking association chartered under the laws of the United States and having its principal office in Camden, Maine. Originally founded in 1875, the Bank became a direct, wholly-owned subsidiary of the Company as a result of the corporate reorganization in 1985. The Bank offers its products and services in the Maine counties of Androscoggin, Cumberland, Franklin, Hancock, Knox, Lincoln, Penobscot, Piscataquis, Somerset, Waldo, Washington, and York, and focuses primarily on attracting deposits from the general public through its branches, and then using such deposits to originate residential mortgage loans, commercial business loans, commercial real estate loans and a variety of consumer loans. Customers may also access the Bank's products and services using other channels, including the Bank's website located at [www.camdennational.com](http://www.camdennational.com). The Bank is a member bank of the Federal Reserve System and is subject to supervision, regulation and examination by the Office of the Comptroller of the Currency (the OCC). The

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Federal Deposit Insurance Corporation (the FDIC ) insures the deposits of the Bank up to the maximum amount permitted by law.

*Camden Financial Consultants, located at Camden National Bank.* Camden Financial is a full-service brokerage and insurance division of the Bank, which is in the business of helping clients meet all of their financial needs by using a total wealth management approach. Its financial offerings include college, retirement, and estate planning, mutual funds, Strategic Asset Management accounts, and variable and fixed annuities.

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*Acadia Trust, N.A.* Acadia Trust, a direct, wholly-owned subsidiary of the Company, is a national banking association chartered under the laws of the United States with a limited purpose trust charter, and has its principal office in Portland, Maine, and a website located at [www.acadiatrust.com](http://www.acadiatrust.com). Acadia Trust provides a broad range of trust, trust-related, investment and wealth management services, in addition to retirement and pension plan management services, to both individual and institutional clients. The financial services provided by Acadia Trust complement the services provided by the Bank by offering customers investment management services. Acadia Trust is a member bank of the Federal Reserve System and is subject to supervision, regulation and examination by the OCC as well as to supervision, examination and reporting requirements under the BHCA and the regulations of the FRB.

*Competition.* Through the Bank and its division, Camden Financial, the Company competes throughout the State of Maine, and considers its primary market areas to be in Knox, Hancock, Waldo, Penobscot, and Franklin counties, with a growing presence in Cumberland, Lincoln, Androscoggin and York counties. The combined population of the two primary counties of Knox and Waldo is approximately 81,000 people and their economies are based primarily on tourism and fishing and supported by a substantial population of retirees. The Bank's downeast, central and western Maine markets are characterized as rural areas, with the exception of Bangor and Lewiston, which have populations of approximately 33,000 and 37,000, respectively. Major competitors in the Company's market areas include local branches of large regional bank affiliates and brokerage houses, as well as local independent banks, financial advisors, thrift institutions and credit unions. Other competitors for deposits and loans within the Bank's primary market areas include insurance companies, money market funds, consumer finance companies and financing affiliates of consumer durable goods manufacturers.

The Company and its banking subsidiary generally have effectively competed with other financial institutions by emphasizing customer service, which it has branded the Camden National Experience, including local decision-making, establishing long-term customer relationships, building customer loyalty and providing products and services designed to meet the needs of customers. No assurance can be given, however, that in the future, the Company and its banking subsidiary will continue to be able to effectively compete with other financial institutions.

The Company, through its non-bank subsidiary, Acadia Trust, competes for trust, trust-related, investment management, retirement and pension plan management services with local banks and non-banks, which may now, or in the future, offer a similar range of services, as well as with a number of brokerage firms and investment advisors with offices in the Company's market area. In addition, most of these services are widely available to the Company's customers by telephone and over the internet through firms located outside the Company's market area.

*The Company's Philosophy.* The Company is committed to the philosophy of serving the financial needs of customers in local communities, as described in its core purpose: *Through each interaction, we will enrich the lives of people, help businesses succeed and vitalize communities.* The Company, through the Bank, has branches that are located in communities within the Company's geographic market areas. The Company believes that its comprehensive retail, small business and commercial loan products enable the Bank to effectively compete.

*The Company's Growth.* The Company has achieved a five-year compounded annual asset growth rate of 5.4%, resulting in \$2.3 billion in total assets as of the end of 2011. The primary factor contributing to the growth was the acquisition of Union Trust. The financial services industry continues to experience consolidations through mergers that could create opportunities for the Company to promote its value proposition to customers. The Company evaluates the possibility of expansion into new markets through both de novo expansion and acquisitions. In addition, the Company is focused on maximizing the potential for growth in existing markets, especially in markets where the Company has less of a presence.

*The Company's Employees.* The Company employs approximately 425 people on a full- or part-time basis, which calculates into 410 people on a full-time equivalent basis. The Company's management measures the corporate culture

every 18 months and is pleased with the most recent rating, which came in as a positive culture, signifying that employees understand and support the overall Company objectives and

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strategies. In 2009, the Company was named one of the top two Best Places to Work in Maine in the large-size category (200 or more employees) by ModernThink, a workplace excellence firm. There are no known disputes between management and employees.

*The Company's Employee Incentives.* All Company employees are eligible for participation in the Company's performance-based incentive compensation program and Retirement Savings 401(k) Plan, while certain officers of the Company may also participate in various components of the Company's 2003 Stock Option Plan, Supplemental Executive Retirement Plan, Postretirement Medical Plan, Defined Contribution Retirement Plan, Executive Incentive Compensation Program, Deferred Compensation Plan and Long-term Incentive Plan.

**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 regulatory agencies (the Agencies), including the FRB and the OCC. The Bank is also subject to regulation under the laws of the State of Maine and the jurisdiction of the Maine Bureau of Financial Institutions. State and federal banking laws generally have as their principal objective either the maintenance of the safety and soundness of financial institutions and the federal deposit insurance system or the protection of consumers or classes of consumers, and depositors in particular, rather than the specific protection of shareholders. Set forth below is a brief description of certain laws and regulations that relate to the regulation of the Company and its banking subsidiaries.

*Regulatory Reform.* The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) comprehensively reformed the regulation of financial institutions, products and services. Among other things, the Dodd-Frank Act:

- bars banking organizations, such as the Company, from engaging in proprietary trading and from sponsoring and investing in hedge funds and private equity funds, except as permitted under certain limited circumstances, as discussed in Supervision and Regulation Bank Holding Company Activities and Other Limitations and Supervision and Regulation Activities and Investments of National Banking Associations below;
- codifies the source of strength doctrine, as discussed in more detail in Supervision and Regulation Bank Holding Company Support of Subsidiary Banks below;
- grants the FRB increased supervisory authority allowing it to directly examine the subsidiaries of the Company, including the Bank;
- provides for new capital standards applicable to the Company and the Bank, as discussed in more detail in Supervision and Regulation Capital Requirements below;
- modifies deposit insurance coverage, as discussed in Supervision and Regulation Deposit Insurance below;
- established the Bureau of Consumer Financial Protection (the CFPB), as discussed in Supervision and Regulation Consumer Protection Consumer Protection Laws General below;
- established a new standard for preemption of state consumer financial laws, which will affect national banking associations such as the Bank, as discussed in Supervision and Regulation Consumer Protection Regulation Preemption of State Consumer Protection Laws below;
- established new minimum mortgage underwriting standards for residential mortgages, as discussed in Supervision and Regulation Consumer Protection Regulation Mortgage Reform below;
- established new corporate governance and proxy disclosure requirements, as discussed in Supervision and Regulation Other Regulatory Requirements Corporate Governance and Executive Compensation below;



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authorizes the FRB to regulate interchange fees for debit card transactions. The FRB has issued a rule governing the interchange fees charged on debit cards which caps the fees a bank may charge on a debit card transactions and shifts such interchange fees from a percentage of the transaction amount to a per transaction fee. Although the rule does not directly apply to institutions with less than \$10 billion in assets, market forces may result in debit card issuers of all sizes adopting fees that comply with this rule;

permits the payment of interest on business demand deposit accounts;  
established and empowered the Financial Stability Oversight Council to designate certain activities as posing a risk to the U.S. financial system and recommend new or heightened standards and safeguards for financial institutions engaging in such activities; and  
established the Office of Financial Research, which has the power to require reports from financial services companies such as the Company.

*Bank Holding Company Activities and Other Limitations.* As a BHC, the Company is subject to regulation under the BHCA. In addition, the Company is subject to examination and supervision by the FRB, and is required to file reports with, and provide additional information requested by, the FRB.

Under the BHCA, the Company may not generally engage in activities or acquire more than 5% of any class of voting securities of any company which is not a bank or BHC, and may not engage directly or indirectly in activities other than those of banking, managing or controlling banks or furnishing services to its subsidiary banks, except that it may engage in and may own shares of companies engaged in certain activities the FRB determined to be so closely related to banking or managing and controlling banks as to be a proper incident thereto. However, a BHC 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. Additionally, the Dodd-Frank Act bars banking organizations, such as the Company, from engaging in proprietary trading and from sponsoring and investing in hedge funds and private equity funds, except as permitted under certain limited circumstances.

*Acquisitions and Branching.* The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ( Riegle-Neal ) and the Dodd-Frank Act permit well capitalized and well managed BHCs and banks, as determined by the FRB and the OCC, respectively, 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 and the Dodd-Frank Act permit banks to establish new branches on an interstate basis to the same extent a bank chartered by the host state may establish branches. However, as a BHC, we are 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 BHC, bank or savings association.

The Change in Bank Control Act prohibits a person or group of persons from acquiring control of a BHC, such as the Company, 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 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 the FRB under the BHCA 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 BHC in certain instances discussed in the guidance.

*Activities and Investments of National Banking Associations.* National banking associations must comply with the National Bank Act and the regulations promulgated thereunder by the OCC, which limit the activities of national banking associations to those that are deemed to be part of, or incidental to, the business of banking. Activities that are part of, or incidental to, the business of banking include taking

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deposits, borrowing and lending money and discounting or negotiating paper. Subsidiaries of national banking associations generally may only engage in activities permissible for the parent national bank. As noted above, the Dodd-Frank Act bars the Bank from engaging in proprietary trading and from sponsoring and investing in hedge funds and private equity funds, except as permitted under certain limited circumstances.

*Bank Holding Company Support of Subsidiary Banks.* Under the Dodd-Frank Act, the Company is required to serve as a source of financial strength for the Bank in the event of the financial distress of the Bank. This provision codifies the longstanding policy of the FRB. This support may be required at times when the BHC may not have the resources to provide it. Similarly, under the cross-guarantee provisions of the Federal Deposit Insurance Act, as amended (the FDIA ), 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.

*Transactions with Affiliates.* Under Sections 23A and 23B of the Federal Reserve Act and Regulation W promulgated thereunder, there are various legal restrictions on the extent to which a BHC and its nonbank 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 nondepository 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. The Dodd-Frank Act amended the definition of affiliate to include an investment fund for which the depository institution or one of its affiliates is an investment adviser. 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, the issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate, securities borrowing or lending transactions with an affiliate that creates a credit exposure to such affiliate, or a derivatives transaction with an affiliate that creates a credit exposure to such affiliate. Covered transactions are also subject to certain collateral security requirements. Further, a BHC 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.

*Declaration of Dividends.* According to its Policy Statement on Cash Dividends Not Fully Covered by Earnings (the FRB Dividend Policy ), the FRB considers adequate capital to be critical to the health of individual banking organizations and to the safety and stability of the banking system. Of course, one of the major components of the capital adequacy of a bank or a BHC is the strength of its earnings, and the extent to which its earnings are retained and added to capital or paid to shareholders in the form of cash dividends. Accordingly, the FRB Dividend Policy suggests that banks and BHCs generally should not maintain their existing rate of cash dividends on common stock unless the organization's net income available to common shareholders over the past year has been sufficient to fully fund the dividends, and the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. The FRB Dividend Policy reiterates the FRB's belief that a BHC should not maintain a level of cash dividends to its shareholders that places undue pressure on the capital of bank subsidiaries, or that can be funded only through additional borrowings or other arrangements that may undermine the BHC's ability to serve as a source of strength. The FRB has the authority to prohibit a BHC, such as the Company, from paying dividends if it deems such payment to be an unsafe or unsound practice.

Under Maine law, a corporation's board of directors may declare, and the corporation may pay, dividends on its outstanding shares, in cash or other property, generally only out of the corporation's unreserved and unrestricted earned surplus, or out of the unreserved and unrestricted net earnings of the current fiscal year and the next preceding fiscal year taken as a single period, except under certain circumstances, including when the corporation is insolvent, or when the payment of the dividend would render the corporation insolvent or when the declaration would be contrary to the corporation's charter.

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The revenue of the Company is derived substantially from interest and dividends paid to it by the Bank. Dividend payments by national banks, such as the Bank, also are subject to certain restrictions. For instance, national banks generally may not declare a dividend in excess of the bank's undivided profits and, absent OCC approval, if the total amount of dividends declared by the national bank in any calendar year exceeds the total of the national bank's retained net income of that year to date combined with its retained net income for the preceding two years. National banks also are prohibited from declaring or paying any dividend if, after making the dividend, the national bank would be considered undercapitalized (as defined by reference to other OCC regulations). The OCC has the authority to use its enforcement powers to prohibit a national bank, such as the 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.

*Capital Requirements.* The FRB and the OCC have issued substantially similar risk-based and leverage capital guidelines applicable to United States banking organizations. In addition, the 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's risk-based guidelines define a three-tier capital framework. Tier 1 capital for bank holding companies generally consists of the sum of common stockholders' equity, perpetual preferred stock and trust preferred securities (both subject to certain limitations and, in the case of the latter, to specific limitations on the kind and amount of such securities which may be included as Tier 1 capital and certain additional restrictions described below), and minority interests in the equity accounts of consolidated subsidiaries, less goodwill and other non-qualifying intangible assets. Pursuant to the Dodd-Frank Act, trust preferred securities issued after May 19, 2010, will not count as Tier 1 capital; however, the Company's currently outstanding trust preferred securities have been grandfathered for Tier 1 eligibility.

Tier 2 capital generally consists of hybrid capital instruments, perpetual debt and mandatory convertible debt securities; perpetual preferred stock and trust preferred securities, to the extent it is not eligible to be included as Tier 1 capital; term subordinated debt and intermediate-term preferred stock; and, subject to limitations, general allowances for loan losses. The sum of Tier 1 and Tier 2 capital less certain required deductions, such as investments in unconsolidated banking or finance subsidiaries, represents qualifying total capital. Risk-based capital ratios are calculated by dividing Tier 1 and total capital, respectively, by risk-weighted assets. Assets and off-balance sheet credit equivalents are assigned to one of four categories of risk-weights, based primarily on relative credit risk. The minimum Tier 1 risk-based capital ratio is 4% and the minimum total risk-based capital ratio is 8%. The Dodd-Frank Act requires the FRB to establish minimum risk-based capital requirements that may not be lower than those in effect on July 21, 2010. As of December 31, 2011, the Company's Tier 1 risk-based capital ratio was 14.69% and its total risk-based capital ratio was 15.95%.

In addition to the risk-based capital requirements, the FRB requires top rated bank holding companies to maintain a minimum leverage capital ratio of Tier 1 capital (defined by reference to the risk-based capital guidelines) to its average total consolidated assets of at least 3.0%. For most other bank holding companies (including the Company), the minimum leverage capital ratio is 4.0%. Bank holding companies with supervisory, financial, operational or managerial weaknesses, as well as bank holding companies that are anticipating or experiencing significant growth, are expected to maintain capital ratios well above the minimum levels. The Company's leverage capital ratio was 9.59% as of December 31, 2011.

Pursuant to the Dodd-Frank Act, as with the risk-based capital requirements discussed above, the leverage capital requirements generally applicable to insured depository institutions will serve as a floor for any leverage capital requirements the FRB may establish for bank holding companies, such as the Company. The Dodd-Frank Act also specifies that the FRB may not establish leverage capital requirements for bank holding companies that are quantitatively lower than the leverage capital requirements in effect for insured depository institutions as of July 21,

2010.

The OCC has promulgated regulations and adopted a statement of policy regarding the capital adequacy of national banks. These requirements are substantially similar to those adopted by the FRB regarding bank holding companies, as described above. Moreover, the OCC has promulgated corresponding regulations to implement the system of prompt corrective action established by Section 38 of the Federal Deposit Insurance

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Act ( FDIA ). Under the regulations, a bank is well capitalized if it has: (1) a total risk-based capital ratio of 10.0% or greater; (2) a Tier 1 risk-based capital ratio of 6.0% or greater; (3) a leverage ratio of 5.0% or greater; and (4) is not subject to any written agreement, order, capital directive or prompt corrective action directive to meet and maintain a specific capital level for any capital measure. A bank is adequately capitalized if it has: (1) a total risk-based capital ratio of 8.0% or greater; (2) a Tier 1 risk-based capital ratio of 4.0% or greater; and (3) a leverage ratio of 4.0% or greater (3.0% under certain circumstances) and does not meet the definition of a well capitalized bank.

The OCC also must take into consideration: (1) concentrations of credit risk; (2) interest rate risk; 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. At December 31, 2011, the Bank was deemed to be a well capitalized institution for the above purposes. Information concerning the Company and its subsidiaries with respect to capital requirements is incorporated by reference from Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, in the section entitled Capital Resources, and Item 8. Financial Statements and Supplementary Data, in the section entitled Note 18, Regulatory Capital Requirements.

Generally, a bank, upon receiving notice that it is not adequately capitalized (i.e., that it is undercapitalized), becomes subject to the prompt corrective action provisions of Section 38 of FDIA that, for example, (i) restrict payment of capital distributions and management fees, (ii) require that the OCC monitor the condition of the institution and its efforts to restore its capital, (iii) require submission of a capital restoration plan, (iv) restrict the growth of the institution's assets and (v) require prior regulatory approval of certain expansion proposals. A bank that is required to submit a capital restoration plan must concurrently submit a performance guarantee by each company that controls the bank. A bank that is critically undercapitalized (i.e., has a ratio of tangible equity to total assets that is equal to or less than 2.0%) will be subject to further restrictions, and generally will be placed in conservatorship or receivership within 90 days.

The Company has not elected, and does not expect to elect, to calculate its risk-based capital requirements under either the advanced or standard approach of the Basel II capital accords. The Basel Committee on Banking Supervision has also released new capital requirements, known as Basel III, setting forth higher capital requirements, enhanced risk coverage, a global leverage ratio, provisions for counter-cyclical capital, and liquidity standards. The FRB has not yet adopted Basel III, and when it is implemented in the United States, it may be with some modifications or adjustments. Additionally, the timetable for the adoption and implementation of Basel III is expected to last for several years. Accordingly, the Company is not yet in a position to determine the effect of Basel III on its capital requirements.

The Agencies may raise capital requirements applicable to banking organizations beyond current levels. The Company is unable to predict whether higher capital requirements will be imposed and, if so, at what levels and on what schedules. Therefore, the Company cannot predict what effect such higher requirements may have on it.

*Deposit Insurance.* The Bank pays deposit insurance premiums to the FDIC based on an assessment rate established by the FDIC. For most banks and savings associations, including the Bank, FDIC rates depend upon a combination of CAMELS component ratings and financial ratios. CAMELS ratings reflect the applicable bank regulatory agency's evaluation of the financial institution's capital, asset quality, management, earnings, liquidity and sensitivity to risk. For large banks and savings associations that have long-term debt issuer ratings, assessment rates depend upon such ratings, and CAMELS component ratings. Pursuant to the Dodd-Frank Act, deposit premiums are now based on assets rather than insurable deposits. To determine its actual deposit insurance premiums, the Bank will compute the base amount on its average consolidated assets less its average tangible equity (defined as the amount of Tier 1 capital) and its applicable assessment rate. The new assessment formula was effective on April 1, 2011, and was used to calculate

the June 30, 2011 assessment. Future expenses will be based on asset levels, Tier 1 capital levels, assessment rates, CAMELS ratings, and whether there are any future special assessments by the FDIC.

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Pursuant to an FDIC rule issued in November 2009, the Bank prepaid its quarterly risk-based assessments to the FDIC for the fourth quarter of 2009 and for all of 2010, 2011, and 2012 on December 30, 2009. The amount of the Bank's prepaid deposit premium was \$4.8 million as of December 31, 2011. The Bank recorded the entire amount of its prepayment as an asset (a prepaid expense). The prepaid assessments bear a 0% risk weight for risk-based capital purposes. Each quarter, the Bank has recorded and will record an expense for its regular quarterly assessment for the quarter and a corresponding credit to the prepaid assessment until the asset is exhausted. The FDIC will not refund or collect additional prepaid assessments because of a decrease or growth in deposits over the remaining two years. However, should the prepaid assessment not be exhausted after collection of the amount due on June 30, 2013, the remaining amount of the prepayment will be returned to the Bank. Pursuant to the Dodd-Frank Act, FDIC deposit insurance has been permanently increased from \$100,000 to \$250,000 per depositor. Additionally, the Dodd-Frank Act provides temporary unlimited deposit insurance coverage for noninterest-bearing transactions accounts beginning December 31, 2010, and ending December 31, 2012. This replaced the FDIC's Transaction Account Guarantee Program, which expired on December 31, 2010.

The FDIC has the power to adjust deposit insurance assessment rates at any time. We cannot predict whether, as a result of the adverse change in U.S. economic conditions and, in particular, declines in the value of real estate in certain markets served by the Bank, the FDIC will in the future increase deposit insurance assessment levels.

## **Consumer Protection Regulation**

*Consumer Protection Laws - General.* The Company and the Bank are subject to a number of federal and state laws designed to protect consumers and prohibit unfair or deceptive business practices. These laws include the Equal Credit Opportunity Act, the Fair Housing Act, the Home Ownership Protection Act, the Fair Credit Reporting Act, as amended by the Fair and Accurate Credit Transactions Act of 2003 (the FACT Act), the Gramm-Leach-Bliley Act of 1999 (the GLBA), Truth in Lending Act, the Community Reinvestment Act (the CRA), the Home Mortgage Disclosure Act, Real Estate Settlement Procedures Act, National Flood Insurance Act and various state law counterparts. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must interact with customers when taking deposits, making loans, collecting loans and providing other services. Further, the Dodd-Frank Act established the CFPB, which has the responsibility for making rules and regulations under the federal consumer protection laws relating to financial products and services. The CFPB also has a broad mandate to prohibit unfair or deceptive acts and practices and is specifically empowered to require certain disclosures to consumers and draft model disclosure forms. Failure to comply with consumer protection laws and regulations can subject financial institutions to enforcement actions, fines and other penalties. The OCC examines the Bank for compliance with CFPB rules and enforce CFPB rules with respect to the Bank.

*Preemption of State Consumer Protection Laws.* The Dodd-Frank Act established a new standard for preemption of state consumer financial laws, which will affect national banking associations such as the Bank. Under the new standard, a state consumer protection law may only be preempted if it has a discriminatory effect against national banks, it prevents or significantly interferes with the exercise of a national bank's powers as determined by court order or by the OCC on a case-by-case basis or such law is preempted by a provision of federal law. This standard is expected to result in the preemption of fewer state consumer laws, thus, the Bank may have to comply with certain state laws that were considered preempted before the enactment of the Dodd-Frank Act.

*Mortgage Reform.* The Dodd-Frank Act prescribes certain standards that mortgage lenders must consider before making a residential mortgage loan, including verifying a borrower's ability to repay such mortgage loan. The Dodd-Frank Act also allows borrowers to assert violations of certain provisions of the Truth-in-Lending Act as a defense to foreclosure proceedings. Under the Dodd-Frank Act, prepayment penalties are prohibited for certain

mortgage transactions and creditors are prohibited from financing insurance policies in connection with a residential mortgage loan or home equity line of credit. The Dodd-Frank Act requires mortgage lenders to make additional disclosures prior to the extension of credit, in each billing statement and for negative amortization loans and hybrid adjustable rate mortgages.



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*Privacy and Customer Information Security.* GLBA requires financial institutions to implement policies and procedures regarding the disclosure of nonpublic personal information about consumers to nonaffiliated third parties. In general, the Bank must provide its customers with an annual disclosure that explains its policies and procedures regarding the disclosure of such nonpublic personal information, and, except as otherwise required or permitted by law, the Bank is prohibited from disclosing such information except as provided in such policies and procedures. GLBA also requires that the Bank develop, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information (as defined under GLBA), 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 Bank is also required to send a notice 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. Pursuant to the FACT Act, the Bank must also develop and implement a written identity theft prevention program to detect, prevent, and mitigate identity theft in connection with the opening of certain accounts or certain existing accounts. Additionally, the FACT Act amends the Fair Credit Reporting Act to generally prohibit a person from using information received from an affiliate to make a solicitation for marketing purposes to a consumer, unless the consumer is given notice and a reasonable opportunity and a reasonable and simple method to opt out of the making of such solicitations.

## **Other Regulatory Requirements**

*The Community Reinvestment Act.* The CRA requires lenders to identify the communities served by the Bank's offices and other deposit taking facilities and to make loans and investments and provide services that meet the credit needs of these communities. The Agencies examine banks and rate such institutions' compliance with the 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 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 Outstanding on its most recent CRA examination.

*Anti-Money Laundering and the Bank Secrecy Act.* Under the Bank Secrecy Act (BSA), a financial institution, is required to have systems in place to detect certain transactions, based on the size and nature of the transaction. Financial institutions are generally required to report to the United States Treasury any cash transactions involving more than \$10,000. In addition, financial institutions are required to file suspicious activity reports for transactions that involve more than \$5,000 and which the financial institution knows, suspects or has reason to suspect involves illegal funds, is designed to evade the requirements of the BSA or has no lawful purpose. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the USA PATRIOT Act), which amended the BSA, is designed to deny terrorists and others the ability to obtain anonymous access to the U.S. financial system. The USA PATRIOT Act has significant implications for financial institutions and businesses of other types involved in the transfer of money. The USA PATRIOT Act, together with the implementing regulations of various federal regulatory agencies, has caused financial institutions, such as the Bank, to adopt and implement additional policies or amend existing policies and procedures with respect to, among other things, anti-money laundering compliance, suspicious activity, currency transaction reporting, customer identity verification and customer risk analysis. In evaluating an application under Section 3 of the BHCA to acquire a bank or an application under the Bank Merger Act to merge banks or affect a purchase of assets and assumption of deposits and other liabilities, the applicable federal banking regulator must consider the anti-money laundering compliance

record of both the applicant and the target. In addition, under the USA PATRIOT Act financial institutions are required to take steps to monitor their correspondent banking and private banking relationships as well as, if applicable, their relationships with shell banks.

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*Office of Foreign Assets Control ( OFAC ).* The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These sanctions, which are administered by OFAC, take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on U.S. persons engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (for example, property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences for the Company.

*Regulation R.* The GLBA also amended the federal securities laws to eliminate the blanket exceptions that banks traditionally have had from the definition of broker, dealer and investment adviser under the Exchange Act. The GLBA provided 11 exceptions from the definition of broker in Section 3(a)(4) of the Exchange Act that permit banks to effect securities transactions under certain conditions without registering as broker-dealers with the SEC. Regulation R, which was issued jointly by the SEC and the FRB, implements certain of these exceptions. The FRB and SEC have stated that they will jointly issue any interpretations or no action letters/guidance regarding Regulation R and consult with each other and the appropriate federal banking agency with respect to formal enforcement actions pursuant to Regulation R.

*Corporate Governance and Executive Compensation.* Under the Dodd-Frank Act, the SEC has adopted rules granting shareholders a non-binding vote on executive compensation and golden parachute payments. Pursuant to modifications of the proxy rules under the Dodd-Frank Act, the Company will be required to disclose the relationship between executive pay and financial performance, the ratio of the median pay of all employees to the pay of the chief executive officer, and employee and director hedging activities. The Dodd-Frank Act also requires that stock exchanges change their listing rules to require that each member of a listed company's compensation committee be independent and be granted the authority and funding to retain independent advisors and to prohibit the listing of any security of an issuer that does not adopt policies governing the claw back of excess executive compensation based on inaccurate financial statements. The Agencies have proposed new regulations which prohibit incentive-based compensation arrangements that encourage executives and certain other employees to take inappropriate risks.

*Regulatory Enforcement Authority.* The enforcement powers available to the Agencies 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. 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 Agencies.

## **Legal Contingencies**

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

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

In October 2010, Daniel G. Lilley Law Offices, P.A. filed a complaint against the Bank in the Superior Court in Oxford County, Maine claiming that the Bank owed Daniel G. Lilley Law Offices, P.A. compensation for a benefit that the Law Offices provided to the Bank. While the plaintiff has not yet given a final

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calculation of the damages sought, it appears that it seeks payment of approximately \$574,000, or 40% of the benefit it alleges was retained by the Bank from *The Steamship Navigation Company* judgment in September 2004. The case was transferred to the Business Court in Portland and a motion to dismiss was filed with the court by the Bank. On May 19, 2011, the court granted the Bank's motion to dismiss the complaint. However, on June 8, 2011, Daniel G. Lilley Law Offices, P. A. filed an appeal to this ruling. In December 2011, both parties filed documents with the law court under the appeal and we are awaiting a final ruling. We anticipate final ruling and/or resolution in the next few months.

## **Available Information**

The Company's Investor Relations information can be obtained through its subsidiary bank's internet address, [www.camdennational.com](http://www.camdennational.com). The Company makes available on or through its Investor Relations page without charge, its annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K 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 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). In addition, the Company makes available, free of charge, its press releases and Code of Ethics through the Company's Investor Relations page. Information on our website is not incorporated by reference into this document and should not be considered part of this Report.

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## **Item 1A. Risk Factors**

### **If our allowance for loan losses is not adequate to cover actual loan losses, our earnings could decrease.**

We make various assumptions and judgments about the collectability of our loan portfolio and provide an allowance for probable loan losses based on a number of factors. Monthly, the Corporate Risk Management group reviews the assumptions, calculation methodology and balance of the allowance for loan losses with the board of directors for the Bank. On a quarterly basis, the Company's board of directors, as well as the board of directors for the subsidiary bank, completes a similar review of the allowance for loan losses. If the assumptions are incorrect, the allowance for loan losses may not be sufficient to cover the losses we could experience, which would have an adverse effect on operating results, and may also cause us to increase the allowance for loan losses in the future. In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our provisions for credit losses or recognize further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by regulatory authorities could have a material adverse effect on our consolidated results of operations and financial condition. If additional amounts are provided to the allowance for loan losses, our earnings could decrease.

### **Our loans are concentrated in certain areas of Maine and adverse conditions in those markets could adversely affect our operations.**

We are exposed to real estate and economic factors throughout Maine, as virtually the entire loan portfolio is concentrated among borrowers in Maine, with higher concentrations of exposure in Cumberland, Hancock, Knox and Waldo counties. Further, because a substantial portion of the loan portfolio is secured by real estate in this area, the value of the associated collateral is also subject to regional real estate market conditions. Adverse economic, political or business developments or natural hazards may affect these areas and the ability of property owners in these areas to make payments of principal and interest on the underlying mortgages. If these regions experience adverse economic, political or business conditions, we would likely experience higher rates of loss and delinquency on these loans than if the loans were more geographically diverse.

### **We experience strong competition within our markets, which may impact our profitability.**

Competition in the banking and financial services industry is strong. In our market areas, we compete for loans, deposits and other financial products and services with local independent banks, thrift institutions, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies and brokerage and investment banking firms operating locally as well as nationally. Many of these competitors have substantially greater resources and lending limits than those of our subsidiaries and may offer services that our subsidiaries do not or cannot provide. Our long-term success depends on the ability of our subsidiaries to compete successfully with other financial institutions in their service areas. Because we maintain a smaller staff and have fewer financial and other resources than larger institutions with which we compete, we may be limited in our ability to attract customers. If we are unable to attract and retain customers, we may be unable to achieve growth in the loan and core deposit portfolios, and our results of operations and financial condition may be negatively impacted.

**If we do not maintain net income growth, the market price of our common stock could be adversely affected.**

Our return on shareholders' equity and other measures of profitability, which affect the market price of our common stock, depend in part on our continued growth and expansion. Our growth strategy has two principal components—internal growth and external growth. Our ability to generate internal growth is affected by the competitive factors described below as well as by the primarily rural characteristics and related demographic features of the markets we serve. Our ability to continue to identify and invest in suitable acquisition candidates on acceptable terms is an important component of our external growth strategy. In pursuing acquisition opportunities, we may be in competition with other companies having similar growth strategies. As a result, we may not be able to identify or acquire promising acquisition candidates on acceptable terms. Competition for these acquisitions could result in increased acquisition prices and a diminished pool of acquisition opportunities. An inability to find suitable acquisition candidates at reasonable prices could slow our growth rate and have a negative effect on the market price of our common stock.

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**Interest rate volatility may reduce our profitability.**

Our profitability depends to a large extent upon our net interest income, which is the difference between interest income on interest-earning assets, such as loans and investments, and interest expense on interest-bearing liabilities, such as deposits and borrowed funds. Net interest income can be affected significantly by changes in market interest rates. In particular, changes in relative interest rates may reduce our net interest income as the difference between interest income and interest expense decreases. As a result, we have adopted asset and liability management policies to minimize the potential adverse effects of changes in interest rates on net interest income, primarily by altering the mix and maturity of loans, investments and funding sources. However, there can be no assurance that a change in interest rates will not negatively impact our results from operations or financial position. Since market interest rates may change by differing magnitudes and at different times, significant changes in interest rates over an extended period of time could reduce overall net interest income. An increase in interest rates could also have a negative impact on our results of operations by reducing the ability of borrowers to repay their current loan obligations, which could not only result in increased loan defaults, foreclosures and write-offs, but also necessitate further increases to our allowance for loan losses.

**Our banking business is highly regulated, and we may be adversely affected by changes in law and regulation.**

We are subject to regulation and supervision by the FRB, and the Bank is subject to regulation and supervision by the OCC and the FDIC. Federal laws and regulations govern numerous matters, including changes in the ownership or control of banks and bank holding companies, maintenance of adequate capital and the financial condition of a financial institution, permissible types, amounts and terms of extensions of credit and investments, permissible nonbanking activities, the level of reserves against deposits and restrictions on dividend payments. The OCC possesses the power to issue cease and desist orders to prevent or remedy unsafe or unsound practices or violations of law by banks subject to their regulation, and the FRB possesses similar powers with respect to bank holding companies. These and other restrictions limit the manner in which we may conduct business and obtain financing.

The Dodd-Frank Act comprehensively reformed the regulation of financial institutions, products and services. Because many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, it is difficult to forecast the impact that such rulemaking will have on us, our customers or the financial industry. Certain provisions of the Dodd-Frank Act that affect deposit insurance assessments, the payment of interest on demand deposits and interchange fees could increase the costs associated with the Bank's deposit-generating activities, as well as place limitations on the revenues that those deposits may generate. For example, while the FRB adopted rules pursuant to the Dodd-Frank Act governing debit card interchange fees that apply to institutions with greater than \$10 billion in assets, market forces may effectively require all banks to adopt debit card interchange fee structures that comply with these rules.

Among other things, the Dodd-Frank Act established the Consumer Financial Protection Bureau, or the CFPB, as an independent bureau of the FRB. The CFPB has the authority to prescribe rules for all depository institutions governing the provision of consumer financial products and services, which may result in rules and regulations that reduce the profitability of such products and services or impose greater costs on us and our subsidiaries. The Bank will be examined by the OCC for compliance with such rules. The Dodd-Frank Act established new minimum mortgage underwriting standards for residential mortgages and the regulatory agencies have focused on the examination and supervision of mortgage lending and servicing activities. Over the past year there has been a heightened regulatory scrutiny of consumer fees, which may result in new disclosure requirements or regulations regarding the fees that the Bank may charge for products and services.



Regulators may raise capital requirements above current levels in connection with the implementation of Basel III, the Dodd-Frank Act or otherwise, which may require us and the Bank to hold additional capital which could limit the manner in which we and the Bank conduct our business and obtain financing. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III in the United States, or otherwise, could result in us and the Bank having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. If the federal banking agencies

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implement a capital conservation buffer and/or a countercyclical capital buffer, as proposed in Basel III, a failure by us or the Bank to satisfy the applicable buffer's requirements would limit our ability to make distributions, including paying out dividends or buying back shares.

### **Our cost of funds may increase as a result of general economic conditions, interest rates and competitive pressures.**

The Bank has traditionally obtained funds principally through deposits and borrowings. As a general matter, deposits are a less costly source of funds than borrowings because interest rates paid for deposits are typically less than interest rates charged for borrowings. If, as a result of general economic conditions, market interest rates, competitive pressures or otherwise, the value of deposits at our banking subsidiary decreases relative to our overall banking operations, we may have to rely more heavily on borrowings as a source of funds in the future.

### **We are subject to liquidity risk.**

Liquidity risk is the risk of potential loss if we are unable to meet our funding requirements at a reasonable cost. Our liquidity could be impaired by an inability to access the capital markets or by unforeseen outflows of cash. This situation may arise due to circumstances that we may be unable to control, such as a general market disruption or an operational problem that affects third parties or us. Our credit ratings are important to our liquidity. A reduction in our credit ratings could adversely affect our liquidity and competitive position, increase our borrowing costs, limit our access to the capital markets or trigger unfavorable contractual obligations.

### **Our access to funds from subsidiaries may be restricted.**

The Company is a separate and distinct legal entity from our banking subsidiaries. We therefore depend on dividends, distributions and other payments from our banking and nonbanking subsidiaries to fund dividend payments on our common stock and to fund all payments on our other obligations. Our subsidiaries are subject to laws that authorize regulatory bodies to block or reduce the flow of funds from those subsidiaries to the Company, which could impede access to funds we need to make payments on our obligations or dividend payments.

### **Prepayments of loans may negatively impact our business.**

Generally, our customers may prepay the principal amount of their outstanding loans at any time. The speeds at which such prepayments occur, as well as the size of such prepayments, are within our customers' discretion. If customers prepay the principal amount of their loans, and we are unable to lend those funds to other borrowers or invest the funds at the same or higher interest rates, our interest income will be reduced. A significant reduction in interest income could have a negative impact on our results of operations and financial condition.

### **We may incur significant losses as a result of ineffective risk management processes and strategies.**

We seek to monitor and control our risk exposure through a risk and control framework encompassing a variety of separate but complementary financial, credit, operational, compliance and legal reporting systems, internal controls, management review processes and other mechanisms. While we employ a broad and diversified set of risk monitoring and risk mitigation techniques, those techniques and the judgments that accompany their application may not be effective and may not anticipate every economic and financial outcome in all market environments or the specifics

and timing of such outcomes. Market conditions over the last several years have involved unprecedented dislocations and highlight the limitations inherent in using historical data to manage risk.

**We may be unable to attract and retain key personnel.**

The Company's success depends, in large part, on its ability to attract and retain key personnel. Competition for qualified personnel in the financial services industry can be intense and the Company may not be able to hire or retain the key personnel that it depends upon for success. The unexpected loss of services of

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one or more of the Company's key personnel could have a material adverse impact on its business because of their skills, knowledge of the markets in which the Company operates, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

**We have credit and counterparty risk inherent in our securities portfolio and bank-owned life insurance policies.**

We maintain a diversified securities portfolio, which includes mortgage-backed securities issued by U.S. government and government sponsored agencies, obligations of the U.S. Treasury and government-sponsored agencies, securities issued by state and political subdivisions, private issue collateralized mortgage obligations and auction preferred securities. We also carry investments in bank-owned life insurance and Federal Home Loan Bank stock. We seek to limit credit losses in our securities portfolios by generally purchasing only highly-rated securities.

The current economic environment and financial markets volatility increase the difficulty of assessing investment securities impairment and the same influences tend to increase the risk of potential impairment of these assets. During the years ended December 31, 2011, 2010 and 2009, we recorded charges for other-than-temporary impairment of securities of \$109,000, \$221,000 and \$11,000, respectively. We believe that we have adequately reviewed our investment securities for impairment and that our investment securities are carried at fair value. However, over time, the economic and market environment may provide additional insight regarding the fair value of certain securities, which could change our judgment regarding impairment. In addition, if the counter-party should default, become insolvent, declare bankruptcy, or otherwise cease to exist, the value of our investment may be impaired. This could result in realized losses relating to other-than-temporary declines being charged against future income. Given the current market conditions and the significant judgments involved, there is continuing risk that further declines in fair value may occur and additional material other-than-temporary impairments may be charged to income in future periods, resulting in realized losses.

**Increases in FDIC deposit insurance premiums will increase our non-interest expense.**

Pursuant to the Dodd-Frank Act, the FDIC has amended the deposit insurance assessment by changing the calculation of deposit assessments. Under the new calculation, deposit premiums will be based on assets rather than insurable deposits. To determine its actual deposit insurance premiums, the Bank will compute the base amount on its average consolidated assets less its average tangible equity (which the FDIC proposes to be defined as the amount of Tier 1 capital) and its applicable assessment rate. The new assessment formula was effective on April 1, 2011, and was used to calculate the June 30, 2011 assessment. Future expenses will be based on asset levels, Tier 1 capital levels, assessment rates, CAMELS ratings, and whether there are any future special assessments by the FDIC. Any increase in our deposit insurance premiums will result in an increase in our non-interest expense.

**We could be held responsible for environmental liabilities of properties we acquired through foreclosure.**

If we are forced to foreclose on a defaulted mortgage loan to recover our investment, we may be subject to environmental liabilities related to the underlying real property. Hazardous substances or wastes, contaminants, pollutants or sources thereof may be discovered on properties during our ownership or after a sale to a third party. The amount of environmental liability could exceed the value of the real property. There can be no assurance that we would not be fully liable for the entire cost of any removal and clean-up on an acquired property, that the cost of

removal and clean-up would not exceed the value of the property, or that we could recoup any of the costs from any third party.

**Due to the nature of our business, we may be subject to litigation from time to time, some of which may not be covered by insurance.**

As a holding company and through our bank subsidiary, we operate in a highly regulated industry, and as a result, are subject to various regulations related to disclosures to our customers, our lending practices, and other fiduciary responsibilities, including those to our shareholders. From time to time, we have been, and may become, subject to legal actions relating to our operations that have involved, or could involve, claims

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for substantial monetary damages. Although we maintain insurance, the scope of this coverage may not provide us with full, or even partial, coverage in any particular case. As a result, a judgment against us in any such litigation could have a material adverse effect on our financial condition and results of operation.

**We are subject to reputational risk.**

Our actual or perceived failure to (a) identify and address potential conflicts of interest, ethical issues, money-laundering, or privacy issues; (b) meet legal and regulatory requirements applicable to the Bank and to the Company; (c) maintain the privacy of customer and accompanying personal information; (d) maintain adequate record keeping; (e) engage in proper sales and trading practices; and (f) identify the legal, reputational, credit, liquidity and market risks inherent in our products could give rise to reputational risk that could cause harm to the Bank and our business prospects. If we fail to address any of these issues in an appropriate manner, we could be subject to additional legal risks, which, in turn, could increase the size and number of litigation claims and damages asserted or subject us to enforcement actions, fines and penalties and cause us to incur related costs and expenses. Our ability to attract and retain customers and employees could be adversely affected to the extent our reputation is damaged.

**To the extent that we acquire other companies, our business may be negatively impacted by certain risks inherent with such acquisitions.**

We have acquired and will continue to consider the acquisition of other financial services companies. To the extent that we acquire other companies in the future, our business may be negatively impacted by certain risks inherent with such acquisitions. These risks include the following:

the risk that the acquired business will not perform in accordance with management's expectations;  
the risk that difficulties will arise in connection with the integration of the operations of the acquired business with the operations of our businesses;

the risk that management will divert its attention from other aspects of our business;

the risk that we may lose key employees of the combined business; and

the risks associated with entering into geographic and product markets in which we have limited or no direct prior experience.

**We may be required to write down goodwill and other identifiable intangible assets.**

When the Company acquires a business, a portion of the purchase price of the acquisition is allocated to goodwill and other identifiable intangible assets. The excess of the purchase price over the fair value of the net identifiable tangible and intangible assets acquired determines the amount of the purchase price that is allocated to goodwill acquired. At

December 31, 2011, the Company's goodwill and other identifiable intangible assets were approximately \$45.2 million. Under current accounting standards, if the Company determines goodwill or intangible assets are impaired, it would be required to write down the value of these assets. The Company conducts an annual review to determine whether goodwill and other identifiable intangible assets are impaired. The Company recently completed such an impairment analysis and concluded that goodwill was impaired by \$50,000, which resulted in an expense recorded in 2011. The Company cannot provide assurance whether it will be required to take an additional impairment charge in the future. Any impairment charge would have a negative effect on its shareholders' equity and financial results and may cause a decline in our stock price.

**We are subject to operational risk.**

We are subject to certain operational risks, including, but not limited to, information technology system failures and errors, customer or employee fraud and catastrophic failures resulting from terrorist acts or natural disasters. We depend upon information technology, software, communication, and information exchange on a variety of computing platforms and networks and over the Internet. Despite instituted safeguards, we cannot be certain that all of our systems are entirely free from vulnerability to attack or other technological difficulties or failures. If our information security is breached or other technology difficulties or failures occur,

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information may be lost or misappropriated, services and operations may be interrupted and we could be exposed to claims from customers. While we maintain a system of internal controls and procedures, any of these results could have a material adverse effect on our business, financial condition, results of operations or liquidity.

**We must adapt to information technology changes in the financial services industry, which could present operational issues, require significant capital spending, or impact our reputation.**

The financial services industry is constantly undergoing technological changes, with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and reduce costs. The Company's future success will depend, in part, upon the Company's ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional efficiencies in the Company's operations. The Company may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to the Company's customers.

**The market value of wealth management assets under administration may be negatively affected by changes in economic and market conditions.**

A substantial portion of income from fiduciary services is dependent on the market value of wealth management assets under administration, which are primarily marketable securities. Changes in domestic and foreign economic conditions, volatility in financial markets, and general trends in business and finance, all of which are beyond our control, could adversely impact the market value of these assets and the fee revenues derived from the management of these assets.

**We may not be able to attract and retain wealth management clients at current levels.**

Due to strong competition, our wealth management division may not be able to attract and retain clients at current levels. Competition is strong as there are numerous well-established and successful investment management and wealth advisory firms including commercial banks and trust companies, investment advisory firms, mutual fund companies, stock brokerage firms, and other financial companies. Our ability to attract and retain wealth management clients is dependent upon our ability to compete with competitors' investment products, level of investment performance, client services, marketing and distribution capabilities. If we are not successful, our results of operations and financial condition may be negatively impacted.

**Our shareholders may not receive dividends on the common stock.**

Holders of our common stock are entitled to receive dividends only when, and if declared by our board of directors. Although we have historically declared cash dividends on our common stock, we are not required to do so and our board of directors may reduce or eliminate our common stock dividend in the future. Further, the FRB has issued guidelines for evaluating proposals by large bank holding companies to increase dividends or repurchase or redeem shares, which includes a requirement for such firms to develop a capital distribution plan. The FRB has indicated that it is considering expanding these requirements to cover all bank holding companies, which may in the future restrict our ability to pay dividends. A reduction or elimination of dividends could adversely affect the market price of our common stock.



**Changes in accounting standards can be difficult to predict and can materially impact how we record and report our financial condition and results of operations.**

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. From time to time, the Financial Accounting Standards Board ( FASB ) changes the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be hard to anticipate and implement and can materially impact how we record and report our financial condition and results of operations. For example, the FASB 's current financial instruments project could, among other things, significantly change the way loan loss provisions are determined from an incurred loss model to an expected loss model, and may also result in most financial instruments being required to be reported at fair value.

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**Our financial statements are based in part on assumptions and estimates, which, if wrong, could cause unexpected losses in the future.**

Pursuant to U.S. generally accepted accounting principles, we are required to use certain assumptions and estimates in preparing our financial statements, including in determining credit loss reserves, reserves related to litigation and the fair value of certain assets and liabilities, among other items. If assumptions or estimates underlying our financial statements are incorrect, we may experience material losses. For additional information, see Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies.

**Our financial condition and results of operations have been adversely affected, and may continue to be adversely affected, by the U.S. and international financial market and economic conditions.**

We have been and continue to be impacted by general business and economic conditions in the United States and, to a lesser extent, abroad. These conditions include short-term and long-term interest rates, inflation, money supply, political issues, legislative and regulatory changes, fluctuations in both debt and equity capital markets, broad trends in industry and finance, unemployment and the strength of the U.S. economy and the local economies in which the Company operates, all of which are beyond the Company's control. Continued deterioration in any of these conditions could result in an increase in loan delinquencies, and non-performing assets, decreases in loan collateral values and a decrease in demand for the Company's products and services. While there are indications that the U.S. economy is stabilizing, there remains significant uncertainty regarding the sustainability of the economic recovery, unemployment levels and the impact of the U.S. government's unwinding of its extensive economic and market support.

**Continued market volatility may impact our business and the value of our common stock.**

Our business performance and the trading price of shares of our common stock may be affected by many factors affecting financial institutions, including volatility in the credit, mortgage and housing markets, the markets for securities relating to mortgages or housing, and the value of debt and mortgage-backed and other securities that we hold in our investment portfolio. Government action and legislation may also impact us and the value of our common stock. We cannot predict what impact, if any, volatility will have on our business or share price and for these and other reasons our shares of common stock may trade at a price lower than that at which they were purchased.

TABLE OF CONTENTS**Item 1B. Unresolved Staff Comments**

There are no unresolved written comments relating to our periodic or current reports under the Securities Exchange Act of 1934 that were received from the SEC staff 180 days or more before the end of our fiscal year.

**Item 2. Properties**

The Company operates in 40 facilities, all of which are fully utilized and considered suitable and adequate for the purposes intended. The Company has a 38 branch network located in 12 counties throughout Maine. The Company owns twenty-three of its branch facilities, none of which are subject to a mortgage and the remaining branch facilities and, two parking lots are leased. Related rent expense appears in Note 5 of the Consolidated Financial Statements. The following table presents our materially important properties as of December 31, 2011.

Facility Name	Location	General Character of the Physical Property	Primary Business Segment	Property Status	Property Square Feet
Main Office	Camden, Maine	3 story building	Principal executive office	Owned	15,500
Hanley Center	Rockport, Maine	2 story building	Service center	Owned	32,360
Bangor	Bangor, Maine	2 story building	Branch	Owned	25,334 <sup>(a)</sup>
Acadia Trust	Portland, Maine	1 floor	Main office	Leased	18,966 <sup>(b)</sup>
Rockland	Rockland, Maine	3 story building	Branch	Owned	21,600
Ellsworth	Ellsworth, Maine	3 story building	Branch	Owned	44,000 <sup>(a)</sup>

(a) Includes leased space to third parties.

(b) Property square feet represents the square footage occupied by the Company.

**Item 3. Legal Proceedings**

Various legal claims arise from time to time in the normal course of the Company's business, which in our opinion, are not expected to have a material effect on our Consolidated Financial Statements.

**Item 4. Removed and Reserved**

TABLE OF CONTENTS**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The Company's common stock is currently traded on the NASDAQ Global Market (NASDAQ) under the ticker symbol CAC. The Company has paid quarterly dividends since its inception in 1984 following a corporate reorganization in which the shareholders of the Bank exchanged shares of Bank stock for shares in the Company. The high and low closing sales prices (as quoted by NASDAQ for 2011 and 2010) and cash dividends paid per share of the Company's common stock, by calendar quarter for the past two years were as follows:

	2011			2010		
	Market Price		Dividends	Market Price		Dividends
	High	Low	Paid per Share	High	Low	Paid per Share
First Quarter	\$ 37.63	\$ 31.74	\$ 0.25	\$ 34.53	\$ 28.75	\$ 0.25
Second Quarter	\$ 37.67	\$ 30.95	\$ 0.25	\$ 36.94	\$ 27.42	\$ 0.25
Third Quarter	\$ 34.57	\$ 25.19	\$ 0.25	\$ 35.00	\$ 26.58	\$ 0.25
Fourth Quarter	\$ 33.12	\$ 25.80	\$ 0.75	\$ 39.63	\$ 32.63	\$ 0.25

As of December 31, 2011, there were 7,664,975 shares of the Company's common stock outstanding held of record by approximately 1,700 shareholders, as obtained through our transfer agent. Such number of record holders does not reflect the number of persons or entities holding stock in nominee name through banks, brokerage firms and other nominees, which is estimated to be 3,500 shareholders based on the number of requested copies from such institutions.

Although the Company has historically paid quarterly dividends on its common stock, the Company's ability to pay such dividends depends on a number of factors, including restrictions under federal laws and regulations on the Company's ability to pay dividends, and as a result, there can be no assurance that dividends will be paid in the future. For further information on dividend restrictions, refer to the Capital Resources section in Item 7.

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The following graph illustrates the annual percentage change in the cumulative total shareholder return of the Company's common stock for the period December 31, 2006 through December 31, 2011. For purposes of comparison, the graph illustrates comparable shareholder returns of the ABA NASDAQ Community Bank Index, the SNL \$1B - \$5B Bank Index, and the Russell 2000 Stock Index. The graph assumes a \$100 investment on December 31, 2006 in each case and measures the amount by which the market value, assuming reinvestment of dividends, has changed as of December 31, 2011.

**Stock Performance Graph**

In September 2011, the Company's board of directors authorized the 2011 Common Stock Repurchase Program (The Repurchase Program). The Repurchase Program will allow for the repurchase of up to 500,000 shares, or approximately 6.5%, of the Company's outstanding common stock over the next year when it feels conditions warrant. The following table presents the Company's purchase of equity securities during the fourth quarter of 2011.

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publically announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
November 1 - 30, 2011	7,616	\$ 29.03	7,616	492,384
December 1 - 31, 2011	5,625	29.71	5,625	486,759
Total	13,241	\$ 29.34	13,241	486,759

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	At or for the Year Ended December 31,									
(In Thousands, Except per Share Data)	2011		2010		2009		2008 <sup>(1)</sup>		2007	
Financial Condition Data										
Investments	\$611,998		\$611,643		\$539,587		\$670,040		\$483,648	
Loans and loans held for sale	1,520,089		1,530,280		1,526,758		1,500,908		1,145,639	
Allowance for loan losses	23,011		22,293		20,246		17,691		13,653	
Total assets	2,302,720		2,306,007		2,235,383		2,341,496		1,716,788	
Deposits	1,591,366		1,515,811		1,495,807		1,489,517		1,118,051	
Borrowings	456,233		559,919		527,347		661,805		460,133	
Shareholders equity	218,876		205,995		190,561		166,400		120,203	
Operating Data										
Interest income	\$98,372		\$104,507		\$113,331		\$127,120		\$107,736	
Interest expense	23,153		30,217		40,320		56,899		57,866	
Net interest income	75,219		74,290		73,011		70,221		49,870	
Provision for credit losses	4,735		6,299		8,213		4,397		100	
Net interest income after provision for credit losses	70,484		67,991		64,798		65,824		49,770	
Non-interest income before other-than-temporary impairment of securities	23,162		21,046		19,434		16,673		12,652	
Other-than-temporary impairment of securities	(109 )		(221 )		(11 )		(14,950 )			
Non-interest expense	55,579		52,937		51,005		46,829		33,686	
Income before income taxes	37,958		35,879		33,216		20,718		28,736	
Income taxes	11,781		11,113		10,443		5,383		8,453	
Net income	\$26,177		\$24,766		\$22,773		\$15,335		\$20,283	
Ratios										
Return on average assets	1.13	%	1.09	%	1.00	%	0.67	%	1.16	%
Return on average equity	12.16	%	12.42	%	12.81	%	9.15	%	18.34	%
Allowance for credit losses to total loans	1.52	%	1.46	%	1.33	%	1.18	%	1.19	%
Non-performing loans to total loans	1.82	%	1.47	%	1.29	%	0.85	%	0.93	%
Non-performing assets to total assets	1.27	%	1.08	%	1.13	%	0.71	%	0.64	%
Average equity to average assets	9.32	%	8.77	%	7.80	%	7.28	%	6.33	%
Efficiency ratio <sup>(2)</sup>	54.68	%	55.74	%	54.26	%	52.44	%	52.70	%
Tier 1 leverage capital ratio	9.59	%	8.77	%	8.17	%	7.19	%	8.55	%
Tier 1 risk-based capital ratio	14.69	%	13.80	%	12.24	%	11.11	%	13.41	%
Total risk-based capital ratio	15.95	%	15.05	%	13.49	%	12.32	%	14.64	%
Per common share data										
Basic earnings per share	\$3.41		\$3.23		\$2.98		\$2.00		\$3.09	
Diluted earnings per share	3.41		3.23		2.97		2.00		3.09	
Dividends declared per share	1.50		1.00		1.00		1.00		1.20	
Dividends paid per share	1.50		1.00		1.00		0.99		0.96	
Book value per share	28.56		26.90		24.93		21.78		18.45	

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Tangible book value per share <sup>(3)</sup>	22.66		20.91		18.86		15.62		17.79	
Dividend payout ratio	44.05	%	30.95	%	33.56	%	50.00	%	38.83	%

(1) The 2008 data includes the merger of Union Bankshares Company with and into the Company as of January 3, 2008.

Computed by dividing non-interest expense (excluding prepayment penalties) by the sum of net interest income (tax equivalent) and non-interest income (excluding security gains/losses, OTTI and proceeds from legal settlement of \$2.0 million in 2010). The Company uses certain non-GAAP financial measures, such as the efficiency ratio and tangible book value per share, to provide information for investors to effectively analyze financial trends of ongoing business activities, and to enhance comparability with peers across the financial sector.

(2) Computed by dividing shareholdings equity less goodwill and other intangibles by the number of common shares outstanding.

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## **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 our consolidated results of operations for the years ended December 31, 2011, 2010 and 2009 and financial condition at December 31, 2011 and 2010 and, where appropriate, factors that may affect our future financial performance. This discussion should be read in conjunction with the Consolidated Financial Statements, Notes to Consolidated Financial Statements and Selected Consolidated Financial Data.

### **Executive Overview**

Net income for 2011 of \$26.2 million, or \$3.41 per diluted share, was 6% higher than the net income of \$24.8 million, or \$3.23 per diluted share, reported for 2010. This financial performance translated to an increase in return on average assets to 1.13% for 2011, compared to 1.09% in 2010. The following were significant factors influencing the results of fiscal year 2011 compared to fiscal year 2010:

Total loans were \$1.5 billion, a decrease of \$10.2 million, or 1%, compared to a year ago. The decrease in total loans was primarily related to the residential real estate loan portfolio, which declined by \$17.4 million due to the sale of thirty-year fixed rate mortgages totaling \$28.6 million. The commercial and commercial real estate portfolios grew \$4.5 million and \$6.0 million, respectively, while consumer and home equity balances declined \$3.2 million; Investments at December 31, 2011 were \$612.0 million, an increase of \$355,000 compared to December 31, 2010; Total deposits of \$1.6 billion at December 31, 2011 increased \$75.6 million, or 5%, compared to December 31, 2010. During 2011, we experienced strong core deposit (demand, checking, savings, and money market accounts) growth of \$133.9 million, or 14%, which offset the decline in retail certificates of deposit of \$69.2 million, or 15%. The overall growth across our core deposits reflects excess customer liquidity and success in obtaining several large deposit relationships;

Stabilized asset quality ratios and a reduction in net loan charge-offs for the year resulted in a decline in the loan loss provision to \$4.7 million for 2011 compared to \$6.3 million in 2010. The allowance for credit losses compared to total loans was 1.52% and 1.46% at December 31, 2011 and 2010, respectively;

Non-performing assets as a percentage of total assets amounted to 1.27% and 1.08% at December 31, 2011 and 2010, respectively;

Net interest income, our primary revenue source, increased \$929,000, or 1%, due to an increase in average earning assets of \$39.2 million or 2% in 2011, partially offset by a decline in our net interest margin of three basis points to 3.57% during 2011;

Non-interest income increased \$2.2 million, or 11%, primarily due to increases in investment security gains of \$2.4 million, loan servicing income of \$1.1 million and bank-owned life insurance earnings and proceeds of \$695,000, partially offset by the \$2.0 million settlement proceeds received in 2010; and

Non-interest expenses increased \$2.6 million, or 5%, primarily as a result of the prepayment penalty on borrowings of \$2.3 million and increases in compensation and benefit costs of \$2.3 million, partially offset by declines in OREO and collections costs of \$1.4 million and FDIC assessment costs of \$913,000.

### **Critical Accounting Policies**

In preparing the Company's Consolidated Financial Statements, management is required to make significant estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses. Actual results could differ from our current estimates, as a result of changing conditions and future events. Several estimates are



particularly critical and are susceptible to significant near-term change, including the allowance for credit losses, accounting for acquisitions and our review of goodwill and other identifiable intangible assets for impairment, valuation of other real estate owned, other-than-temporary impairment of

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investments, accounting for postretirement plans, and income taxes. Our significant accounting policies and critical estimates are summarized in Note 1 to the Consolidated Financial Statements included in Item 8.

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

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

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

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

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

Because the methodology is based upon historical experience and trends as well as management's judgment, factors may arise that result in different estimations. Significant factors that could give rise to changes in these estimates may include, but are not limited to, changes in economic conditions in our market area, concentration of risk, declines in local property values, and the results of regulatory examinations. While management's evaluation of the ALL as of December 31, 2011 determined the allowance to be appropriate,

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under adversely different conditions or assumptions, we may need to increase the allowance. The Corporate Risk Management group reviews the ALL with the Bank's board of directors on a monthly basis. A more comprehensive review of the ALL is reviewed with the Company's board of directors, as well as the Bank's board of directors, on a quarterly basis.

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

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

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

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

*Effectiveness of Hedging Derivatives.* The Company maintains an overall interest rate risk management strategy that incorporates the use of interest rate contracts, which are generally non-leveraged generic interest rate and basis swaps, to minimize significant fluctuations in earnings that are caused by interest rate volatility. Interest rate contracts are used by the Company in the management of its interest rate risk position. The Company's goal is to manage interest rate sensitivity so that movements in interest rates do not significantly adversely affect earnings. When interest rates fluctuate, hedged assets and liabilities appreciate or depreciate in fair value or cash flows. Gains or losses on the derivative instruments that are linked to the hedged assets and liabilities are expected to substantially offset this unrealized appreciation or depreciation or changes in cash flows. The Company utilizes a third-party service to

evaluate the effectiveness of its cash flow hedges on a quarterly basis. The effective portion of a gain or loss on a cash flow hedge is recorded in other comprehensive income, net of tax, and other assets or other liabilities on the Consolidated Statements of Condition. The ineffective portions of cash flow hedging transactions are included in other income in the Consolidated Statements of Income, if material.

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*Accounting for Postretirement Plans.* We use a December 31 measurement date to determine the expenses for our postretirement plans and related financial disclosure information. Postretirement plan expense is sensitive to changes in the number of eligible employees (and their related demographics) and to changes in the discount rate and other expected rates, such as medical cost trends rates. As with the computations on plan expense, cash contribution requirements are also sensitive to such changes.

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

*Income Taxes.* We account for income taxes by deferring income taxes based on the estimated future tax effects of differences between the tax and book bases of assets and liabilities considering the provisions of enacted tax laws. These differences result in deferred tax assets and liabilities, which are included in the Consolidated Statements of Condition. We must also assess the likelihood that any deferred tax assets will be recovered from future taxable income and establish a valuation allowance for those assets determined not likely to be recoverable. Judgment is required in determining the amount and timing of recognition of the resulting deferred tax assets and liabilities, including projections of future taxable income. Although we have determined a valuation allowance is not required for all deferred tax assets, there is no guarantee that these assets will be realized. We are currently under review by the Internal Revenue Service for the year ended December 31, 2009. Although not currently under review, income tax returns for the years ended December 31, 2008 and 2010 are open to audit by federal and Maine authorities. If we, as a result of an audit, were assessed interest and penalties, the amounts would be recorded through other non-interest expense.

## **Non-GAAP Financial Measures and Reconciliation to GAAP**

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

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*Efficiency Ratio.* The efficiency ratio, which represents an approximate measure of the cost required for the Company to generate a dollar of revenue, is the ratio of (i) total non-interest expense excluding prepayment penalties (the numerator) to (ii) net interest income on a fully taxable equivalent basis plus total non-interest income excluding net gains or losses on sale of securities, OTTI, and proceeds from a 2010 legal settlement (the denominator).

(In Thousands)	At or for the Year Ended December 31,				
	2011	2010	2009	2008	2007
Non-interest expense, as presented	\$55,579	\$52,937	\$51,005	\$46,829	\$33,686
Prepayment penalty on borrowings	2,318				
Adjusted non-interest expense	53,261	52,937	51,005	46,829	33,686
Net interest income, as presented	75,219	74,290	73,011	70,221	49,870
Effect of tax-exempt income	1,212	1,452	1,628	1,765	1,393
Non-interest income	23,053	20,825	19,423	1,723	12,652
Gains (losses) on sale of securities	2,185	(188 )	52	(624 )	
Other-than-temporary impairment of securities	(109 )	(221 )	(11 )	(14,950)	
Legal settlement proceeds		2,000			
Adjusted net interest income plus non-interest income	\$97,408	\$94,976	\$94,021	\$89,283	\$63,915
Non-GAAP efficiency ratio	54.68 %	55.74 %	54.26 %	52.44 %	52.70 %
GAAP efficiency ratio	56.49 %	55.53 %	55.17 %	53.89 %	53.88 %

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

(In Thousands)	At or for the Year Ended December 31,				
	2011	2010	2009	2008	2007
Net interest income, as presented	\$ 75,219	\$ 74,290	\$ 73,011	\$ 70,221	\$ 49,870
Effect of tax-exempt income	1,212	1,452	1,628	1,765	1,393
Net interest income, tax equivalent	\$ 76,431	\$ 75,742	\$ 74,639	\$ 71,986	\$ 51,263

*Tangible Book Value per Share.* Tangible book value per share is the ratio of (i) shareholders equity less goodwill, premium on deposits and other acquisition-related intangibles (the numerator) to (ii) total common shares outstanding at period end. The following table reconciles tangible book value per share to book value per share.

(In Thousands, Except per Share Data)	At or for the Year Ended December 31,				
	2011	2010	2009	2008	2007
Shareholders equity	\$218,876	\$205,995	\$190,561	\$166,400	\$120,203
Less goodwill and other intangibles	45,194	45,821	46,379	47,083	4,327
Tangible shareholders equity	\$173,682	\$160,174	\$144,182	\$119,317	\$115,876
Shares outstanding at period end	7,664,975	7,658,496	7,644,837	7,638,713	6,513,573
Tangible book value per share	\$22.66	\$20.91	\$18.86	\$15.62	\$17.79
Book value per share	\$28.56	\$26.90	\$24.93	\$21.78	\$18.45





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## Results of Operations

For the year ended December 31, 2011, we reported record net income of \$26.2 million compared to \$24.8 million for the year ended December 31, 2010, and \$22.8 million for the year ended December 31, 2009. Diluted earnings per share for each of these years were \$3.41, \$3.23, and \$2.97, respectively. The major components of these results, which include net interest income, provision for credit losses, non-interest income, non-interest expense, and income taxes, are discussed below.

### Net Interest Income

Net interest income is interest earned on loans, securities, and other earning assets, plus loan fees, less the interest paid on interest-bearing deposits and borrowings. Net interest income, which is our largest source of revenue and accounts for approximately 77% of total revenues, is affected by factors including, but not limited to: changes in interest rates, loan and deposit pricing strategies and competitive conditions, the volume and mix of interest-earning assets and interest-bearing liabilities, and the level of non-performing assets.

Net interest income was \$76.4 million on a fully-taxable equivalent basis for 2011, compared to \$75.7 million for 2010, an increase of \$689,000, or 1%. The increase in net interest income was primarily due to growth in our average earning assets of \$39.2 million, partially offset by a three basis point decline in our net interest margin. The tax equivalent net interest margin was 3.57% and 3.60% for the years ended December 31, 2011 and 2010, respectively. The yield on our earning assets averaged 4.65% in 2011 compared to 5.04% in 2010, a decrease of 39 basis points, as amortization and prepayments on loans and investments are reinvested at lower rates, particularly in the investment portfolio. The cost of funds averaged 1.27% in 2011, compared to 1.64% in 2010, as a result of lower interest rates and a favorable shift in the deposit mix to lower cost transaction accounts. Average balance sheet growth was funded primarily by growth in average core deposits (demand deposits, interest checking, savings and money market accounts) of \$112.3 million, or 12%. Average balances on retail certificates of deposit declined \$84.0 million as customers continue to shift to more liquid deposit instruments given the current low interest rate environment.

Net interest income was \$75.7 million on a fully-taxable equivalent basis for 2010, compared to \$74.6 million for 2009, an increase of \$1.1 million, or 2%. The increase in net interest income was primarily due to an improvement of seven basis points in the net interest margin, to 3.60%, for 2010. Total average interest-earning assets decreased \$10.9 million for 2010 compared to 2009, primarily due to decreases in investments, partially offset by increases in average loans of \$25.9 million. The yield on earning assets averaged 5.04% in 2010 compared to 5.44% in 2009, a decrease of 40 basis points. The earning asset yield declined during 2010 primarily as the result of reinvestment of cash flows at lower rates. Average interest-bearing liabilities decreased \$48.6 million for 2010 compared to 2009, primarily due to declines in Federal Home Loan Bank ( FHLB ) advances, in part offset by an increase in brokered deposits. The cost of funds averaged 1.64% in 2010 compared to 2.13% in 2009, a decrease of 49 basis points. The cost of funds declined in 2010 due to lower interest rates on deposit accounts, maturing retail certificates of deposit and wholesale funding combined with a favorable change in our deposit mix as a result of growth in lower cost deposit accounts. The average balance for demand deposit, interest checking, savings and money market accounts increased \$64.8 million, or 8%, to \$909.2 million for 2010.

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The following table presents, for the years noted, average balances, interest income, interest expense, and the corresponding average yields earned and rates paid, as well as net interest income, net interest rate spread and net interest margin:

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

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The following table presents certain information on a fully-taxable equivalent basis regarding changes in interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided with respect to changes attributable to rate and volume.

(Dollars in Thousands)	December 31, 2011 vs. 2010			December 31, 2010 vs. 2009		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest-earning assets:						
Securities taxable	\$2,099	\$(4,028)	\$(1,929)	\$(1,354)	\$(4,200)	\$(5,554 )
Securities nontaxable	(614 )	(77 )	(691 )	(530 )	70	(460 )
Trading account assets	5	(2 )	3	8	4	12
Residential real estate	(1,611)	(1,370)	(2,981)	(125 )	(2,436)	(2,561 )
Commercial real estate	1,115	(1,220)	(105 )	1,744	(1,426)	318
Commercial	147	(604 )	(457 )	(498 )	(208 )	(706 )
Municipal	167	(158 )	9	(256 )	78	(178 )
Consumer	72	(297 )	(225 )	653	(524 )	129
Total interest income	1,380	(7,756)	(6,376)	(358 )	(8,642)	(9,000 )
Interest-bearing liabilities:						
Interest checking accounts	19	(371 )	(352 )	162	(343 )	(181 )
Savings accounts	46	(87 )	(41 )	57	(89 )	(32 )
Money market accounts	425	(464 )	(39 )	(84 )	(666 )	(750 )
Certificates of deposit	(1,571)	(1,754)	(3,325)	(1,725)	(4,625)	(6,350 )
Brokered deposits	298	(93 )	205	688	(809 )	(121 )
Junior subordinated debentures	7	(210 )	(203 )	7	(35 )	(28 )
Borrowings	(762 )	(2,548)	(3,310)	(1,573)	(1,068)	(2,641 )
Total interest expense	(1,538)	(5,527)	(7,065)	(2,468)	(7,635)	(10,103)
Net interest income (fully-taxable equivalent)	\$2,918	\$(2,229)	\$689	\$2,110	\$(1,007)	\$1,103

**Provision and Allowance for Loan Losses**

The provision for loan losses is a recorded expense determined by management that adjusts the allowance for loan losses to a level, which, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. The provision for loan losses reflects loan quality trends, including, among other factors, the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans, net charge-offs or recoveries and growth in the loan portfolio. Accordingly, the amount of the provision reflects both the necessary increases in the allowance for loan losses related to newly identified criticized loans, as well as the actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools. The provision for credit losses for 2011 totaled \$4.7 million, or 0.31% of average loans, compared with \$6.3 million in 2010 and \$8.2 million in 2009. Please see the caption "Asset Quality" located below for additional discussion regarding the allowance for loan losses.

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Non-interest income represented 21.8%, 22.2% and 21.0% of total revenues (net interest income and non-interest income), before net securities gains, losses and OTTI, for the years ended December 31, 2011, 2010 and 2009, respectively. Non-interest income of \$23.1 million for 2011 increased \$2.2 million, or 11%, compared to \$20.8 million for 2010. The following table presents the components of non-interest income:

(Dollars in Thousands)	Year Ended December 31,		
	2011	2010	2009
Income from fiduciary services	\$ 6,027	\$ 6,236	\$ 5,902
Service charges on deposit accounts	5,134	4,911	5,261
Other service charges and fees	3,577	3,345	2,908
Proceeds from legal settlement		2,000	
Bank-owned life insurance	2,173	1,478	1,476
Brokerage and insurance commissions	1,363	1,449	1,356
Mortgage banking income, net	729	761	1,314
Other income	1,974	1,054	1,154
Non-interest income before security gains (losses)	20,977	21,234	19,371
Net gains (losses) on sale of securities	2,185	(188 )	63
Other-than-temporary impairment of securities	(109 )	(221 )	(11 )
Total non-interest income	\$ 23,053	\$ 20,825	\$ 19,423

The significant changes in non-interest income in 2011 compared to 2010 include:

Increase in net gains on sale of securities of \$2.4 million related to sale of \$54.6 million in available-for-sale ( AFS ) securities during 2011 and a decrease in OTTI of \$112,000;

Increase in other income primarily related to a \$1.1 million increase in loan servicing income resulted from the growth of our loan servicing business, which services 9,000 MaineHousing loans;

Increase in bank-owned life insurance income of \$695,000, primarily related to revenue recorded from insurance proceeds; and

Legal settlement proceeds of \$2.0 million recorded in 2010, related to the Company's investment in auction pass-through certificates with Federal Home Loan Mortgage Corporation ( Freddie Mac ) for preferred stock assets which resulted in an OTTI write-down of \$15.0 million in 2008.

Non-interest income increased to \$20.8 million for the year ended December 31, 2010, compared to non-interest income of \$19.4 million in 2009, an increase of \$1.4 million. The increase was primarily related to: legal settlement proceeds of \$2.0 million recorded in 2010; increase in fiduciary services of \$334,000, resulting from the market value increases in assets under management; an increase in other service charges and fees of \$437,000, resulting from increased debit card income associated with increased transaction volume; decrease in mortgage banking income of \$553,000, due to the decline in loan sales proceeds to \$20.2 million in 2010 compared to \$72.6 million during 2009; and a decrease in service charges on deposit accounts of \$350,000 resulting primarily from a decrease in overdraft fee income associated with recent regulation prohibiting financial institutions from charging consumers fees for paying overdrafts on automated teller machines and debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those types of transactions.

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Non-interest expenses increased \$2.6 million, or 5%, for the year ended December 31, 2011 compared to the year ended December 31, 2010. The following table presents the components of non-interest expense:

(Dollars in Thousands)	Year Ended December 31,		
	2011	2010	2009
Salaries and employee benefits	\$ 28,627	\$ 26,337	\$ 24,588
Furniture, equipment and data processing	4,773	4,647	4,150
Net occupancy	3,949	3,833	3,908
Consulting and professional fees	2,629	2,596	2,455
OREO and collection costs	2,104	3,459	2,314
Regulatory assessments	1,955	2,868	4,035
Amortization of identifiable intangible assets	577	577	578
Prepayment penalty on borrowings	2,318		
Other expenses	8,647	8,620	8,977
Total non-interest expenses	\$ 55,579	\$ 52,937	\$ 51,005

The significant changes in non-interest expenses in 2011 compared to 2010 include:

Prepayment penalty on wholesale borrowings of \$2.3 million as a result of the refinancing of \$70.0 million of wholesale borrowings that had an average cost of 4.90% into lower cost short-term funds;

An increase in salaries and employee benefits of \$2.3 million, or 9%, primarily due to increases in incentive compensation of \$1.4 million, based on the Company's 2011 financial performance, which exceeded the benchmarks determined by the board of directors, salaries of \$522,000, or 3%, due to merit increases and new positions, and health insurance cost and retirement expenses of \$414,000, or 12%;

A decrease in OREO and collection costs of \$1.4 million, or 39%, primarily due to a \$1.4 million decrease in write-downs on OREO properties;

A decrease in regulatory assessments of \$913,000, or 32%, primarily due to a decrease in the FDIC deposit assessment fee related to change in the assessment base from deposits to assets minus tangible equity; and

The efficiency ratio (non-interest expense excluding prepayment penalties divided by net interest income on a tax equivalent basis plus non-interest income excluding net investment securities gains/losses, OTTI and proceeds from legal settlement) was 54.68% for the year ended December 31, 2011, compared to 55.80% for 2010.

Total non-interest expense increased \$1.9 million, or 4%, for the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase was primarily due to: increase in salaries and employee benefits of \$1.7 million, primarily due to a \$799,000 increase in benefits associated with increased health insurance cost and retirement expenses: a reduction in deferred salary costs of \$522,000 related to the decline in mortgage production volume in 2010: an increase in salary and incentives of \$504,000 due to merit increases and new positions; an increase in furniture, equipment and data processing of \$497,000, related to depreciation associated with investments in technology, including a telephone system and document imaging technology; an increase in foreclosure and collection costs and expenses on OREO of \$1.2 million, which includes OREO write-downs of \$1.6 million due to declining real estate values; and a decrease in regulatory assessments of \$1.2 million, related to the FDIC special assessment imposed on all banks in 2009.



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### **Income Taxes**

Income tax expense totaled \$11.8 million, \$11.1 million and \$10.4 million for the years ended December 31, 2011, 2010 and 2009, respectively. The Company's effective income tax rate was approximately 31.0%, 31.0%, and 31.4% in each of the past three years, respectively. These effective rates differ from our marginal rate of about 35%, primarily due to our significant non-taxable interest income from state and political subdivisions obligations. A full detail of these amounts can be found in Note 10 to the Consolidated Financial Statements.

### **Impact of Inflation and Changing Prices**

The Consolidated Financial Statements and the Notes to Consolidated Financial Statements presented in Item 8, Financial Statements and Supplementary Data, have been prepared in accordance with accounting principles generally accepted in the United States of America, which require the measurement of financial position and operating results in terms of historical dollars and, in some case, current fair values without considering changes in the relative purchasing power of money over time due to inflation. Unlike many industrial companies, substantially all of our assets and virtually all of our liabilities are monetary in nature. As a result, interest rates have a more significant impact on our performance than the general level of inflation. Over short periods of time, interest rates and the yield curve may not necessarily move in the same direction or in the same magnitude as inflation.

## **Financial Condition**

### **Overview**

Total assets at December 31, 2011 were \$2.3 billion, a slight decline of \$3.3 million compared to December 31, 2010. At December 31, 2011, total loans were \$1.5 billion, a decrease of \$10.2 million, or 1%, compared to a year ago. The decrease in total loans was primarily related to the residential real estate loan portfolio, which declined by \$17.4 million due to the sale of thirty-year fixed rate mortgages totaling \$27.6 million. Total liabilities decreased \$16.2 million as total borrowings decreased \$103.7 million, partially offset by an increase in total deposits (including brokered deposits) of \$75.6 million. Total shareholders' equity increased \$12.9 million, which was a result of earnings in 2011 of \$26.2 million offset by dividends declared of \$11.5 million and a decrease of \$2.3 million in other comprehensive income.

Growth in total deposits resulted from strong core deposit growth of \$133.9 million, or 14%, which was offset by the decline in retail certificates of deposit of \$69.2 million, or 15%. The overall growth across our core deposits reflects excess customer liquidity and success in obtaining several large deposit relationships.

Average assets during 2011 were \$2.3 billion, an increase of \$34.8 million, compared to 2010. This increase was primarily the result of an increase in average investments of \$42.6 million offset by decline in average loans of \$3.4 million. Average interest bearing liabilities decreased \$23.4 million in 2011 compared to 2010; however, the deposit mix reflected an increase in average core deposits (interest checking, savings and money market accounts) of \$72.9 million and brokered deposits of \$17.4 million, partially offset by a decline in average retail certificates of deposit of \$84.0 million and average wholesale funding (excluding brokered deposits) of \$29.8 million. In addition, average demand deposit balances grew \$39.4 million. Average shareholders' equity increased \$15.9 million, which was primarily the result of current earnings, partially offset by other comprehensive income and dividends declared to shareholders.

## Investment Securities

We invest in securities of U.S. government sponsored enterprises, states and political subdivisions, mortgage-backed securities, FHLB and Federal Reserve Bank ( FRB ) stock, investment grade corporate bonds and equities to diversify our revenues, interest rate and credit risk, and to provide for liquidity and funding needs. Total investment securities increased \$355,000 to \$612.0 million at December 31, 2011. At December 31, 2010, we held investment securities in both the AFS and held-to-maturity ( HTM ) portfolios. During 2011, we transferred \$36.1 million of municipal bonds from the HTM portfolio to the AFS portfolio. This change reflects management's decision during 2011 to more actively manage these investments in changing economic environments.



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Unrealized gains or losses on securities classified as AFS are recorded as adjustments to shareholders' equity, net of related deferred income taxes and are a component of other comprehensive income in the Consolidated Statements of Changes in Shareholders' Equity and Note 19 to the Consolidated Financial Statements. At December 31, 2011, we had \$11.1 million of unrealized gains on AFS securities, net of deferred taxes, compared to \$6.2 million of unrealized gains, net of deferred taxes, at December 31, 2010. The increase in unrealized gains from 2010 to 2011 is primarily attributed to a decline in market interest rates.

Within our AFS portfolio, we hold senior tranches of non-agency collateralized mortgage obligations ( CMOs ), which were rated Triple-A by Moody's, S&P and/or Fitch at the time of purchase. At December 31, 2011, six of our CMOs were non-investment grade, with fair values of \$9.7 million, and unrealized losses of \$1.8 million. We believe that the decline in the fair values is primarily a reflection of the lack of liquidity in the market and not deterioration in the credit. The Company has the intent and ability to hold these securities until recovery and will continue to evaluate the unrealized losses within our portfolio each quarter to determine if the impairment is other than temporary.

We determine if a security has OTTI by evaluating the present value of projected credit losses that result from a discounted cash flow analysis. Each month we obtain various discounted cash flow models, stress tests, and other current information about our securities. Currently, we use the Bloomberg's Cash Flow Analyzer. We review the significant inputs of the discounted cash flow analysis to ensure reasonableness and a prudent measure, we compare the Bloomberg assumptions to the assumptions used by FTN Financial, which is a division of First Tennessee Bank. Included in the monthly analyses is a review of the performance of the individual tranches held and the related entire issue, a base case and several stress test scenarios. The base case scenario uses current data and historical performance, which provides a basis for determining if a credit loss is projected during the life of the security. Stress tests are performed on our higher risk securities (non-investment grade and/or coverage ratio of less than 1.00) using current statistical data to determine expected cash flows and forecast potential losses. Based on the results of this analysis, the Company recorded \$109,000 OTTI write-downs on two private issue CMOs during 2011, compared to a \$221,000 write-down in 2010. During 2011, the Company recorded proceeds of \$7.8 million on the sale of three investment grade CMO investments classified as AFS, which resulted in a net realized gain of \$153,000.

At December 31, 2011, the Company held Duff & Phelps Select Income Fund Auction Preferred Stock with an amortized cost of \$5.0 million. The security, which has maintained its Triple-A rating by Moody's and Standard and Poor's, has failed at auction. Management believes the failed auctions are a temporary liquidity event related to this asset class of securities. No OTTI has been recorded as the Company is currently collecting all amounts due according to contractual terms and has the ability and intent to hold the securities until they clear auction, are called, or mature.

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The following table presents the carrying amount and fully-taxable equivalent weighted average yields of our investment securities by contractual maturity as of the dates indicated.

**Federal Home Loan Bank Stock**

We are required to maintain a level of investment in FHLB of Boston ( FHLBB ) stock based on the level of our FHLBB advances. At December 31, 2011, our investment in FHLBB stock totaled \$21.0 million. No market exists for shares of the FHLBB. FHLBB stock may be redeemed at par value five years following termination of FHLBB membership, subject to limitations which may be imposed by the FHLBB or its regulator, the Federal Housing Finance Agency, to maintain capital adequacy of the FHLBB. While we currently have no intention to terminate our FHLBB membership, the ability to redeem our investment in FHLBB stock would be subject to the conditions imposed by the FHLBB.

In early 2009, the FHLBB advised its members that it was focused on preserving capital in response to ongoing market volatility. Accordingly, payments of quarterly dividends were suspended for 2009 and 2010 and the FHLBB placed a moratorium on excess stock repurchases from its members. The FHLBB commenced quarterly dividends in 2011 at a current annual yield of approximately the daily average of the three-month LIBOR yield.

**Loans**

We provide loans primarily to customers located within our geographic market area. At December 31, 2011, total loans of \$1.5 billion (including loans held-for-sale) decreased \$10.2 million from December 31, 2010, primarily related to the residential real estate loan portfolio (net of deferred fees), which declined by \$18.0 million due to the sale of thirty-year fixed rate mortgages in 2011 totaling \$28.6 million. The commercial and commercial real estate portfolios grew \$4.5 million and \$6.0 million, respectively, while consumer and home equity balances declined \$3.2 million.

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The following table sets forth the composition of our loan portfolio at the dates indicated.

*Residential real estate loans.* Residential real estate loans consist of loans secured by one to four-family residences.

We generally retain in our portfolio adjustable-rate mortgages and fixed-rate mortgages with original terms of 20 years or less. Based on market risk assessments, we may retain thirty-year fixed-rate mortgages. We originated and sold \$28.6 million in residential fixed-rate real estate production on the secondary market to Freddie Mac, and \$6.1 million of loans were held for sale at December 31, 2011. In 2010, residential real estate loan balances decreased \$31.3 million, or 5% from 2009 due to the sale of \$20.1 million in production on the secondary market.

*Commercial real estate loans.* Commercial real estate loans consist of loans secured by income and non-income producing commercial real estate. We focus on lending to financially sound business customers within our geographic marketplace, as well as offering loans for the acquisition, development and construction of commercial real estate. In 2011, commercial real estate loans increased \$6.0 million, or 1%, from 2010, and in 2010, commercial real estate loans increased \$29.3 million, or 7%, from 2009. We have experienced five consecutive years of growth in commercial real estate portfolio because of the opportunity created by the pull-back of many financial institutions in this segment.

*Commercial loans.* Commercial loans consist of loans secured by various corporate assets, as well as loans to provide working capital in the form of lines of credit, which may be secured or unsecured. Municipal loans primarily consist of short-term tax anticipation notes made to municipalities for fixed asset or construction related purposes and are included in commercial loans. We focus on lending to financially sound business customers and municipalities within our geographic marketplace. In 2011, commercial loans increased \$4.5 million, or 2%, from 2010 and in 2010, commercial loans decreased \$10.6 million, or 6%, from 2009.

*Consumer loans and home equity loans.* Consumer loans and home equity loans are originated for a wide variety of purposes designed to meet the needs of our customers. Consumer loans include overdraft protection, automobile, boat, recreational vehicle, and mobile home loans, home equity loans and lines, and secured and unsecured personal loans. In 2011, consumer loans decreased by \$3.2 million, or 1%, from 2010. In 2010, consumer loans increased by \$10.7 million, or 4%, from 2009.

## **Asset Quality**

The board of directors monitors credit risk management through the Directors Loan Committee and Corporate Risk Management. The Directors Loan Committee reviews large exposure credit requests, monitors asset quality on a regular basis and has approval authority for credit granting policies. Corporate Risk Management oversees management's systems and procedures to monitor the credit quality of the loan portfolio, conduct a loan review program, maintain the integrity of the loan rating system and determine the adequacy of the ALL. Our practice is to identify problem credits early and take charge-offs as promptly as practical. In addition, management continuously reassesses its underwriting standards in response to credit risk posed by changes in economic conditions.

*Non-Performing Assets.* Non-performing assets include non-accrual loans, accruing loans 90 days or more past due, accruing renegotiated loans and property acquired through foreclosure or repossession. The level of our non-performing assets over the past five (5) years is shown in the table below. Non-performing assets represented 1.27% of total assets as of December 31, 2011 compared to 1.08% at year-end 2010. While this ratio has increased over last year, it continues to compare favorably to our peer group's most recently available ratio of 3.57% as of September 30, 2011. For purposes of comparison, this peer data is based upon



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information available through the FFIEC for banks and holding companies with \$1-\$3 billion in assets (peer group 3).

Overall, the increase in the Company's non-performing assets is attributable to the generally weak economy, substantial changes in real estate valuations, and legislative changes that have resulted in lengthening foreclosure timelines, among other factors.

(Dollars in Thousands)	December 31,				
	2011	2010	2009	2008	2007
Non-accrual loans					
Residential real estate loans	\$9,503	\$7,225	\$6,161	\$4,048	\$1,800
Commercial real estate	7,830	6,072	6,476	4,957	6,625
Commercial loans	3,955	4,421	4,145	2,384	2,200
Consumer loans	2,822	1,721	1,158	1,112	
Non-accrual loans	24,110	19,439	17,940	12,501	10,625
Accruing loans past due 90 days	236	711	1,135	206	6
Accruing renegotiated loans not included above	3,276	2,295	581		
Total non-performing loans	27,622	22,445	19,656	12,707	10,631
Other real estate owned	1,682	2,387	5,479	4,024	400
Total non-performing assets	\$29,304	\$24,832	\$25,135	\$16,731	\$11,031
Non-performing loans to total loans	1.82 %	1.47 %	1.29 %	0.85 %	0.93 %
Allowance for credit losses to non-performing loans	83.38 %	99.44 %	103.26 %	139.22 %	128.43 %
Non-performing assets to total assets	1.27 %	1.08 %	1.13 %	0.71 %	0.64 %
Allowance for credit losses to non-performing assets	78.59 %	89.88 %	80.75 %	105.73 %	123.77 %

Generally, a loan is classified as non-accrual when interest and/or principal payments are 90 days past due or when management believes collecting all principal and interest owed is in doubt. All previously accrued but unpaid interest on non-accrual loans is reversed from interest income in the current period. Interest payments received on non-accrual loans (including impaired loans) are applied as a reduction of principal. A loan remains on non-accrual status until all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Non-accrual loans at December 31, 2011 were \$24.1 million compared to \$19.4 million a year ago. This \$4.7 million increase in non-accruals is primarily attributable to the continued pressure on homeowners and real estate values affecting both the residential real estate and home equity loan (included in consumer) portfolios.

Interest income that would have been recognized if loans on non-accrual status had been current in accordance with their original terms was approximately \$1.1 million, \$985,000 and \$961,000 in 2011, 2010, and 2009, respectively.

Interest income attributable to these loans included in the Consolidated Statements of Income amounted to approximately \$141,000, \$36,000 and \$12,000 in 2011, 2010 and 2009, respectively.

The OREO balance at December 31, 2011 consisted of fifteen properties, including ten residential properties and five commercial/mixed use properties. After foreclosure, management periodically obtains updated valuations of the OREO assets and, if additional impairments are deemed necessary, the subsequent write-downs for declines in value are recorded. During 2011, the Company recorded OREO write-downs of \$188,000 related to five properties.

*Potential Problem Loans.* Potential problem loans consist of classified accruing commercial and commercial real estate loans that were between 30 and 89 days past due. Such loans are characterized by weaknesses in the financial

condition of our borrowers or collateral deficiencies. Based on historical experience, the credit quality of some of these loans may improve due to changes in collateral values or the financial condition of the borrowers, while the credit quality of other loans may deteriorate, resulting in some amount of loss. These loans are not included in the above analysis of non-accrual loans. At December 31,

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2011, potential problem loans amounted to approximately \$1.6 million, or 0.11% of total loans, compared to \$1.8 million, or 0.12% of total loans, at December 31, 2010.

*Past Due Loans.* Past due loans consist of accruing loans that were between 30 and 89 days past due. The following table sets presents past due loans at the dates indicated:

(Dollars in Thousands)	December 31, 2011	December 31, 2010
Loans 30 – 89 days past due:		
Residential real estate loans	\$ 2,429	\$ 2,493
Commercial real estate	2,107	1,439
Commercial loans	911	928
Consumer loans	1,793	926
Total loans 30 – 89 days past due	\$ 7,240	\$ 5,786
Loans 30 – 89 days past due to total loans	0.48 %	0.38 %

*Allowance for Loan Losses.* We use a methodology to systematically measure the amount of estimated loan loss exposure inherent in the loan portfolio for purposes of establishing a sufficient ALL. The ALL is management's best estimate of the probable loan losses as of the balance sheet date. The allowance is increased by provisions charged to earnings and by recoveries of amounts previously charged-off, and is reduced by charge-offs on loans. During 2011, there were no significant changes to the allowance assessment methodology.

*Reserve for Unfunded Commitments.* The reserve for unfunded commitments is based on management's estimate of the amount required to reflect the probable inherent losses on outstanding letters and unused loan credit lines. Adequacy of the reserve is determined using a methodology similar to the one that analyzes the allowance for loan losses. Additionally, management must also estimate the likelihood that these commitments would be funded and become loans.

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

(Dollars in Thousands)	Years Ended December 31,									
	2011		2010		2009		2008		2007	
Allowance for loan losses at the beginning of period	\$22,293		\$20,246		\$17,691		\$13,653		\$14,933	
Acquired from Union Trust							4,369			
Provision for loan losses	4,741		6,325		8,162		4,397		100	
Charge-offs:										
Residential real estate loans	1,216		1,262		792		221		50	
Commercial real estate	1,633		1,382		1,844		3,236		416	
Commercial loans	1,256		1,502		2,640		1,286		1,411	
Consumer loans	920		1,401		1,180		810		315	
Total loan charge-offs	5,025		5,547		6,456		5,553		2,192	
Recoveries:										
Residential real estate loans	120		225		10		12			
Commercial real estate loans	374		232		127		78		215	
Commercial loans	296		553		306		422		425	
Consumer loans	212		259		406		313		172	
Total loan recoveries	1,002		1,269		849		825		812	
Net charge-offs	4,023		4,278		5,607		4,728		1,380	
Allowance for loan losses at the end of the period	\$23,011		\$22,293		\$20,246		\$17,691		\$13,653	
Components of allowance for credit losses:										
Allowance for loan losses	\$23,011		\$22,293		\$20,246		\$17,691		\$13,653	
Liability for unfunded credit commitments	20		25		51					
Balance of allowance for credit losses at end of the period	\$23,031		\$22,318		\$20,297		\$17,691		\$13,653	
Average loans outstanding	\$1,530,640		\$1,534,069		\$1,508,204		\$1,517,863		\$1,187,627	
Net charge-offs to average loans outstanding	0.26	%	0.28	%	0.37	%	0.31	%	0.12	%
Provision for credit losses to average loans outstanding	0.31	%	0.41	%	0.54	%	0.29	%	0.01	%
Allowance for loan losses to total loans	1.52	%	1.46	%	1.33	%	1.18	%	1.19	%
Allowance for credit losses to net charge-offs	572.59	%	521.61	%	361.99	%	374.18	%	989.35	%
Allowance for loan losses to non-performing loans	83.31	%	99.32	%	103.00	%	39.22	%	128.43	%

During 2011, the Company provided \$4.7 million of expense to the ALL compared to \$6.3 million for 2010. As stated previously, the determination of an appropriate level of ALL, and subsequent provision for loan losses, which affects earnings, is based on our analysis of various economic factors and our review of the loan portfolio, which may change due to numerous factors including, but not limited to, loan growth, payoffs of lower quality loans, recoveries on previously charged-off loans, improvement in the financial condition of the borrowers, risk rating downgrades/upgrades and charge-offs. We utilize a comprehensive approach toward determining the ALL, which



includes an expanded risk rating system to assist us in identifying the risks being undertaken, as well as migration within the overall loan portfolio. The decrease in the provision for loan

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losses was primarily a result of stabilized asset quality ratios and a decline in net loan charge-offs. Non-performing assets as a percentage of total assets increased to 1.27% at December 31, 2011 compared to 1.08% and 1.13% at December 30, 2010 and 2009, respectively, as a result of an increase in non-accrual loans. Our local economy continues to experience a decline in retail sales, sustained unemployment, and an overall decline in real estate values. We believe the ALL of \$23.0 million, or 1.52% of total loans outstanding and 83.31% of total non-performing loans at December 31, 2011, was appropriate given the current economic conditions in our service area and the condition of the loan portfolio, although, if conditions continue to deteriorate, the provision will likely be increased. The ALL was 1.46% of total loans outstanding and 99.32% of total non-performing loans at December 31, 2010.

We remain vigilant in the monitoring of asset quality and continue to be proactive in resolving credit issues and managing through the economic cycle. We believe the economy is still in a credit cycle correction and could be negatively affected by national, regional and local economic impacts. We continue to have concerns regarding various industries, including hospitality and commercial real estate, and do not yet know how or when the economy will improve. An additional future risk factor is a potential change in federal and state regulations which may impact a bank's ability to take appropriate action to protect its financial interests in certain loan situations.

For further discussion of the ALL, refer to Critical Accounting Policies above and Notes 1 and 3 to the Consolidated Financial Statements.

The following table sets forth information concerning the allocation of the ALL by loan categories at the dates indicated.

Prior to the Company's recognition in 2009 of a separate reserve for unfunded commitments, a portion of the unallocated category was reserved for inherent losses in the off-balance sheet exposures, which are not recognized in the separate liability.

### **Investment in Bank-Owned Life Insurance**

Bank-owned life insurance ( BOLI ) amounted to \$43.7 million and \$43.2 million at December 31, 2011 and 2010, respectively, with the net increase due to normal increases in the cash surrender value less proceeds from death benefits. BOLI provides a means to mitigate increasing employee benefit costs. We expect to benefit from the BOLI contracts as a result of the tax-free growth in cash surrender value and death benefits that are expected to be generated over time. The largest risk to the BOLI program is credit risk of the insurance carriers. To mitigate this risk, annual financial condition reviews are completed on all carriers. BOLI is invested in the general account of quality insurance companies or in separate account products. All such general account carriers were rated A or better by two of the three major rating agencies at December 31, 2011. BOLI is included in the Consolidated Statements of Condition at its cash surrender value. Increases in BOLI's cash surrender value are reported as a component of non-interest income in the Consolidated Statements of Income.

TABLE OF CONTENTS**Deposits**

The Bank receives checking, savings and time deposits primarily from customers located within its geographic market area, from the brokered deposit market, and the Certificate of Deposit Account Registry System. Total deposits of \$1.6 billion at December 31, 2011 increased \$75.6 million from 2010. The deposit growth was primarily derived from low cost deposits with an increase in demand deposit balances of \$26.8 million, or 12%, and increases in interest checking, savings and money market accounts of \$107.1 million, or 15%. Brokered funds increased \$10.9 million, or 11%, as a result of more favorable pricing compared to other funding alternatives. Growth in total deposits was partially offset by a decline in retail certificates of deposit of \$69.2 million as customers shifted to more liquid deposit accounts in response to the low interest rate environment.

In 2010, total deposits increased \$20.0 million from 2009. Core deposit growth was strong with increases in demand deposit balances of \$36.0 million and increases in interest checking, savings and money market accounts of \$46.2 million. Brokered funds increased \$18.9 million as a result of more favorable pricing compared to other funding alternatives. Growth in total deposits was partially offset by a decline in retail certificates of deposit of \$81.1 million.

**Borrowings**

In 2011, borrowings decreased \$103.7 million, or 19%, from 2010 primarily due to decreases in FHLBB advances and retail and commercial repurchase agreements of \$77.4 million, \$11.7 million, and \$35.1 million, respectively. The Company prepaid \$70.0 million in wholesale borrowings in 2011, resulting in prepayment penalties totaling \$2.3 million. These borrowings had an average cost of 4.90% and an average remaining maturity of 10 months. These decreases were partially offset by increases in overnight funding of \$21.4 million. In 2010, borrowings increased \$32.6 million, or 6%, from 2009 primarily due to an increase in retail repurchase agreements of \$43.3 million and FHLB overnight funds of \$8.6 million, partially offset by a decline in commercial repurchase agreements of \$20.1 million.

The borrowings we utilized have primarily been advances from the FHLBB. In addition, we use Federal Funds, treasury, tax and loan deposits and repurchase agreements secured by United States government or agency securities. Approximately 24% of all borrowings mature or reprice within the next three months. The following table presents certain information regarding short-term borrowings included in other borrowed funds as of or for the years ended:

(Dollars in Thousands)	December 31,					
	2011		2010		2009	
Balance outstanding at end of year	\$202,928		\$193,930		\$145,541	
Average balance outstanding	202,423		188,663		190,142	
Maximum amount outstanding at any month-end during the year	287,334		268,197		277,562	
Weighted average interest rate during the year	0.35	%	0.63	%	0.81	%
Weighted average interest rate at end of year	0.22	%	0.45	%	1.06	%

TABLE OF CONTENTS**Shareholders Equity**

Total shareholders equity increased \$12.9 million, or 6%, since December 31, 2010, which was primarily a result of current year earnings of \$26.2 million and net unrealized gains on securities available for sale, net of tax of \$4.9 million, offset by dividends declared to shareholders of \$11.5 million and other comprehensive loss on derivatives and postretirement benefits of \$7.2 million.

The following table presents certain information regarding shareholders equity for the years ended:

	December 31,		
	2011	2010	2009
Return on average equity	12.16 %	12.42 %	12.81 %
Average equity to average assets	9.32 %	8.77 %	7.80 %
Dividend payout ratio	44.05 %	30.95 %	33.56 %
Dividends declared per share	\$ 1.50	\$ 1.00	\$ 1.00
Book value per share	28.56	26.90	24.93

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Our liquidity needs require the availability of cash to meet the withdrawal demands of depositors and credit commitments to borrowers. Liquidity is defined as our ability to maintain availability of funds to meet customer needs, as well as to support our asset base. The primary objective of liquidity management is to maintain a balance between sources and uses of funds to meet our cash flow needs in the most economical and expedient manner. Due to the potential for unexpected fluctuations in both deposits and loans, active management of liquidity is necessary. We maintain various sources of funding and levels of liquid assets in excess of regulatory guidelines in order to satisfy their varied liquidity demands. We monitor liquidity in accordance with internal guidelines and all applicable regulatory requirements. As of December 31, 2011 and 2010, our level of liquidity exceeded target levels. We believe that we currently have appropriate liquidity available to respond to liquidity demands. Sources of funds that we utilize consist of deposits, borrowings from the FHLBB and other sources, cash flows from operations, prepayments and maturities of outstanding loans, investments and mortgage-backed securities and the sales of mortgage loans.

Deposits continue to represent our primary source of funds. In 2011, average deposits (including brokered deposits) of \$1.6 billion increased \$45.8 million compared to 2010. Comparing average deposits for 2011 to 2010, we experienced growth in the average balances of money market accounts of \$51.9 million, demand deposits of \$39.4 million, brokered deposits of \$17.4 million, savings accounts of \$15.4 million, and interest checking accounts of \$5.6 million, while average retail certificate of deposit balances declined \$84.0 million. Included in the money market and interest checking deposit categories are deposits from our wealth management subsidiary, Acadia Trust, N.A., which represent client funds. The deposits in the Acadia Trust, N.A. client accounts, which totaled \$106.8 million at December 31, 2011, fluctuate with changes in the portfolios of the clients of Acadia Trust, N.A. The movement from retail certificates of deposit to other core deposit categories reflects customers continuing shift to more liquid deposit instruments given the current low interest rate environment.

The maturity dates of certificates of deposit, including brokered certificates of deposit, in denominations of \$100,000 or more are set forth in the following table. These deposits are generally considered to be more rate sensitive than other deposits and, therefore, more likely to be withdrawn to obtain higher yields elsewhere if available.

(Dollars in Thousands)	December 31, 2011
Time remaining until maturity:	
Less than 3 months	\$ 33,175
3 months through 6 months	28,568
6 months through 12 months	29,717
Over 12 months	103,341
	\$ 194,801

Borrowings are used to supplement deposits as a source of liquidity. In addition to borrowings from the FHLBB, we purchase federal funds, sell securities under agreements to repurchase and utilize Treasury Tax and Loan accounts.

Average borrowings and long-term debt for 2011 were \$494.7 million, a decrease of \$29.8 million, or 5.7%, from 2010. We secure borrowings from the FHLBB, whose advances remain the largest non-deposit-related funding source, with qualified residential real estate loans, certain investment securities and certain other assets available to be pledged. The carrying value of loans pledged as collateral at the FHLBB was \$698.8 million and \$738.3 million at December 31, 2011 and 2010, respectively. The carrying value of securities pledged as collateral at the FHLBB was \$8.3 million and \$16.8 million at December 31, 2011 and 2010, respectively. Through the Bank, we have an available

line of credit with the FHLBB of \$9.9 million at December 31, 2011 and 2010. We had no outstanding balance on the line of credit with the FHLBB at December 31, 2011. Long-term borrowings represent securities sold under repurchase agreements with major brokerage firms and a note payable with a maturity date over one year. Both wholesale and retail repurchase agreements are secured by mortgage-backed securities and government sponsored enterprises. The Company has \$10.0 million in other lines of credit with a maturity date of December 20, 2012. We had no outstanding balance on these lines of credit at December 31, 2011.

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

Loan demand also affects our liquidity position. Of the loans maturing over one year, approximately 55% are variable rate loans. The following table presents the maturities of loans at December 31, 2011:

(Dollars in Thousands)	< 1 Year	1 Through 5 Years	More than 5 Years	Total
Maturity Distribution:				
Fixed Rate:				
Residential real estate	\$ 2,546	\$ 13,082	\$ 415,685	\$ 431,313
Commercial real estate	7,131	52,005	29,438	88,574
Commercial	10,030	28,415	13,308	51,753
Consumer	2,410	9,327	74,006	85,743
Municipal	1,185	7,361	4,517	13,063
Total Fixed Rate	23,302	110,190	536,954	670,446
Variable Rate:				
Residential real estate	21	605	146,323	146,949
Commercial real estate	19,613	49,210	312,664	381,487
Commercial	41,045	19,559	59,625	120,229
Consumer	687	589	193,641	194,917
Municipal				
Total Variable Rate	61,366	69,963	712,253	843,582
	\$ 84,668	\$ 180,153	\$ 1,249,207	\$ 1,514,028

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## Capital Resources

Under FRB guidelines, we are required to maintain capital based on risk-adjusted assets. These capital requirements represent quantitative measures of our assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. Our capital classification is also subject to qualitative judgments by our regulators about components, risk weightings and other factors. Quantitative measures established by regulation to ensure capital adequacy require us to maintain minimum amounts and ratios of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined in the regulations), and of Tier 1 capital to average assets (as defined in the regulations). These guidelines apply to us on a consolidated basis. Under the current guidelines, banking organizations must maintain a risk-based capital ratio of 8.0%, of which at least 4.0% must be in the form of core capital (as defined in the regulations). Our risk-based ratios and those of the Bank, exceeded regulatory guidelines at December 31, 2011 and 2010. The Company's Tier 1 capital to risk-weighted assets was 14.69% and 13.80% at December 31, 2011 and 2010, respectively, and its ratio of total capital to risk-weighted assets was 15.95% and 15.05% at December 31, 2011 and 2010, respectively. In addition to risk-based capital requirements, the FRB requires bank holding companies to maintain a minimum leverage capital ratio of core capital to total assets of 4.0%. Total assets for this purpose do not include goodwill and any other intangible assets and investments that the FRB determines should be deducted. Our leverage ratio was 9.59% and 8.77% at December 31, 2011 and 2010, respectively.

Although the junior subordinated debentures are recorded as a liability on our Consolidated Statements of Condition, we are permitted, in accordance with regulatory guidelines, to include, subject to certain limits, the trust preferred securities in our calculation of risk-based capital. At December 31, 2011, \$43.0 million of the trust preferred securities was included in Tier 1 and total risk-based capital.

As part of our goal to operate a safe, sound and profitable financial organization, we are committed to maintaining a strong capital base. Shareholders' equity totaled \$218.9 million and \$206.0 million at December 31, 2011 and 2010, respectively, which amounted to 9.5% and 8.9% of total assets at December 31, 2011 and 2010, respectively.

Our principal cash requirement is the payment of dividends on our common stock, as and when declared by the board of directors. We paid dividends to shareholders in the aggregate amount of \$11.5 million and \$7.7 million for 2011 and 2010, respectively. Our board of directors approves cash dividends on a quarterly basis after careful analysis and consideration of various factors, including the following: a) capital position relative to total assets, b) risk-based assets, c) total classified assets, d) economic conditions, e) growth rates for total assets and total liabilities, f) earnings performance and projections and g) strategic initiatives and related capital requirements. All dividends declared and distributed by the Company will be in compliance with applicable state corporate law and regulatory requirements.

We are primarily dependent upon the payment of cash dividends by our subsidiaries to service our commitments. We, as the sole shareholder of our subsidiaries, are entitled to dividends, when and as declared by each subsidiary's respective board of directors from legally available funds. The Bank declared dividends in the aggregate amount of \$13.5 million and \$12.0 million for 2011 and 2010, respectively. Under regulations prescribed by the Office of the Comptroller of the Currency (OCC), without prior OCC approval, the Bank may not declare dividends in any year in excess of the Bank's (i) net income for the current year, (ii) plus its retained net income for the prior two years. If we are required to use dividends from the Bank to service unforeseen commitments in the future, we may be required to reduce the dividends paid to our shareholders going forward.

On September 27, 2011, the board of directors authorized the 2011 Common Stock Repurchase Program (The Repurchase Program). The Repurchase Program will allow for the repurchase of up to 500,000 shares, or approximately 6.5%, of the Company's outstanding common stock over the next year when it feels conditions warrant.





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On April 29, 2003, our shareholders approved the 2003 Stock Option and Incentive Plan (the Plan ). The maximum number of shares of stock reserved and available for issuance under the Plan is 800,000 shares. Awards may be granted in the form of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, deferred stock, unrestricted stock, performance shares and dividend equivalent rights, or any combination of the preceding, and the exercise price shall not be less than 100% of the fair market value on the date of grant in the case of incentive stock options, or 85% of the fair market value on the date of grant in the case of non-qualified stock options. No stock options are exercisable more than ten years after the date the stock option is granted. Prior to April 29, 2003, we had three stock option plans. Under all three plans, the options vested over a five year period, and expire ten years from the date the option was granted. The exercise price of all options equaled the market price of our stock on the date of grant. For further information on equity compensation plans and related accounting treatment, refer to Note 1 and Note 14 in the Notes to Consolidated Financial Statements in Item 8.

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In the normal course of business, we are a party to credit related financial instruments with off-balance sheet risk, which are not reflected in the Consolidated Statements of Condition. These financial instruments include lending commitments and letters of credit. Those instruments involve varying degrees of credit risk in excess of the amount recognized in the Consolidated Statements of Condition. We follow the same credit policies in making commitments to extend credit and conditional obligations as we do for on-balance sheet instruments, including requiring similar collateral or other security to support financial instruments with credit risk. Our exposure to credit loss in the event of nonperformance by the customer is represented by the contractual amount of those instruments. Since many of the commitments are expected to expire without being drawn upon, the total amount does not necessarily represent future cash requirements. At December 31, 2011, we had the following levels of commitments to extend credit:

(Dollars in Thousand)	Total Amount Committed	Commitment Expires in:			
		<1 Year	1 3 Years <sup>4</sup>	5 Years	>5 Years
Letters of credit	\$ 1,178	\$ 1,178	\$	\$	\$
Commercial commitment letters	21,972	21,972			
Residential loan origination	2,060	2,060			
Home equity line of credit commitments	254,603	74,805	2,124	851	176,823
Other commitments to extend credit	1,932	1,932			
Total	\$ 281,745	\$ 101,947	\$ 2,124	\$ 851	\$ 176,823

We are a party to several off-balance sheet contractual obligations through lease agreements on a number of branch facilities. We have an obligation and commitment to make future payments under these contracts. At December 31, 2011, we had the following levels of contractual obligations:

(Dollars in Thousands)	Total Amount Committed	Payments Due per Period			
		<1 Year	1 3 Years <sup>4</sup>	5 Years	>5 Years
Operating leases	\$ 2,195	\$ 543	\$ 584	\$ 304	\$ 764
Capital leases	1,125	48	103	117	857 <sup>(a)</sup>
Federal funds purchased overnight	50,000	50,000			
FHLBB borrowings overnight	8,700	8,700			
FHLBB borrowings advances	136,860	45,090	25,523	46,247	20,000
Commercial repurchase agreements	71,243	5,000	36,000	25,000	5,243
Retail repurchase agreements	144,228	144,228			
Junior subordinated debentures	43,717				43,717
Note payable	360	275	85		
Total	\$ 458,428	\$ 253,884	\$ 62,295	\$ 71,668	\$ 70,581

<sup>(a)</sup> Excludes contingent rentals, which are based on the Consumer Price Index and reset every five years. Total contingent rentals for year one through year five are \$30,000.

Borrowings from the FHLBB consist of short- and long-term fixed and variable rate borrowings that are collateralized by all stock in the FHLBB and a blanket lien on qualified collateral consisting primarily of loans with first mortgages secured by one-to four-family properties, certain pledged investment securities and other qualified assets. Other borrowed funds include treasury, tax and loan deposits and securities sold under repurchase agreements. We have an

obligation and commitment to repay all borrowings and debentures. These commitments, borrowings, junior subordinated debentures and the related payments are made during the normal course of business.

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We may use derivative instruments as partial hedges against large fluctuations in interest rates. We may also use fixed-rate interest rate swap and floor instruments to partially hedge against potentially lower yields on the variable prime rate loan category in a declining rate environment. If rates were to decline, resulting in reduced income on the adjustable rate loans, there would be an increased income flow from the interest rate swap and floor instruments. We may also use variable-rate interest rate swap and cap instruments to partially hedge against increases in short-term borrowing rates. If rates were to rise, resulting in an increased interest cost, there would be an increased income flow from the interest rate swap and cap instruments. These financial instruments are factored into our overall interest rate risk position. We regularly review the credit quality of the counterparty from which the instruments have been purchased. At December 31, 2011, the Company had five interest rate swaps, three with a notional amount of \$10.0 million, one with a notional amount of \$8.0 million, and one with a notional amount of \$5.0 million, related to the junior subordinated debentures, expiring on June 30, 2021, June 30, 2029, June 30, 2030, July 7, 2031, and March 30, 2031, respectively.

At December 31, 2011, the Company had a notional amount of \$6.1 million in an interest rate swap agreement with a commercial customer and an equal notional amount with a dealer bank related to the Company's commercial loan level derivative program. This program allows the Company to retain variable-rate commercial loans while allowing the customer to synthetically fix the loan rate by entering into a variable-to-fixed interest rate swap. It is anticipated that, over time, customer interest rate derivatives will reduce the interest rate risk inherent in the longer-term, fixed-rate commercial business.

## **Market Risk**

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

## **Interest Rate Risk**

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

The simulation model captures the impact of changing interest rates on the interest income received and interest expense paid on all interest-earning assets and interest-bearing liabilities reflected on our Consolidated Statements of Condition, as well as for derivative financial instruments, if any. None of the assets used in the simulation were held for trading purposes. This sensitivity analysis is compared to ALCO policy limits, which specify a maximum tolerance level for NII exposure over a one-year horizon, assuming no balance sheet growth, given a 200 basis point

( bp ) upward and 200 bp downward shift in interest rates. Although our policy specifies a downward shift of 200 bp, this could result in negative rates as many benchmark rates are currently below 2.00%. A parallel and pro rata shift in rates over a 12-month period is assumed. Using this approach, we are able to produce reports that illustrate the effect that both a gradual change of rates (Year 1) and a rate shock (and beyond) has on margin expectations. In the down 100 bp scenario, Federal Funds and Treasury yields are floored at 0.01% while Prime is floored at 3.00%. All other market rates are floored at 0.25%.

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During the fourth quarter of 2011 and 2010, our NII sensitivity analysis reflected the following changes to NII assuming no balance sheet growth and a parallel shift in interest rates over a one-year horizon. All rate changes were ramped over the first 12-month period and then maintained at those levels over the remainder of the ALCO simulation horizon.

Rate Change from Year 1 Base	Estimated Changes in NII	
	2011	2010
Year 1		
+400 bp	(1.10 )%	(1.30 )%
+200 bp	(1.10 )%	(1.30 )%
-100 bp	(1.00 )%	(0.40 )%
Year 2		
Base	(4.30 )%	(1.70 )%
+400 bp	(1.50 )%	(2.10 )%
+200 bp	(1.30 )%	(0.30 )%
-100 bp	(10.00 )%	(6.10 )%

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

The most significant factors affecting the changes in market risk exposure during 2011 were the slowdown in loan growth and continued growth in core deposits placing pressure on asset yield and overall balance sheet spread. If rates remain at or near current levels and the balance sheet mix remains similar, net interest income is projected to trend downward as the investment and loan cashflows materialize and are replaced in today's lower rate environment with insufficient offsets from funding cost reductions. A falling interest rate environment places the most stress on net interest income as asset yields continue to fall and funding costs hit their assumed floor. In a rising interest rate environment, net interest income levels are initially expected to trend closely with the current rates scenario as short term funding cost adjustments materialize faster than asset yields improve. By Year 2, although at a lower starting point, net interest income begins to improve as funding cost increases slow while asset cashflows materialize and are continually cycled into the elevated rate environment. If the yield curve were to flatten as rates rise, net interest income improves but not to quite the same level as created with the parallel yield curve environment. Long term, rising rate scenarios provide the best case net interest income for the Company. The risk in the various rate scenarios is within our policy limits.

Periodically, if deemed appropriate, we use interest rate swaps, floors and caps, which are common derivative financial instruments, to hedge our interest rate risk position. The board of directors has approved hedging policy statements governing the use of these instruments. As of December 31, 2011, we had a notional principal amount of \$43.0 million in interest rate swap agreements related to the junior subordinated debentures, and a \$6.1 million interest rate swap related to the Company's commercial loan level derivative program. The Board and Management ALCO monitor derivative activities relative to their expectations and our hedging policies.

## **Other Market Risk(s)**

We are also subject to other market risks, including but not limited to, operational risks, actions of government agencies, solvency of counter-parties, changes in investment markets, and changes in consumer demand. For further descriptions of these additional market risks, refer to Item 1A. Risk Factors.



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## **Recent Accounting Pronouncements**

See Note 1 to the Consolidated Financial Statements for details of recently issued accounting pronouncements and their expected impact on our financial statements.

## **Related Party Transactions**

The Bank is permitted, in its normal course of business, to make loans to certain officers and directors of the Company and its subsidiaries under terms that are consistent with the Bank's lending policies and regulatory requirements. In addition to extending loans to certain officers and directors of the Company and its subsidiaries on terms consistent with the Bank's lending policies, federal banking regulations also require training, audit and examination of the adherence to this policy by representatives of the federal and national regulators (also known as Regulation O requirements). Notes 3 and 8 of the Notes to Consolidated Financial Statements provide related party lending and deposit information. We have not entered into significant non-lending related party transactions.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

The information contained in the Market Risk section of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation is incorporated herein by reference.

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## Item 8. Financial Statements and Supplementary Data

### CONSOLIDATED STATEMENTS OF CONDITION

(In Thousands, Except Number of Shares and per Share Data)	December 31,	
	2011	2010
<b>ASSETS</b>		
Cash and due from banks	\$39,325	\$31,009
Securities		
Securities available for sale, at fair value	590,036	553,579
Securities held to maturity, at amortized cost (fair value \$38,037 at December 31, 2010)		36,102
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	21,962	21,962
Total securities	611,998	611,643
Trading account assets	2,244	2,304
Loans held for sale	6,061	5,528
Loans	1,514,028	1,524,752
Less allowance for loan losses	(23,011 )	(22,293 )
Net loans	1,491,017	1,502,459
Goodwill and other intangible assets	45,194	45,821
Bank-owned life insurance	43,672	43,155
Premises and equipment, net	24,113	25,044
Deferred tax asset	13,486	12,281
Interest receivable	6,431	6,875
Prepaid FDIC assessment	4,796	6,155
Other real estate owned	1,682	2,387
Other assets	12,701	11,346
Total assets	\$2,302,720	\$2,306,007
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>Deposits</b>		
Demand	\$256,330	\$229,547
Interest checking, savings and money market	828,977	721,905
Retail certificates of deposit	395,431	464,662
Brokered deposits	110,628	99,697
Total deposits	1,591,366	1,515,811
Federal Home Loan Bank advances	136,860	214,236
Other borrowed funds	275,656	302,069
Junior subordinated debentures	43,717	43,614
Accrued interest and other liabilities	36,245	24,282
Total liabilities	2,083,844	2,100,012
Commitments and Contingencies (Notes 5, 13, 14, 16 and 18)		
<b>Shareholders Equity</b>		
Common stock, no par value; authorized 20,000,000 shares, issued and outstanding 7,664,975 and 7,658,496 shares at December 31, 2011 and 2010, respectively	51,438	50,936

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Retained earnings	165,377	150,730
Accumulated other comprehensive income (loss)		
Net unrealized gains on securities available for sale, net of tax	11,128	6,229
Net unrealized losses on derivative instruments, at fair value, net of tax	(7,264 )	(709 )
Net unrecognized losses on postretirement plans, net of tax	(1,803 )	(1,191 )
Total accumulated other comprehensive income	2,061	4,329
Total shareholders' equity	218,876	205,995
Total liabilities and shareholders' equity	\$2,302,720	\$2,306,007

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

TABLE OF CONTENTS**CONSOLIDATED STATEMENTS OF INCOME**

(In Thousands, Except Number of Shares and per Share Data)	Years Ended December 31,		
	2011	2010	2009
Interest Income			
Interest and fees on loans	\$78,174	\$81,935	\$84,901
Interest on U.S. government and sponsored enterprise obligations	18,342	20,335	25,851
Interest on state and political subdivision obligations	1,662	2,111	2,450
Interest on federal funds sold and other investments	194	126	129
Total interest income	98,372	104,507	113,331
Interest Expense			
Interest on deposits	11,591	15,143	22,577
Interest on borrowings	8,948	12,257	14,898
Interest on junior subordinated debentures	2,614	2,817	2,845
Total interest expense	23,153	30,217	40,320
Net interest income	75,219	74,290	73,011
Provision for credit losses	4,735	6,299	8,213
Net interest income after provision for credit losses	70,484	67,991	64,798
Non-Interest Income			
Income from fiduciary services	6,027	6,236	5,902
Service charges on deposit accounts	5,134	4,911	5,261
Other service charges and fees	3,577	3,345	2,908
Net gains (losses) on sale of securities	2,185	(188)	63
Bank-owned life insurance	2,173	1,478	1,476
Proceeds from legal settlement		2,000	
Brokerage and insurance commissions	1,363	1,449	1,356
Mortgage banking income, net	729	761	1,314
Other income	1,974	1,054	1,154
Total non-interest income before other-than-temporary impairment of securities	23,162	21,046	19,434
Other-than-temporary impairment of securities	(109)	(221)	(11)
Total non-interest income	23,053	20,825	19,423
Non-Interest Expenses			
Salaries and employee benefits	28,627	26,337	24,588
Furniture, equipment and data processing	4,773	4,647	4,150
Net occupancy	3,949	3,833	3,908
Consulting and professional fees	2,629	2,596	2,455
Other real estate owned and collection costs	2,104	3,459	2,314
Regulatory assessments	1,955	2,868	4,035
Amortization of identifiable intangible assets	577	577	578
Other expenses	10,965	8,620	8,977
Total non-interest expenses	55,579	52,937	51,005
Income before income taxes	37,958	35,879	33,216
Income Taxes	11,781	11,113	10,443
Net Income	\$26,177	\$24,766	\$22,773

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Per Share Data

Basic earnings per share	\$3.41	\$3.23	\$2.98
Diluted earnings per share	\$3.41	\$3.23	\$2.97
Weighted average number of common shares outstanding	7,672,126	7,655,668	7,642,492
Diluted weighted average number of common shares outstanding	7,679,895	7,663,498	7,653,973

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

TABLE OF CONTENTS**CONSOLIDATED STATEMENTS OF CHANGES IN  
SHAREHOLDERS EQUITY**

(In Thousands, Except Number of Shares and per Share Data)	Common Stock		Retained Earnings	Accumulated	Total Shareholders Equity
	Shares Outstanding	Amount		Other Comprehensive Income (Loss)	
Balance at December 31, 2008	7,638,713	\$48,984	\$118,564	\$ (1,148 )	\$166,400
Net income for 2009			22,773		22,773
Other comprehensive income, net of tax:					
Change in fair value of securities available for sale				7,172	7,172
Change in fair value of cash flow hedges				739	739
Change in net unrecognized losses on postretirement plans				102	102
Total comprehensive income			22,773	8,013	30,786
Stock-based compensation expense		1,072			1,072
Exercise of stock options and issuance of restricted stock	7,814	6			6
Common stock repurchased	(1,690 )		(55 )		(55 )
Cash dividends declared (\$1.00 per share)			(7,648 )		(7,648 )
Balance at December 31, 2009	7,644,837	50,062	133,634	6,865	190,561
Net income for 2010			24,766		24,766
Other comprehensive loss, net of tax:					
Change in fair value of securities available for sale				(854 )	(854 )
Change in fair value of cash flow hedges				(1,448 )	(1,448 )
Change in net unrecognized losses on postretirement plans				(234 )	(234 )
Total comprehensive income			24,766	(2,536 )	22,230
Stock-based compensation expense		809			809
Exercise of stock options and issuance of restricted stock, net of repurchase for tax withholdings and tax benefit	16,251	114			114
Common stock repurchased	(2,592 )	(49 )			(49 )
Cash dividends declared (\$1.00 per share)			(7,670 )		(7,670 )
Balance at December 31, 2010	7,658,496	50,936	150,730	4,329	205,995
Net income for 2011			26,177		26,177
Other comprehensive income (loss), net of tax:					
Change in fair value of securities available for sale				4,899	4,899
Change in fair value of cash flow hedges				(6,555 )	(6,555 )
				(612 )	(612 )

Change in net unrecognized losses on postretirement plans					
Total comprehensive income			26,177	(2,268 )	23,909
Stock-based compensation expense	1,025				1,025
Exercise of stock options and issuance of restricted stock, net of repurchase for tax withholdings and tax benefit	19,723	(134 )			(134 )
Common stock repurchased	(13,244 )	(389 )			(389 )
Cash dividends declared (\$1.50 per share)			(11,530 )		(11,530 )
Balance at December 31, 2011	7,664,975	\$51,438	\$165,377	\$2,061	\$218,876

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

TABLE OF CONTENTS**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In Thousands)	Years Ended December 31,		
	2011	2010	2009
Operating Activities			
Net income	\$26,177	\$24,766	\$22,773
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for credit losses	4,735	6,299	8,213
Depreciation and amortization	3,703	3,189	2,688
Stock-based compensation expense	1,025	809	1,072
Decrease in interest receivable	444	361	1,089
Amortization of intangible assets	577	577	578
Net decrease (increase) in trading assets	60	(579 )	(421 )
Net (gains) losses on sale of securities	(2,185 )	188	(63 )
Other-than-temporary impairment of securities	109	221	11
Increase in other real estate owned valuation allowance	188	1,606	1,006
Originations of mortgage loans held for sale	(29,126 )	(25,615 )	(72,529 )
Proceeds from the sale of mortgage loans	28,885	20,193	72,615
Gain on sale of mortgage loans	(292 )	(106 )	(86 )
Liquidation of defined benefit pension plan			(735 )
Decrease (increase) in prepaid FDIC assessment	1,359	2,042	(8,197 )
Increase in other assets	(3,187 )	(1,530 )	(1,790 )
Increase (decrease) in other liabilities	951	3,387	(3,811 )
Net cash provided by operating activities	33,423	35,808	22,413
Investing Activities			
Proceeds from sale and maturities of securities held to maturity	251	1,765	4,038
Proceeds from sales and maturities of securities available for sale	227,003	203,172	192,586
Purchase of securities available for sale	(219,092)	(279,313)	(55,460 )
Net decrease (increase) in loans	2,992	(7,061 )	(31,075 )
Proceeds from the sale of other real estate owned	2,506	2,965	959
Proceeds from bank-owned life insurance	1,656		258
Recoveries of previously charged-off loans	1,002	1,269	849
Purchase of premises and equipment	(1,516 )	(2,459 )	(2,493 )
Net cash provided (used) by investing activities	14,802	(79,662 )	109,662
Financing Activities			
Net increase in deposits	75,559	19,992	6,263
Proceeds from Federal Home Loan Bank long-term advances	235,000	75,000	11,663
Repayments on Federal Home Loan Bank long-term advances	(312,355)	(70,387 )	(60,879 )
Net change in short-term Federal Home Loan Bank borrowings	(28,575 )	5,100	(128,160 )
Net increase in other borrowed funds	2,509	22,985	41,318
Common stock repurchase	(389 )	(49 )	(55 )
Exercise of stock options and issuance of restricted stock, net of repurchase for tax withholdings and tax benefit	(134 )	114	6
Cash dividends paid on common stock	(11,524 )	(7,664 )	(7,654 )
Net cash (used) provided by financing activities	(39,909 )	45,091	(137,498 )



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Net increase (decrease) in cash and cash equivalents	8,316	1,237	(5,423 )
Cash and cash equivalents at beginning of year	31,009	29,772	35,195
Cash and cash equivalents at end of year	\$39,325	\$31,009	\$29,772
Supplemental information			
Interest paid	\$23,901	\$30,969	\$41,349
Income taxes paid	12,097	12,985	8,250
Transfer of loans to other real estate owned	1,989	1,479	3,420

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

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## CAMDEN NATIONAL CORPORATION

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Amounts in Tables Expressed in Thousands, Except Number of Shares and per Share Data)

### 1. Summary of Significant Accounting Policies

Camden National Corporation (the *Company*), a Maine corporation, is the bank holding company for Camden National Bank (the *Bank*) and Acadia Trust, N.A. The Bank serves individuals, businesses, municipalities and non-profits through a network of 41 banking offices and ATMs in Maine. Acadia Trust, N.A. provides trust and investment management services to its clients, who are primarily located in the State of Maine, and to clients of the Bank.

The accounting and reporting policies conform to accounting principles generally accepted in the United States of America ( *GAAP* ) and to general practice within the banking industry. The following is a summary of the significant accounting and reporting policies.

*Principles of Consolidation.* The accompanying Consolidated Financial Statements include the accounts of the Company, the Bank (a wholly-owned bank subsidiary), and Acadia Trust, N.A. (a wholly-owned non-bank subsidiary). All intercompany accounts and transactions have been eliminated in consolidation. Assets held by the non-bank subsidiary in a fiduciary capacity are not assets of the Company and, therefore, are not included in the Consolidated Statements of Condition. The Company also owns 100% of the common stock of Camden Capital Trust A and Union Bankshares Capital Trust I. These entities are unconsolidated subsidiaries of the Company.

*Reclassifications.* Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

*Use of Estimates in the Preparation of Financial Statements.* The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could vary from these estimates. Several estimates are particularly critical and are susceptible to significant near-term change, including the allowance for loan losses ( *ALL* ), other real estate owned ( *OREO* ), postretirement benefits and asset impairment judgments including other-than-temporary declines in the value of securities and the recoverability of goodwill, other intangible assets and deferred tax assets.

*Subsequent Events.* The Company has evaluated events and transactions subsequent to December 31, 2011 for potential recognition or disclosure as required by GAAP.

*Cash and Cash Equivalents.* For the purposes of reporting cash flows, cash and cash equivalents consist of cash on hand and amounts due from banks. The Bank is required by the Federal Reserve System to maintain non-interest bearing cash reserves equal to a percentage of deposits. The Company maintains the reserve balances in cash on hand

or at the Federal Reserve Bank ( FRB ).

*Securities.* Marketable equity and debt securities are classified as either available for sale securities or held to maturity securities. Management determines the classification of a security at the time of its purchase.

Securities which the Company has the positive intent and ability to hold to maturity are classified as held to maturity and reported at amortized cost. All other securities are classified as available for sale and reported at fair value. Unrealized gains and temporary unrealized losses on securities classified as available for sale are reported on an after-tax basis in shareholders' equity as accumulated other comprehensive income or loss. Federal Home Loan Bank ( FHLB ) and FRB stocks are non-marketable equity securities reported at cost and evaluated for impairment.

Premiums and discounts are recognized in interest income using the interest method over the period to maturity. Security transactions are recorded on the trade date. Realized gains and losses are determined using the specific identification method and reported in non-interest income.

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## CAMDEN NATIONAL CORPORATION

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Amounts in Tables Expressed in Thousands, Except Number of Shares and per Share Data)

### 1. Summary of Significant Accounting Policies (continued)

Management conducts a periodic review and evaluation of the securities portfolio to determine if the decline in fair value of any security appears to be other-than-temporary. The factors considered by management in its periodic review include, but are not limited to: the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, the ratings of the security, whether the decline in fair value appears to be issuer specific or, alternatively, a reflection of general market or industry conditions, and the Company's intent and ability to hold the security for a period of time sufficient to allow for a recovery in fair value.

Declines in the fair value of individual equity securities that are deemed to be other-than-temporary are reflected in non-interest income when identified. For individual debt securities where the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary decline in the fair value of the debt security related to 1) credit loss is recognized in non-interest income and 2) other factors is recognized in other comprehensive income or loss. Credit loss is deemed to exist if the present value of expected future cash flows using the interest rate at acquisition is less than the amortized cost basis of the debt security. For individual debt securities where the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the date of the consolidated statement of condition.

The Company is a member of the FHLB of Boston ( FHLBB ). As a requirement of membership, the Company must own a minimum amount of FHLB stock based on the level of its FHLB advances. No market exists for shares of the FHLB and therefore they are carried at par value. FHLB stock may be redeemed at par value five years following termination of FHLB membership, subject to limitations which may be imposed by the FHLB or its regulator, the Federal Housing Finance Agency, to maintain capital adequacy of the FHLB. While the Company currently has no intentions to terminate its FHLB membership, the ability to redeem its investment in FHLB stock would be subject to the conditions imposed by the FHLB. The FHLB suspended dividends in 2009 and 2010 to preserve capital. The FHLB reinstated quarterly dividend payments in the first quarter of 2011. The FHLB moratorium on excess stock repurchases from its members still remains in place. The Company will continue to monitor its investment in FHLB stock.

*Loans and Allowance for Loan Losses.* Loans held for sale are reported at the lower of cost or market value in the aggregate, with any adjustment for net unrealized losses reported in non-interest income. All other loans in the aggregate are reported at amortized cost adjusted for any charge-offs, the ALL and any deferred fees or costs. From time to time, management identifies and designates certain residential mortgage loans (either newly originated mortgage loans or held in the loan portfolio) for sale, and, accordingly, these loans are transferred to loans held for sale.

The ALL is established through provisions for credit losses charged to income. Losses on loans, including impaired loans, are charged to the ALL when all or a portion of a loan is deemed to be uncollectible. Recoveries of loans previously charged off are credited to the ALL when realized.

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

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## **CAMDEN NATIONAL CORPORATION**

# **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Amounts in Tables Expressed in Thousands, Except Number of Shares and per Share Data)**

### **1. Summary of Significant Accounting Policies (continued)**

The Company uses a risk rating system to determine the credit quality of loans and applies the related loss allocation factors. In assessing the risk rating of a particular loan, the Company considers, among other factors, the obligor's debt capacity, financial condition, the level of the obligor's earnings, the amount and sources of repayment, the performance with respect to loan terms, the adequacy of collateral, the level and nature of contingent liabilities, management strength, and the industry in which the obligor operates. These factors are based on an evaluation of historical information, as well as subjective assessment and interpretation of current conditions. Emphasizing one factor over another, or considering additional factors that may be relevant in determining the risk rating of a particular loan but which are not currently an explicit part of our methodology, could impact the risk rating assigned to that loan. The Company periodically reassesses and revises the loss allocation factors used in the assignment of loss exposure to appropriately reflect the analysis of loss experience. Portfolios of more homogenous populations of loans including home equity and consumer loans are analyzed as groups taking into account delinquency rates and other economic conditions which may affect the ability of borrowers to meet debt service requirements, including interest rates and energy costs. The Company also considers the results of regulatory examinations, historical loss ranges, portfolio composition, and other changes in the portfolio. An additional allocation is determined based on a judgmental process whereby management considers qualitative and quantitative assessments of other environmental factors. An unallocated portion of the total allowance is maintained to allow for shifts in portfolio composition and to account for uncertainty in the economic environment.

Since the methodology is based upon historical experience and trends as well as management's judgment, factors may arise that result in different estimations. Significant factors that could give rise to changes in these estimates may include, but are not limited to, changes in economic conditions in the Company's market area, concentration of risk, declines in local property values, and results of regulatory examinations.

Loans past due 30 days or more are considered delinquent. In general, consumer loans will be charged off if the loan is delinquent for 90 consecutive days. Commercial and real estate loans may be charged off in part or in full if they appear uncollectible.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all principal and interest due according to the contractual terms of the loan. Impairment is measured on a loan by loan basis for commercial, commercial real estate, and construction loans by one of three measures: the present value of expected future cash flows discounted at the loan's effective interest rate; the loan's observable market price; or the fair value of the collateral if the loan is collateral dependent. Large groups of homogeneous loans are collectively evaluated for impairment. As such, the Company does not typically identify individual loans within these groupings as impaired loans for impairment evaluation and disclosure.

*Interest and Fees on Loans.* Interest on loans is accrued at the contractual rate and credited to income based upon the principal amount outstanding. Loan origination fees received and certain direct loan origination costs are deferred and recognized in interest income as an adjustment of loan yield. A loan is classified as non-accrual generally when it becomes 90 days past due as to interest or principal payments. All previously accrued but unpaid interest on non-accrual loans is reversed from interest income in the current period. Interest payments received on non-accrual loans (including impaired loans) are applied as a reduction of principal. A loan remains on non-accrual status until all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

*Goodwill and Core Deposit Intangible.* Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Goodwill is not subject to amortization but rather is evaluated at least annually for impairment. Any impairment write-down would be charged to non-interest expense. Goodwill is evaluated at least annually for impairment utilizing several standard valuation techniques, including discounted

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# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Amounts in Tables Expressed in Thousands, Except Number of Shares and per Share Data)

### 1. Summary of Significant Accounting Policies (continued)

cash flow analyses, bank merger multiples, and an estimation of the impact of business conditions and investor activities on the long-term value of the goodwill.

Core deposit intangible represents the estimated value of acquired customer relationships and is amortized on a straight-line basis over the estimated life of those relationships (10 years from the acquisition dates). On an ongoing basis, management reviews the valuation and amortization of intangible assets to determine possible impairment.

*Bank-Owned Life Insurance.* Bank-owned life insurance represents the cash surrender value ( CSV ) of life insurance policies on the lives of certain active and retired employees where the Company is the beneficiary. The CSV of the policies is recorded as an asset. Increases in the CSV of the policies, as well as death benefits received, net of any CSV, are recorded in non-interest income, and are not subject to income taxes.

*Premises and Equipment.* Premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed on the straight-line method over the estimated useful lives of the related assets.

*OREO.* OREO properties acquired through foreclosure or deed-in-lieu of foreclosure are recorded initially at estimated fair value less costs to sell. Any write-down of the recorded investment in the related loan is charged to the ALL upon transfer to OREO. Thereafter, any further declines in the property s values are recorded against current earnings. Upon acquisition of a property, a current appraisal or a broker s opinion is used to substantiate fair value for the property.

*Mortgage Servicing.* Servicing assets are recognized as separate assets when servicing rights are acquired through the sale of residential mortgage loans with servicing retained. Capitalized servicing rights, which are reported in other assets, are initially recorded at fair value and are amortized in proportion to, and over the period of, the estimated future servicing of the underlying mortgages. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. 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 for an individual stratum is recognized through earnings to the extent that fair value is less than the capitalized amount for the stratum.

*Other Borrowed Funds.* Other borrowed funds consist of commercial and retail repurchase agreements, FHLB overnight borrowings, federal funds purchased, line of credit advances, notes payable, and treasury, tax and loan deposits. Retail repurchase agreements generally mature within 30 days and are reflected at the amount of cash



received in connection with the transaction. Commercial repurchase agreements are callable quarterly, generally 6 to 24 months after issuance, and mature within five years. The Company may be required to provide additional collateral based on the fair value of the underlying securities. Treasury, tax and loan deposits generally do not have fixed maturity dates.

*Income Taxes.* Income taxes are accounted for using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax implications attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information raises doubt as to the realization of the deferred tax assets, 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.

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## CAMDEN NATIONAL CORPORATION

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Amounts in Tables Expressed in Thousands, Except Number of Shares and per Share Data)

### 1. Summary of Significant Accounting Policies (continued)

*Earnings per Share.* Basic earnings per common share ( EPS ) excludes dilution and is computed by dividing net income applicable to common stock by the weighted average number of common shares outstanding for the year. Diluted EPS reflects the potential dilution that could occur if certain securities or other contracts to issue common stock (such as stock options) were exercised or converted into additional common shares that would then share in the earnings of the Company. Diluted EPS is computed by dividing net income applicable to common stock by the weighted average number of common shares outstanding for the year, plus an incremental number of common-equivalent shares computed using the treasury stock method.

Effective January 1, 2009, in accordance with new accounting requirements issued by the Financial Accounting Standards Board ( FASB ), unvested share-based payment awards, which include the right to receive non-forfeitable dividends, are considered to participate with common stock in undistributed earnings for purposes of computing EPS. Accordingly, share-based payment awards considered to be participating securities, are required to calculate basic and diluted EPS amounts under the two-class method. Restricted share grants and management stock purchase grants are considered participating securities pursuant to this guidance. Calculations of EPS under the two-class method (i) exclude any dividends paid or owed on participating securities and any undistributed earnings considered to be attributable to participating securities from the numerator and (ii) exclude the dilutive impact of the participating securities from the denominator. EPS amounts for the years ended December 31, 2011, 2010 and 2009 have been presented in accordance with these requirements.

*Postretirement and Supplemental Retirement Plans.* The Company sponsors a postretirement health care plan and life insurance to certain eligible retired employees. The cost of providing postretirement benefits is accrued during the active service period of the employee. A supplemental retirement plan is also maintained for certain officers of the Company. The supplemental retirement plan is accrued on a current basis and recognizes costs over the estimated employee service period.

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

*Off-Balance Sheet Credit Related Financial Instruments.* In the ordinary course of business, the Company enters into commitments to extend credit, including commercial letters of credit and standby letters of credit. Such financial

instruments are recorded as loans when they are funded.

*Derivative Financial Instruments Designated as Hedges.* The Company recognizes all derivatives in the Consolidated Statements of Condition at fair value. On the date the Company enters into the derivative contract, the Company designates the derivative as a hedge of either a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ( cash flow hedge ), a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ( fair value hedge ), or a held for trading instrument ( trading instrument ). The Company formally documents relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. The Company also assesses, both at the hedge s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in cash flows or fair values of hedged items. Changes in fair value of a derivative that is effective and that qualifies as a cash flow hedge are recorded in other comprehensive income or loss and are reclassified into earnings when the forecasted transaction or related cash flows affect earnings. Changes in fair value of a

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**1. Summary of Significant Accounting Policies (continued)**

derivative that qualifies as a fair value hedge and the change in fair value of the hedged item are both recorded in earnings and offset each other when the transaction is effective. Those derivatives that are classified as trading instruments are recorded at fair value with changes in fair value recorded in earnings. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item, that it is unlikely that the forecasted transaction will occur, or that the designation of the derivative as a hedging instrument is no longer appropriate.

*Segment Reporting.* The Company, through its bank and non-bank subsidiaries, provides a broad range of financial services to individuals and companies in the State of Maine. These services include lending, demand deposits, savings and time deposits, cash management, brokerage and trust services. While the Company's management monitors operations of each subsidiary, substantially all revenues and profits are derived by the Bank from banking products and services. Revenues and profits derived, and assets owned by Acadia Trust, N.A. are less than 10% of the consolidated Company totals and, accordingly, the Company and its subsidiaries are considered by management to be aggregated in one reportable operating segment.

*Recent Accounting Pronouncements.* In April 2011, the FASB issued ASU No. 2011-02, Receivables (Topic 310): *A Creditor's Determination of whether a Restructuring Is a Troubled Debt Restructuring*. The new guidance clarifies when a loan modification or restructuring is considered a troubled debt restructuring (TDR) in order to address current diversity in practice and lead to more consistent application of accounting principles generally accepted in the United States of America. In evaluating whether a restructuring constitutes a TDR, a creditor must separately conclude that the restructuring constitutes a concession and the debtor is experiencing financial difficulties. Additionally, the guidance clarifies that a creditor is precluded from using the effective interest rate test in the debtor's guidance on restructuring of payables when evaluating whether a restructuring constitutes a TDR. The guidance is effective for interim and annual reporting periods beginning on or after June 15, 2011. The adoption of this new guidance did not have a significant impact on the Company's consolidated financial statements.

In April 2011, the FASB issued ASU No. 2011-03, Transfers and Servicing (Topic 860): *Reconsideration of Effective Control for Repurchase Agreements*. This ASU removes from the assessment of effective control the criterion relating to the transferor's ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. The guidance is effective for interim and annual reporting periods ending after December 15, 2011. The adoption of this new guidance did not have a material effect on the Company's consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRs*. This ASU clarifies how to

measure fair value, but does not require additional fair value measurement and is not intended to affect current valuation practices outside of financial reporting. However, additional information and disclosure will be required for transfers between Level 1 and Level 2, the sensitivity of a fair value measurement categorized as Level 3, and the categorization of items that are not measured at fair value by level of the fair value hierarchy. The guidance is effective during interim and annual reporting periods beginning after December 15, 2011. The Company is currently evaluating the impact of the clarifications provided in ASU No. 2011-04 on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): *Presentation of Comprehensive Income*. This ASU will require that all non-owner changes in shareholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15,

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**1. Summary of Significant Accounting Policies (continued)**

2011. Other than matters of presentation, the Company believes the adoption of this new guidance will not have a material effect on the Company's consolidated financial statements.

In August 2011, the FASB issued ASU No. 2011-08, Intangibles—Goodwill and Other (Topic 350): *Testing Goodwill for Impairment*. This ASU permits an entity to first assess qualitative factors in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for identifying whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. Previous guidance under Topic 350 required an entity to test goodwill for impairment, on at least an annual basis, by comparing the fair value of a reporting unit with its carrying amount, including goodwill (step one). If the fair value of a reporting unit is less than its carrying amount, then the second step of the test must be performed to measure the amount of the impairment loss, if any. Under the amendments in this ASU, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. This guidance is effective for annual periods for fiscal years ending after December 15, 2011, with early adoption permitted. The adoption of this new guidance did not have a material effect on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12, Comprehensive Income (Topic 220): *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. This ASU defers the effective date of a requirement in ASU No. 2011-05 related to the reclassification of items out of accumulated other comprehensive income. The deferral in the effective date was made to allow the FASB time to redeliberate whether to require presentation on the face of the financial statements of the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. The Company believes the adoption of this new guidance will not have a material effect on the Company's consolidated financial statements.

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Number of Shares and per Share Data)****2. Securities**

The following tables summarize the amortized costs and estimated fair values of securities available-for-sale ( AFS ) and held-to-maturity ( HTM ), as of the dates indicated:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2011				
Available-for-sale				
Obligations of U.S. government sponsored enterprises	\$29,996	\$ 116	\$(5 )	\$30,107
Obligations of states and political subdivisions	37,138	2,620		39,758
Mortgage-backed securities issued or guaranteed by U.S. government sponsored enterprises	488,226	17,489	(331 )	505,384
Private issue collateralized mortgage obligations	12,557		(1,916 )	10,641
Total debt securities	567,917	20,225	(2,252 )	585,890
Equity securities	5,000		(854 )	4,146
Total securities available-for-sale	\$572,917	\$20,225	\$(3,106 )	\$590,036
December 31, 2010				
Available-for-sale				
Obligations of U.S. government sponsored enterprises	\$49,870	\$ 237	\$(750 )	\$49,357
Obligations of states and political subdivisions	13,777	443		14,220
Mortgage-backed securities issued or guaranteed by U.S. government sponsored enterprises	451,909	15,986	(3,053 )	464,842
Private issue collateralized mortgage obligations	23,441		(2,719 )	20,722
Total debt securities	538,997	16,666	(6,522 )	549,141
Equity securities	5,000		(562 )	4,438
Total securities available-for-sale	\$543,997	\$16,666	\$(7,084 )	\$553,579
Held-to-maturity				
Obligations of states and political subdivisions	\$36,102	\$1,935	\$	\$38,037
Total securities held-to-maturity	\$36,102	\$1,935	\$	\$38,037

During 2011, \$36.1 million of municipal bonds that had been previously classified as HTM at purchase were moved to the AFS category and the associated unrealized gains of \$2.3 million on these securities that are now being reported on an after-tax basis in shareholders' equity as accumulated other comprehensive income or loss. This change reflects management's decision to more actively manage these investments in changing economic environments.

Net unrealized gains on AFS at December 31, 2011 and 2010 and included in accumulated other comprehensive income amounted to \$11.1 million and \$6.2 million, net of deferred taxes of \$6.0 million and \$3.4 million, respectively.



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(Amounts in Tables Expressed in Thousands, Except  
Number of Shares and per Share Data)****2. Securities (continued)****Impaired Securities**

Management periodically reviews the Company's investment portfolio to determine the cause, magnitude and duration of declines in the fair value of each security. Thorough evaluations of the causes of the unrealized losses are performed to determine whether the impairment is temporary or other-than-temporary in nature. Considerations such as the ability of the securities to meet cash flow requirements, levels of credit enhancements, risk of curtailment, recoverability of invested amount over a reasonable period of time and the length of time the security is in a loss position, for example, are applied in determining other-than-temporary impairment ( OTTI ). Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

The following table presents the estimated fair values and gross unrealized losses of investment securities that were in a continuous loss position at December 31, 2011 and 2010, by length of time that individual securities in each category have been in a continuous loss position:

	Less Than 12 Months	12 Months or More	Total		
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
					Unrealized Losses
December 31, 2011					
U.S. government sponsored enterprises	\$9,995	\$(5 )	\$	\$	\$9,995 \$(5 )
Mortgage-backed securities	38,025	(331 )	66		38,091 (331 )
Private issue collateralized mortgage obligations			10,641	(1,916 )	10,641 (1,916 )
Equity securities			4,146	(854 )	4,146 (854 )
Total	\$48,020	\$(336 )	\$14,853	\$(2,770 )	\$62,873 \$(3,106 )
December 31, 2010					
U.S. government sponsored enterprises	\$29,145	\$(750 )	\$	\$	\$29,145 \$(750 )
Mortgage-backed securities	96,604	(3,053 )	85		96,689 (3,053 )
Private issue collateralized mortgage obligations	2,160	(79 )	18,562	(2,640 )	20,722 (2,719 )
Equity securities			4,438	(562 )	4,438 (562 )
Total	\$127,909	\$(3,882 )	\$23,085	\$(3,202 )	\$150,994 \$(7,084 )

At December 31, 2011, the Company held \$62.9 million in investment securities with unrealized losses that are considered temporary. Included in the unrealized losses were \$9.7 million in private issue collateralized mortgage obligations ( CMOs ) which have been downgraded to non-investment grade. The Company's share of these downgraded CMOs is in the senior tranches. Management believes the unrealized losses for the CMOs are the result of current market illiquidity and the underestimation of value in the market. Including the CMOs, there were 20 securities with a fair value of \$14.9 million in the investment portfolio which had unrealized losses for twelve months or longer. Management currently has the intent and ability to retain these investment securities with unrealized losses until the decline in value has been recovered. Stress tests are performed regularly on the higher risk bonds in the investment portfolio using current statistical data to determine expected cash flows and forecast potential losses. The results of the stress tests during 2011 and at December 31, 2011, indicated potential future credit losses in the most likely scenario on two securities in which the Company recorded \$109,000 in OTTI write-downs.

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At December 31, 2011, the Company held Duff & Phelps Select Income Fund Auction Preferred Stock with an amortized cost of \$5.0 million. Since early 2008, the auction rate securities market has been greatly affected by market turmoil that has resulted in failed auctions for the majority of auction rate securities including DNP. The security has maintained its Triple-A rating by Moody's and Standard and Poor's. Management believes the failed auctions are a temporary liquidity event related to this asset class of securities. The Company is currently collecting all amounts due according to the contractual terms and has the ability and intent to hold the securities until they clear auction, are called, or mature; therefore, the securities are not considered other-than-temporarily impaired.

At December 31, 2010, \$151.0 million of the Company's investment securities had unrealized losses that were primarily considered temporary. A large portion of the unrealized loss was related to the private issue collateralized mortgage obligations (CMOs), which includes \$8.4 million that have been downgraded to non-investment grade. Including the CMOs, there were 23 securities with a fair value of \$23.1 million in the portfolio which had unrealized losses for twelve months or longer.

**Security Gains and Losses**

The following table details the Company's sales of investment securities:

	Years Ended December 31,		
	2011	2010	2009
Available for sale			
Proceeds from sales of securities	\$ 54,600	\$ 4,210	\$ 7,521
Gross realized gains	2,258		65
Gross realized (losses)	(73 )	(188 )	
Held to maturity			
Proceeds from sales of securities	\$	\$	\$ 864
Gross realized gains			1
Gross realized (losses)			(3 )

During 2011, the Company sold sixteen municipal bonds totaling \$7.3 million that the Company was monitoring that either had below A ratings, split ratings, withdrawn ratings, negative outlooks or were revenue bonds. Due to continued pressure on state and local government revenues around the country as municipalities struggle with a weak economy, management decided to sell these securities. The Company also sold one \$10.2 million agency security, thirty-one pass through securities totaling \$29.3 million, and three private issue CMOs totaling \$7.8 million. The Company had not recorded any OTTI on these securities.

During 2010, the Company sold one investment that had been downgraded to non-investment grade in 2009 and, although the Company's tranche was comprised of high quality loans, credit support had declined noticeably due to poor performance of other tranches in the months prior to the sale. The Company had not recorded any OTTI on this security; however, with the increased deterioration and an increase in market price, in a relatively illiquid market for the non-agency sector, management decided to sell the security. During 2009, the Company sold an investment security in the held to maturity portfolio due to a drop in credit rating.

### **Securities Pledged**

At December 31, 2011 and 2010, securities with an amortized cost of \$435.8 million and \$451.6 million and estimated fair values of \$454.2 million and \$464.2 million, respectively, were pledged to secure FHLBB advances, public deposits, and securities sold under agreements to repurchase, and for other purposes required or permitted by law.

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The amortized cost and estimated fair values of debt securities by contractual maturity at December 31, 2011 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Available-for-sale		
Due in one year or less	\$ 2,509	\$ 2,553
Due after one year through five years	34,840	35,572
Due after five years through ten years	121,286	125,916
Due after ten years	409,282	421,849
	\$ 567,917	\$ 585,890

**3. Loans and Allowance for Loan Losses**

The composition of the Company's loan portfolio, excluding residential loans held for sale, at December 31, 2011 and 2010 was as follows:

	December 31,	
	2011	2010
Residential real estate loans	\$ 578,757	\$ 596,655
Commercial real estate loans	470,061	464,037
Commercial loans	185,045	180,592
Home equity loans	268,782	270,627
Consumer loans	11,878	13,188
Deferred loan fees net of costs	(495 )	(347 )
Total loans	\$ 1,514,028	\$ 1,524,752

The Company's lending activities are primarily conducted in Maine. The Company originates single family and multi-family residential loans, commercial real estate loans, business loans, municipal loans and a variety of consumer loans. In addition, the Company makes loans for the construction of residential homes, multi-family properties and commercial real estate properties. The ability and willingness of borrowers to honor their repayment commitments is

generally dependent on the level of overall economic activity within the geographic area and the general economy. For the years ended December 31, 2011, 2010, and 2009, the Company sold \$28.6 million, \$20.1 million, and \$72.5 million of fixed rate residential mortgage loans on the secondary market, which resulted in a net gain on sale of loans of \$292,000, \$106,000, and \$86,000, respectively.

The Company, in the normal course of business, has made loans to its subsidiaries, and certain officers, directors, and their associated companies, under terms that are consistent with the Company's lending policies and regulatory requirements. Loans to related parties were as follows:

	December 31,	
	2011	2010
Balance at beginning of year	\$ 7,318	\$ 9,458
Loans made/advanced and additions	11,292	794
Repayments and reductions	(3,249 )	(2,934 )
Balance at end of year	\$ 15,361	\$ 7,318

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

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

The following is a summary of activity in the ALL:

	December 31,		
	2011	2010	2009
Balance at beginning of year	\$ 22,293	\$ 20,246	\$ 17,691
Loans charged off	(5,025 )	(5,547 )	(6,456 )
Recoveries	1,002	1,269	849
Net charge-offs	(4,023 )	(4,278 )	(5,607 )
Provision for loan losses	4,741	6,325	8,162
Balance at end of year	\$ 23,011	\$ 22,293	\$ 20,246

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The following table presents the activity in the ALL and select loan information by portfolio segment for the year ended December 31, 2011:

	Residential Real Estate	Commercial Real Estate	Commercial	Home Equity	Consumer	Unallocated	Total
ALL:							
Beginning balance	\$3,273	\$8,198	\$5,633	\$2,051	\$202	\$2,936	\$22,293
Loans charged off	(1,216 )	(1,633 )	(1,256 )	(861 )	(59 )		(5,025 )
Recoveries	120	374	296	196	16		1,002
Provision (reduction)	4,221	(1,237 )	173	1,318	261	5	4,741
Ending balance	\$6,398	\$5,702	\$4,846	\$2,704	\$420	\$2,941	\$23,011
Ending Balance:							
Individually evaluated for impairment	\$1,364	\$961	\$815	\$440	\$91	\$	\$3,671
Ending Balance:							
Collectively evaluated for impairment	\$5,034	\$4,741	\$4,031	\$2,264	\$329	\$2,941	\$19,340
Loans ending balance:							
Ending Balance:							
Individually evaluated for impairment	\$12,715	\$7,830	\$4,019	\$2,670	\$152	\$	\$27,386
Ending Balance:							
Collectively evaluated for impairment	\$565,547	\$462,231	\$181,026	\$266,112	\$11,726	\$	\$1,486,642
Loans ending balance	\$578,262	\$470,061	\$185,045	\$268,782	\$11,878	\$	\$1,514,028

The following table presents activity in the ALL and select loan information by portfolio segment for the year ended December 31, 2010:

	Residential Real Estate	Commercial Real Estate	Commercial	Home Equity	Consumer	Unallocated	Total
ALL:							
Beginning balance	\$2,693	\$6,930	\$5,015	\$1,773	\$184	\$3,651	\$20,246
Loans charged off	(1,262 )	(1,382 )	(1,502 )	(932 )	(469 )		(5,547 )



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Recoveries	225	232	553	123	136		1,269
Provision (reduction)	1,617	2,418	1,567	1,087	351	(715 )	6,325
Ending balance	\$3,273	\$8,198	\$5,633	\$2,051	\$202	\$2,936	\$22,293
Ending Balance:							
Individually evaluated for impairment	\$840	\$660	\$631	\$316	\$25	\$	\$2,472
Ending Balance:							
Collectively evaluated for impairment	\$2,433	\$7,538	\$5,002	\$1,735	\$177	\$2,936	\$19,821
Loans ending balance:							
Ending Balance:							
Individually evaluated for impairment	\$9,330	\$6,182	\$4,486	\$1,711	\$25	\$	\$21,734
Ending Balance:							
Collectively evaluated for impairment	\$586,978	\$457,855	\$176,106	\$268,916	\$13,163	\$	\$1,503,018
Loans ending balance	\$596,308	\$464,037	\$180,592	\$270,627	\$13,188	\$	\$1,524,752

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## CAMDEN NATIONAL CORPORATION

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Amounts in Tables Expressed in Thousands, Except Number of Shares and per Share Data)

### 3. Loans and Allowance for Loan Losses (continued)

The Company focuses on maintaining a well-balanced and diversified loan portfolio. Despite such efforts, it is recognized that credit concentrations may occasionally emerge as a result of economic conditions, changes in local demand, natural loan growth and runoff. To ensure that credit concentrations can be effectively identified, all commercial and commercial real estate loans are assigned Standard Industrial Classification codes, North American Industry Classification System codes, and state and county codes. Shifts in portfolio concentrations are continuously monitored by the Company's Corporate Risk Management group.

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

**Grade 1** Substantially risk free loans. Loans to borrowers of unquestioned financial strength with stable earnings, cash flows and sufficient primary and secondary sources of repayment. These loans have no known or suspected shortcomings or weaknesses. Most loans in this category are secured by properly margined liquid collateral. Loan to value and loan to cost parameters are most conservative.

**Grade 2** Loans with minimal risk. Includes loans to borrowers with a solid financial condition and good liquidity, significant cash flows and interest coverage and well-defined repayment strength. Loan to value and loan to cost parameters are conservative.

**Grade 3** Loans with very modest risk. Borrowers in this category exhibit strong sources of repayment, consistent earnings and acceptable profitability growth. Working capital, debt to worth and coverage ratios are comparable with industry standards and there are no known negative trends. Collateral protection is adequate. Loan to value parameters do not exceed the maximum established by the Company's loan policy.

**Grade 4** Loans with less than average risk. Loans to borrowers with adequate repayment source or a recently demonstrated ability to service debt with acceptable margins. Working capital, debt to worth and coverage ratios may be on the lower end of industry standards, but are not considered unsatisfactory. There may be minor negative trends but collateral position is adequate. Loan to value and debt coverage ratios meet the criteria in the Company's loan policy.

Grade 5 Average risk loans. Loans to borrowers with acceptable financial strength but possible vulnerability to changing economic conditions or inconsistent earnings history. Borrower evidences a reasonable ability to service debt in the normal course of business and has available and adequate secondary sources of repayment. Working capital, debt to worth and coverage ratios may be below industry standards, but are not considered unsatisfactory.

Loan to value and debt coverage ratios meet the criteria outlined in the Company's loan policy.

Grade 6 Loans with maximum acceptable risk (Watch List). Loans in this grade exhibit the majority of the attributes associated with Grade 5, perform at that level, but have been recognized to possess characteristics or deficiencies that warrant monitoring. These loans have potential weaknesses which may, if not checked or corrected, weaken the assets or inadequately protect the Company's credit position at some future date.

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**3. Loans and Allowance for Loan Losses (continued)**

A Grade 6 Watch rating is assigned to a loan when one or more of the following circumstances exist:

Lack of sufficient current information to properly assess the risk of the loan facility or value of pledged collateral.  
Adverse economic, market or other external conditions which may directly affect the obligor's financial condition.  
Significant cost overruns occurred.

Market share may exhibit some volatility. Sales and profits may be tied to business, credit or product cycles.

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

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

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

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

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



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(Amounts in Tables Expressed in Thousands, Except  
Number of Shares and per Share Data)****3. Loans and Allowance for Loan Losses (continued)**

The following table summarizes credit risk exposure indicators by portfolio segment as of December 31, 2011:

	Residential Real Estate	Commercial Real Estate	Commercial	Home Equity	Consumer
Pass (Grades 1 - 6) Performing	\$ 560,926	\$ 413,489	\$ 157,141	\$ 266,112	\$ 11,726
Special Mention (Grade 7)	876	8,134	8,998		
Substandard (Grade 8)	16,460	48,438	18,335		
Non-performing Doubtful (Grade 9)			571	2,670	152
Total	\$ 578,262	\$ 470,061	\$ 185,045	\$ 268,782	\$ 11,878

The following table summarizes credit risk exposure indicators by portfolio segment as of December 31, 2010:

	Residential Real Estate	Commercial Real Estate	Commercial	Home Equity	Consumer
Pass (Grades 1 - 6) Performing	\$ 583,460	\$ 390,488	\$ 146,412	\$ 268,873	\$ 13,163
Special Mention (Grade 7)		22,692	11,089		
Substandard (Grade 8)	12,848	50,852	23,091		
Non-performing Doubtful (Grade 9)		5		1,754	25
Total	\$ 596,308	\$ 464,037	\$ 180,592	\$ 270,627	\$ 13,188

The Company closely monitors the performance of its loan portfolio. A loan is placed on non-accrual status when the financial condition of the borrower is deteriorating, payment in full of both principal and interest is not expected as scheduled or principal or interest has been in default for 90 days or more. Exceptions may be made if the asset is well-secured by collateral sufficient to satisfy both the principal and accrued interest in full and collection is assured by a specific event such as the closing of a pending sale contract. When one loan to a borrower is placed on non-accrual status, all other loans to the borrower are re-evaluated to determine if they should also be placed on non-accrual status. All previously accrued and unpaid interest is reversed at this time. A loan may be returned to accrual status when collection of principal and interest is assured and the borrower has demonstrated timely payments of principal and interest for a reasonable period. Unsecured loans, however, are not normally placed on non-accrual status because they are charged-off once their collectability is in doubt.



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**3. Loans and Allowance for Loan Losses (continued)**

The following is a loan aging analysis by portfolio segment (including loans past due over 90 days and non-accrual loans) and a summary of non-accrual loans, which include troubled debt restructured loans ( TDRs ), and loans past due over 90 days and accruing as of December 31, 2011:

The following is a loan aging analysis by portfolio segment (including loans past due over 90 days and non-accrual loans) and a summary of non-accrual loans which include TDRs, and loans past due over 90 days and accruing as of December 31, 2010:

Interest foregone was approximately \$1.1 million, \$985,000, and \$961,000 for 2011, 2010, and 2009, respectively.

The Company takes a conservative approach in credit risk management and remains focused on community lending and reinvesting. The Company's Credit Administration works closely with borrowers experiencing credit problems to assist in loan repayment or term modifications. TDR loans consist of loans where the Company, for economic or legal reasons related to the borrower's financial difficulties, granted a concession to the borrower that it would not otherwise consider. TDRs involve term modifications or a reduction of either interest or principal. Once such an obligation has been restructured, it will continue to remain in a restructured status until paid in full. Loans restructured due to credit difficulties that are now performing were \$3.3 million and \$2.3 million at December 31, 2011 and December 31, 2010, respectively. The Company did not have any TDR loans that subsequently defaulted during 2011.

Loans that were restructured on or after January 1, 2011 were reassessed during 2011 as a result of the adoption of the new accounting guidance for TDRs. In its reassessment, the Company did not identify any loan modifications that would be considered TDRs under the new guidance that were not previously considered TDRs. At December 31, 2011 and 2010, the allowance related to TDRs was \$357,000 and \$124,000, respectively. The specific reserve component was determined by discounting the total expected future cash flows from the borrower, or if the loan is currently collateral-dependent, using the fair value of the underlying collateral, which was obtained through independent appraisals and internal evaluations. At December 31, 2011, the Company did not have any commitments to lend additional funds to borrowers with loans classified as TDRs.



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(Amounts in Tables Expressed in Thousands, Except  
Number of Shares and per Share Data)****3. Loans and Allowance for Loan Losses (continued)**

The following is a summary of accruing and non-accruing TDR loans by portfolio segment as of December 31, 2011:

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Current Balance
Troubled-Debt Restructurings				
Residential real estate	19	\$ 3,221	\$ 3,426	\$ 3,330
Commercial real estate	3	1,708	1,708	1,249
Commercial	2	163	163	103
Total	24	\$ 5,092	\$ 5,297	\$ 4,682

Impaired loans consist of non-accrual and TDR loans. All impaired loans are allocated a portion of the allowance to cover potential losses.

The following is a summary of impaired loan balances and associated allowance by portfolio segment as of December 31, 2011:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With related allowance recorded:					
Residential real estate	\$ 10,717	\$ 11,287	\$ 1,364	\$ 11,280	\$ 109
Commercial real estate	5,477	5,478	961	7,257	3
Commercial	3,636	3,636	815	3,963	7
Home equity	1,888	1,887	440	1,457	1
Consumer	136	136	91	106	
Ending Balance	\$ 21,854	\$ 22,424	\$ 3,671	\$ 24,063	\$ 120
Without related allowance recorded:					
Residential real estate	\$ 1,998	\$ 1,810	\$	\$ 1,847	\$ 21
Commercial real estate	2,353	3,815		2,078	
Commercial	383	665		393	
Home equity	782	1,189		422	
Consumer	16	176		18	

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Ending Balance	\$ 5,532	\$ 7,655	\$	\$ 4,758	\$ 21
Total impaired loans	\$ 27,386	\$ 30,079	\$ 3,671	\$ 28,821	\$ 141

The following is a summary of impaired loan balances and associated allowance by portfolio segment as of December 31, 2010:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With an allowance recorded:					
Residential real estate	\$ 9,330	\$ 9,750	\$ 840	\$ 7,739	\$ 30
Commercial real estate	6,182	7,198	660	6,334	4
Commercial	4,486	4,708	631	4,499	1
Home equity	1,711	2,049	316	1,118	1
Consumer	25	185	25	113	
Ending Balance	\$ 21,734	\$ 23,890	\$ 2,472	\$ 19,803	\$ 36

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(Amounts in Tables Expressed in Thousands, Except  
Number of Shares and per Share Data)****4. Goodwill, Core Deposit and Trust Relationship Intangibles**

On January 3, 2008, the Company acquired all of the outstanding common stock of Union Bankshares in exchange for 1,222,497 shares of the Company's common stock valued at \$43.5 million and \$29.0 million in cash. The Company recorded \$37.9 million of goodwill, \$5.0 million of core deposit intangible and \$753,000 of trust relationship intangible related to the acquisition. The changes in goodwill, core deposit intangible and trust relationship intangible for the years ended December 31, 2011 and 2010 are shown in the table below:

	Goodwill		
	Banking	Financial Services	Total
Balance at December 31, 2009 and 2010	\$ 34,720	\$ 7,060	\$ 41,780
2011 impairment charge		(50 )	(50 )
Balance at December 31, 2011	\$ 34,720	\$ 7,010	\$ 41,730

	Core Deposit Intangible		
	Total	Accumulated Amortization	Net
Balance at December 31, 2009	\$ 14,444	\$ (10,428 )	\$ 4,016
2010 amortization		(502 )	(502 )
Balance at December 31, 2010	14,444	(10,930 )	3,514
2011 amortization		(502 )	(502 )
Balance at December 31, 2011	\$ 14,444	\$ (11,432 )	\$ 3,012

	Trust Relationship Intangible		
	Total	Accumulated Amortization	Net
Balance at December 31, 2009	\$ 753	\$ (151 )	\$ 602
2010 amortization		(75 )	(75 )
Balance at December 31, 2010	753	(226 )	527
2011 amortization		(75 )	(75 )
Balance at December 31, 2011	\$ 753	\$ (301 )	\$ 452

The annual evaluation of goodwill resulted in a \$50,000 impairment charge recorded by Acadia Trust, N.A. in December 2011.

The following table reflects the expected amortization schedule for intangible assets at December 31, 2011:

	Core Deposit Intangible	Trust Relationship Intangible
2012	\$ 502	\$ 75
2013	502	75
2014	502	75
2015	502	75
2016	502	75
Thereafter	502	77
Total unamortized intangible	\$ 3,012	\$ 452

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(Amounts in Tables Expressed in Thousands, Except  
Number of Shares and per Share Data)****5. Premises and Equipment**

Details of premises and equipment, at cost, at December 31 were as follows:

	2011	2010
Land and land improvements	\$ 2,567	\$ 2,567
Buildings and leasehold improvements	30,552	29,823
Furniture, fixtures and equipment	16,783	16,411
Total cost	49,902	48,801
Accumulated depreciation and amortization	(25,789 )	(23,757 )
Net premises and equipment	\$ 24,113	\$ 25,044

Depreciation and amortization expense was \$2.3 million, \$2.3 million and \$2.2 million for 2011, 2010 and 2009, respectively. Lease expense was approximately \$918,000, \$840,000 and \$789,000 for 2011, 2010 and 2009, respectively. The Company has a capital lease for a branch facility with payments that extend until 2026 at an interest rate of 9.75% per year. The related asset, recorded in premises and equipment, has a cost basis of \$855,000 and accumulated depreciation of \$245,000. At December 31, 2011, under current operating and capital lease contracts, the Company had the following schedule of future minimum lease payments:

	Operating	Capital
2012	\$ 543	\$ 48
2013	327	50
2014	257	53
2015	177	55
2016	126	62
Thereafter	765	857
	\$ 2,195	\$ 1,125

**6. Other Real Estate Owned**

OREO properties acquired through foreclosure or deed-in-lieu of foreclosure are recorded at the fair value of the real estate, less costs to sell. Any write-down of the recorded investment in the related loan is charged to the allowance for loan losses upon transfer to OREO. Subsequent write-downs required for declines in value are recorded through a valuation allowance and charged to other non-interest expense.

Activity in OREO was as follows:

	2011	2010	2009
Balance at beginning of year	\$ 2,387	\$ 5,479	\$ 4,024
Additions	1,989	1,479	3,420
Disposals	(2,506 )	(2,965 )	(1,070 )
Write-downs	(188 )	(1,606 )	(895 )
Balance at end of year	\$ 1,682	\$ 2,387	\$ 5,479

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Residential real estate mortgages are originated by the Company both for its portfolio and for sale into the secondary market. The Company may sell its loans to institutional investors such as the Federal Home Loan Mortgage Corporation. Under loan sale and servicing agreements with the investor, the Company generally continues to service the residential real estate mortgages. The Company pays the investor an agreed-upon rate on the loan, which is less than the interest rate received 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, 2011 and 2010 was \$768,000 and \$898,000, respectively. For the same periods, the fair value of the mortgage servicing rights were approximated \$1.1 million and \$1.4 million, respectively. In evaluating the reasonableness of the carrying values of the mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. The model utilizes a variety of assumptions, the most significant of which are loan prepayment assumptions and the discount rate used to discount future cash flows. Prepayment assumptions, which are impacted by loan rates and terms, are calculated using a three-month moving average of weekly prepayment data published by the Public Securities Association and modeled against the serviced loan portfolio by the third party valuation specialist. The discount rate is the quarterly average 10-year U.S. Treasury rate plus 5.11%. 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.

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

	2011	2010	2009
Mortgage Servicing Rights:			
Balance at beginning of year	\$ 898	\$ 810	\$ 139
Capitalized upon sale	204	308	811
Amortization charged against mortgage servicing fee income	(310 )	(235 )	(575 )
Valuation adjustment	(24 )	15	435
Balance at end of year	\$ 768	\$ 898	\$ 810
Valuation Allowance:			
Balance at beginning of year	\$ (19 )	\$ (34 )	\$ (469 )
Increase in impairment reserve	(33 )	(43 )	

Reduction of impairment reserve	9	58	435
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Balance at end of year	\$ (43 )	\$ (19 )	\$ (34 )
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Mortgage loans serviced for others are not included in the accompanying Consolidated Statements of Condition and totaled \$178.0 million, \$179.6 million and \$218.3 million at December 31, 2011, 2010 and 2009, respectively.

Custodial escrow balances maintained in connection with the foregoing loan servicing, and included in demand deposits, were \$429,000 and \$471,000 at December 31, 2011 and 2010, respectively.



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The following is a summary of scheduled maturities of certificates of deposit as of December 31, 2011:

	Retail	Brokered	Total
2012	\$ 231,876	\$ 11,805	\$ 243,681
2013	73,507		73,507
2014	34,475	2,126	36,601
2015	32,385	17,033	49,418
2016	19,660	28,622	48,282
Thereafter	3,528	6,545	10,073
Total certificates of deposit	\$ 395,431	\$ 66,131	\$ 461,562

Certificates of deposit issued in amounts of \$100,000 or more totaled \$187.9 million and \$177.8 million at December 31, 2011 and 2010, respectively, including brokered certificates of deposit of \$39.2 million and \$10.0 million, respectively.

At December 31, 2011 and 2010, the Company, in the normal course of business, had deposits from certain officers, directors, and their associated companies totaling \$28.1 million and \$36.3 million, respectively.

**9. Borrowings****Other Borrowed Funds**

Short-term borrowings consist of retail repurchase agreements, FHLBB overnight borrowings and line of credit advances, correspondent bank overnight borrowings, and treasury, tax and loan deposits that are due within one year from the origination date. The Company, through its bank subsidiary, had an available line of credit with the FHLBB of \$9.9 million at December 31, 2011 and 2010. The Company had no outstanding balance on the line of credit with the FHLBB at December 31, 2011 and 2010. Long-term borrowings represent securities sold under repurchase agreements with major brokerage firms and notes payable with maturity dates over one year. Both wholesale and retail repurchase agreements are secured by mortgage-backed securities and securities of government sponsored enterprises. The Company has \$10.0 million in lines of credit with a maturity date of December 20, 2012.

The following table summarizes other borrowed funds outstanding at December 31:

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	2011	2010
Short-term Borrowings		
Securities sold under repurchase agreements retail	\$ 144,228	\$ 155,932
FHLBB and correspondent bank overnight borrowings	58,700	37,275
Treasury, tax and loan deposits		723
Total short-term borrowings	202,928	193,930
Long-term Borrowings		
Securities sold under repurchase agreements commercial	71,243	106,355
Notes payable	360	615
Capital lease obligation	1,125	1,169
Total long-term borrowings	72,728	108,139
Total other borrowed funds	\$ 275,656	\$ 302,069

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Number of Shares and per Share Data)****9. Borrowings (continued)**

Information on the amounts outstanding and interest rates of short-term borrowings for each of the three years in the period ended December 31 are as follows:

	2011	2010	2009
Balance outstanding at end of year	\$ 202,928	\$ 193,930	\$ 145,541
Average daily balance outstanding	\$ 202,423	\$ 188,663	\$ 190,142
Maximum balance outstanding at any month end	\$ 287,334	\$ 268,197	\$ 277,562
Weighted average interest rate for the year	0.35 %	0.63 %	0.81 %
Weighted average interest rate at end of year	0.22 %	0.45 %	1.06 %

The securities sold under repurchase agreements – commercial are fixed rate borrowings, which are callable quarterly, with the following schedule of maturities, rate and year in which the instrument became or becomes callable, as of December 31, 2011:

	Amount	Rate	Callable
2012	\$ 5,000	4.60 %	2008
2013	36,000	3.33 %	2011
2016	25,000	2.61 %	2012
2017	5,243	4.67 %	2008
Total	\$ 71,243	3.27 %	

**Federal Home Loan Bank Advances**

FHLB advances are collateralized by a blanket lien on qualified collateral consisting primarily of loans with first mortgages secured by one-to four-family properties, certain commercial real estate loans, certain pledged investment securities and other qualified assets. The carrying value of residential real estate and commercial loans pledged as collateral was \$698.8 million and \$738.3 million at December 31, 2011 and 2010, respectively. The carrying value of securities pledged as collateral at the FHLB was \$8.3 million and \$16.8 million at December 31, 2011 and 2010, respectively.

The advances payable to the FHLB are summarized as follows:

December 31, 2011	December 31, 2010
Callable	Callable

	Total Outstanding	Total Outstanding	Total Outstanding	Total Outstanding
Fixed Rate:				
0.22% 5.06% due in 2011	\$	\$	\$ 112,024	\$ 12,000
0.15% 7.23% due in 2012	45,090		15,082	
3.46% 6.15% due in 2013	5,523	5,000	25,819	5,000
2.71% 3.35% due in 2014	20,000	10,000	20,000	10,000
2.75% 4.75% due in 2015	16,247	10,000	16,311	10,000
1.80% 2.91% due in 2016	30,000		5,000	
3.99% 4.06% due in 2017	20,000	20,000	20,000	20,000
Total FHLB advances	\$ 136,860	\$ 45,000	\$ 214,236	\$ 57,000

### Junior Subordinated Debentures

In April 2006, the Company formed Camden Capital Trust A ( CCTA ), which issued and sold trust preferred securities to the public. The Company received \$36.1 million from the issuance of the trust preferred securities in return for junior subordinated debentures issued by the Company to CCTA. The Company owns all of the \$1.1 million of outstanding common securities of CCTA. The interest rate of the trust preferred

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(Amounts in Tables Expressed in Thousands, Except  
Number of Shares and per Share Data)****9. Borrowings (continued)**

securities was fixed at 6.71% through June 2011 and now floats at the 3 month London Interbank Offered Rate ( LIBOR ) plus 140 basis points. The proceeds from the offering were used to repurchase Company common stock under the tender offer completed in May 2006. The trust preferred securities, which pay interest quarterly at the same rate as the junior subordinated debentures held by CCTA, are mandatorily redeemable on June 30, 2036, or may be redeemed by CCTA at par any time on or after June 30, 2011.

In connection with the Union Trust acquisition, the Company assumed \$8.0 million of trust preferred securities, held through a Delaware trust affiliate, Union Bankshares Capital Trust I ( UBCT ). In 2006, Union Trust issued an aggregate principal amount of \$8.2 million of 30-year junior subordinated deferrable interest debt securities to UBCT. The Company owns all of the \$248,000 of outstanding common securities of UBCT. The debt securities obligate the Company to pay interest on their principal sum quarterly in arrears on January 7, April 7, July 7, and October 7 of each year. The interest rate of the trust preferred securities until April 7, 2011 was a blended rate equal to the sum of (1) the product of 50% times the average three-month LIBOR plus 1.42%, plus (2) the product of 50% times 6.4725%. The rate is now the average three-month LIBOR plus 1.42%. The debt securities mature on April 7, 2036, but may be redeemed by the Company, in whole or in part, beginning on April 7, 2011, on any interest payment date. The debt securities may also be redeemed by the Company in whole or in part, within 90 days of the occurrence of certain special redemption events as defined in the Indenture.

CCTA and UBCT are Delaware statutory trusts created for the sole purpose of issuing trust preferred securities and investing the proceeds in junior subordinated debentures of the Company. The junior subordinated debentures are the sole assets of the trusts. The Company is the owner of all of the common securities of CCTA and UBCT and fully and unconditionally guarantees each trust's securities obligations. In accordance with GAAP, CCTA and UBCT are treated as unconsolidated subsidiaries. The common stock investment in the statutory trusts is included in Other Assets in the Consolidated Statements of Condition. Interest expense on the junior subordinated debentures totaled \$2.6 million during 2011 and \$2.8 million during both 2010 and 2009. At December 31, 2011, \$43.0 million of the trust preferred securities were included in the Company's total Tier 1 capital and amounted to 20.1% of Tier 1 capital of the Company.

The Company has a notional amount of \$43.0 million in interest rate swap agreements on its junior subordinated debentures. The Company swapped the variable cost for a fixed cost and the terms of the interest rate swap agreements are as follows:

Notional Amount	Fixed Cost		Maturity Date
\$10,000	5.09	%	June 30, 2021

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10,000	5.84	%	June 30, 2029
10,000	5.71	%	June 30, 2030
5,000	4.35	%	March 30, 2031
8,000	4.14	%	July 7, 2031

The fair value of the swap agreements on its junior subordinated debentures at December 31, 2011 was a liability of \$11.2 million and, as this instrument qualifies as a highly effective cash flow hedge, the change in fair value was recorded in other comprehensive income, net of tax, and other liabilities. In connection with the interest rate swap agreements and the liability position, the Company has posted \$10.9 million of cash held as collateral with counterparties at December 31, 2011.

The Company has a notional amount of \$6.1 million in an interest rate swap agreement with a commercial customer and an interest rate swap agreement of an equal notional amount with a dealer bank related to the Company's commercial loan level derivative program. As the two swap agreements have substantially equivalent and offsetting terms, they do not materially change the Company's interest rate risk.

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Number of Shares and per Share Data)****10. Income Taxes**

The current and deferred components of income tax expense were as follows:

	2011	2010	2009
Current:			
Federal	\$ 11,301	\$ 11,282	\$ 10,316
State	463	433	407
	11,764	11,715	10,723
Deferred:			
Federal	17	(602 )	(280 )
Income tax expense	\$ 11,781	\$ 11,113	\$ 10,443

The income tax expense differs from the amount computed by applying the statutory federal income tax rate as a result of the following:

	2011	2010	2009
Computed tax expense	\$ 13,285	\$ 12,558	\$ 11,626
Increase (reduction) in income taxes resulting from:			
Tax exempt income	(753 )	(888 )	(1,009 )
State taxes, net of federal benefit	301	281	265
Income from life insurance	(760 )	(517 )	(450 )
Low income housing credits	(393 )	(381 )	(230 )
Other	101	60	241
Income tax expense	\$ 11,781	\$ 11,113	\$ 10,443

Temporary differences between the financial statements carrying amounts and the tax basis of assets and liabilities gave rise to the following deferred tax assets and liabilities:

	2011		2010	
	Asset	Liability	Asset	Liability
Allowance for possible losses on loans	\$8,061	\$	\$7,811	\$
Allowance for OTTI of investments	5,352		5,314	
Allowance for OREO valuation	179		428	
Pension and other benefits	3,690		3,531	
Depreciation		1,687		1,686

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Deferred loan origination fees		1,155		1,161
Deferred compensation and benefits	890		919	
Net unrealized gains on investments available for sale and derivative instruments		2,080		2,972
Net unrealized losses on postretirement plans	970		641	
Purchase accounting	571		815	
Deposit premium		937		939
Mortgage servicing rights		269		314
Prepaid expenses		579		525
Other	480		419	
	\$20,193	\$6,707	\$19,878	\$7,597

The related income taxes have been calculated using a rate of 35%. No valuation allowance is deemed necessary for the net deferred tax asset.



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**10. Income Taxes (continued)**

The Company is currently under review by the Internal Revenue Service for the income tax return for the year ended December 31, 2009. Although not currently under review, income tax returns for the years ended December 31, 2010 and 2008 are open to audit by federal and Maine authorities. If the Company, as a result of an audit, was assessed interest and penalties, the amounts would be recorded through other non-interest expense.

**11. Shareholders Equity**

**Dividends**

The primary source of funds available to the Company for the payment of dividends to its shareholders is dividends paid to the Company by its subsidiaries. The Company's subsidiaries are 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 subsidiaries to the Company. Under regulations prescribed by the Office of the Comptroller of the Currency (the OCC), without prior OCC approval, a bank subsidiary may not declare dividends in any year in excess of the bank's (i) net income for the current year, (ii) plus its retained net income for the prior two years. The Company declared \$11.5 million, \$7.7 million and \$7.6 million in dividends to shareholders for the years ended December 31, 2011, 2010 and 2009, respectively. On December 30, 2011, the Company paid a special dividend of \$0.50 per share.

**Common Stock Repurchase**

In September 2011, the Company's board of directors authorized the 2011 Common Stock Repurchase Program (The Repurchase Program). The Repurchase Program authorizes management to repurchase up to 500,000 shares, or approximately 6.5%, of the Company's outstanding common stock, over the next year when it feels conditions warrant. As of December 31, 2011, the Company repurchased 13,244 shares of common stock at an average price of \$29.34.

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Basic earnings per common share ( EPS ) excludes dilution and is computed by dividing net income applicable to common stock by the weighted average number of common shares outstanding for the year. Diluted EPS reflects the potential dilution that could occur if certain securities or other contracts to issue common stock (such as stock options) were exercised or converted into additional common shares that would then share in the earnings of the Company.

Diluted EPS is computed by dividing net income applicable to common stock by the weighted average number of common shares outstanding for the year, plus an incremental number of common-equivalent shares computed using the treasury stock method. The following table sets forth the computation of basic and diluted earnings per share under the two-class method, as unvested share-based payment awards include the nonforfeitable right to receive dividends and therefore are considered participating securities:

	2011	2010	2009
Net income, as reported	\$26,177	\$24,766	\$22,773
Weighted-average common shares outstanding basic	7,672,126	7,655,668	7,642,492
Dilutive effect of stock-based compensation	7,769	7,830	11,481
Weighted-average common and potential common shares diluted	7,679,895	7,663,498	7,653,973
Basic earnings per share common stock	\$3.41	\$3.23	\$2.98
Basic earnings per share unvested share-based payment awards	3.17	3.23	2.98
Diluted earnings per share common stock	3.41	3.23	2.97
Diluted earnings per share unvested share-based payments awards	3.41	3.23	2.97

At December 31, 2011 and 2010, options to purchase 102,000 and 88,300 shares, respectively, of common stock were not considered in the computation of potential common shares for purposes of diluted EPS because the exercise prices of the options were greater than the average market price of the common stock for the respective periods.

**13. Employee Benefit Plans****401(k)/Profit Sharing Plan**

The Company has a 401(k) plan and the majority of employees participate in the plan. Employees may contribute pre-tax contributions to the 401(k) plan up to the maximum amount allowed by federal tax laws. The Company makes matching contributions of up to 4% of an employee's eligible compensation. The Company may make additional

matching contributions subject to the discretion of the board of directors. For the years ended December 31, 2011, 2010, and 2009, these amounted to 3%, 2%, and 3%, respectively, of pre-tax compensation. For the years ended December 31, 2011, 2010 and 2009, expenses under the other postretirement plan amounted to \$1.1 million, \$1.0 million, and \$1.1 million, respectively.

## **Supplemental Executive Retirement Plan and Other Postretirement Benefit Plan**

The Company sponsors unfunded, non-qualified supplemental executive retirement plans ( SERP ) for certain officers. These agreements are designed to make up the shortfall (when compared to a non-highly compensated employee) in replacing income at retirement due to Internal Revenue Service compensation and benefit limits under the 401(k) plan and Social Security. With a SERP in place, participants should be able to replace 65 75% of their final average compensation. For those eligible for benefits, the SERP provides for a minimum 15-year guaranteed benefit for all vested participants. In addition, the Company provides medical and life insurance to certain eligible retired employees under the other postretirement benefit plan.

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The following table summarizes changes in the benefit obligation and plan assets for (i) the supplemental executive retirement plan and (ii) the other postretirement benefit plan as of December 31, 2011 and 2010:

	SERP		Other Postretirement Benefits	
	2011	2010	2011	2010
Benefit obligations:				
Beginning of year	\$8,102	\$ 7,700	\$2,700	\$ 2,580
Service cost	232	181	65	60
Interest cost	431	427	150	143
Actuarial loss	615	361	417	50
Benefits paid	(512 )	(567 )	(145 )	(133 )
End of year	8,868	8,102	3,187	2,700
Fair value of plan assets:				
Beginning of year				
Employer contributions	512	567	145	133
Benefits paid	(512 )	(567 )	(145 )	(133 )
End of year				
Funded status at end of year, included in other liabilities	\$8,868	\$ 8,102	\$3,187	\$ 2,700
Amounts recognized in accumulated other comprehensive loss				
Net actuarial loss	\$ 1,953	\$ 1,405	\$ 739	\$ 327
Prior service cost	81	100		
Total	\$2,034	\$ 1,505	\$ 739	\$ 327

The accumulated benefit obligation for the SERP was \$7.2 million and \$8.4 million at December 31, 2011 and 2010, respectively. In 2012, approximately \$115,000 and \$67,000 in net actuarial losses and prior service cost, respectively, are expected to be recognized as components of net period benefit cost for the SERP, and approximately \$31,000 in net actuarial loss is expected to be recognized for the other postretirement benefit plan.

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The components of net period benefit cost and other amounts recognized in other comprehensive income were as follows:

	SERP			Other Postretirement Benefits		
	2011	2010	2009	2011	2010	2009
Net period benefit cost						
Service cost	\$232	\$181	\$205	\$65	\$60	\$66
Interest cost	431	427	418	150	143	136
Recognized net actuarial loss	67	30	50	5	2	2
Recognized prior service cost	19	19	19			
Net period benefit cost	749	657	692	220	205	204
Changes in funded status recognized in other comprehensive loss (income), before taxes						
Net actuarial loss (gain)	615	361	(86 )	417	50	
Reclassifications to net period benefit cost	(67 )	(30 )	(50 )	(5 )	(2 )	(2 )
Amortization of net unrecognized actuarial loss	(19 )	(19 )	(19 )			
Amortization of prior service cost	(19 )	(19 )	(19 )			
Total recognized in other comprehensive loss (income)	529	312	(155)	412	48	(2 )
Total recognized in net period benefit cost and other comprehensive loss (income)	\$1,278	\$969	\$537	\$632	\$253	\$202

The following assumptions were used in determining benefit obligations and net period benefit costs:

	SERP			Other Postretirement Benefits		
	2011	2010	2009	2011	2010	2009
Weighted-average assumptions as of end of year						
Discount rate for benefit obligation	4.75%	5.50%	5.75%	4.75%	5.45%	5.70 %
Discount rate for net period benefit cost	5.50%	5.75%	6.00%	5.45%	5.70%	5.70 %
Rate of compensation increase	4.50%	4.50%	4.50%	7.00%	7.00%	7.00 %

Health care cost trend rate assumed for future  
years

A 1.0% increase or decrease in the assumed health care cost trend rate would not have a material impact on the accumulated postretirement benefit obligation due to a built-in cap on annual benefits.

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In 2012, the expected contribution is \$502,000 for the SERP and \$249,000 for the other postretirement benefit plan. The expected benefit payments for the next ten years are presented in the following table:

	SERP	Other Postretirement Benefits
2012	\$ 502	\$ 149
2013	505	154
2014	371	158
2015	371	161
2016	422	158
2017 - 2021	2,265	836

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act (the Act) was signed into law. The Act introduces a prescription drug benefit under Medicare as well as a federal subsidy to sponsors of retiree health care plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. The effects of the Act on the accumulated projected benefit obligation or net period post-retirement benefit cost are not reflected in the financial statements or accompanying notes because the Company has not concluded whether the benefits provided by the Plan are actuarially equivalent to Medicare Part D under the Act.

**14. Stock-Based Compensation Plans****Stock-Based Compensation**

On April 29, 2003, the shareholders of the Company approved the 2003 Stock Option and Incentive Plan (the Plan). The maximum number of shares of stock reserved and available for issuance under the Plan is 800,000 shares. Awards may be granted in the form of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, deferred stock, unrestricted stock, performance shares and dividend equivalent rights, or any combination of the preceding, and the exercise price shall not be less than 100% of the fair market value on the date of grant in the case of incentive stock options, or 85% of the fair market value on the date of grant in the case of non-qualified stock options. Prior to April 29, 2003, the Company had various stock option plans with options vesting immediately upon grant and expiring ten years from the date of the option grant. The exercise price of all options equaled the market price of the Company's stock on the date of grant.

## Stock Option Awards

Stock options granted under the current Plan have been incentive stock options. Options granted vest based on five years of continuous service and have ten year contractual terms.

On the date of each grant, the fair value of each award is estimated using the Black-Scholes option pricing model based on assumptions made by the Company as follows:

Dividend yield is based on the dividend rate of the Company's stock at the date of grant.

Risk-free interest rate is based on the U.S. Treasury bond rate with a term equaling the expected life of the granted options.

Expected volatility is based on the historical volatility of the Company's stock price.

Expected life represents the period of time that granted options are expected to be outstanding based on historical trends.

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The following table presents the option pricing assumptions and the estimated fair value of the options using these assumptions:

	2011	2010	2009
Dividend yield	3.04 %	3.10 %	4.01 %
Weighted average risk-free interest rate	1.95 %	2.36 %	1.60 %
Weighted average expected volatility	51.90 %	50.50 %	42.89 %
Weighted average expected life in years	5.12	5.12	5.20
Weighted average fair value of options granted	\$ 12.30	\$ 11.72	\$ 6.90

Compensation expense is recognized on a straight-line basis over the option vesting period and totaled \$204,000, \$182,000 and \$189,000 for the years ended December 31, 2011, 2010 and 2009, respectively. Unrecognized compensation cost for nonvested stock options, which reflects an estimated annualized forfeiture rate of 5% per year over the vesting period, totaled \$504,000 at December 31, 2011, and is expected to be recognized over the remaining weighted-average vesting period of 3.4 years. The total intrinsic value of options exercised during the years ended December 31, 2011 and 2010 was \$16,000 and \$56,000, respectively. No options were exercised during the year ended December 31, 2009.

Stock option activity for 2011 is as follows:

	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000)
Options outstanding at January 1, 2011	146,300	\$ 32.22		\$
Granted	27,000	33.39		
Exercised	(1,900 )	24.46		
Forfeited and expired	(14,400 )	33.89		
Options outstanding at December 31, 2011	157,000	\$ 32.36	6.4	\$ 375
Options exercisable at December 31, 2011	79,650	\$ 34.00	4.9	\$ 161

A summary of the status of the Company's nonvested stock options as of December 31, 2011 and changes during the year then ended is presented below:

	Awards	Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2011	84,950	\$ 8.65
Granted	27,000	12.30
Vested	(23,700 )	8.88
Forfeited	(10,900 )	10.34
Nonvested at December 31, 2011	77,350	\$ 9.20

### **Restricted Stock Awards and Management Stock Purchase Plan**

The Company issues restricted stock awards to certain key employees. Employees generally become fully vested in these shares after a three-year period, with requisite service conditions and no performance-based conditions to such vesting. The Company provides a Management Stock Purchase Plan (the MSPP ) to provide an opportunity for management employees to receive restricted shares of the Company's common stock in lieu of their annual incentive bonus. Restricted shares under the MSPP are granted at a discount of

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one-third of the fair market value of the stock on the date of grant and fully vest two years after the grant date. During the vesting period, dividends are accrued on the restricted stock and the recipients are entitled to vote these restricted shares.

Compensation expense recognized in connection with the restricted stock awards and MSPP is presented in the following table:

	Year Ended December 31,		
	2011	2010	2009
Restricted stock awards	\$ 92	\$ 72	\$ 139
Management stock purchase plan grants	37	19	21
Total compensation expense	\$ 129	\$ 91	\$ 160
Related income tax benefit	\$ 45	\$ 32	\$ 56
Fair value of grants vested	\$ 106	\$ 134	\$ 273

The following table presents a summary of the activity related to restricted stock awards and stock purchase grants for the period indicated:

	Restricted Stock		Stock Purchase (MSPP)	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2011	7,833	\$ 30.60	4,298	\$ 8.26
Granted	1,500	33.60	5,541	11.01
Vested	(2,837 )	30.60	(2,736 )	6.97
Forfeited and expired			(321 )	9.55
Nonvested at December 31, 2011	6,496	\$ 31.92	6,782	\$ 10.96

At December 31, 2011, unrecognized compensation cost related to nonvested restricted stock awards and stock purchase grants was \$137,000 which is expected to be recognized over a weighted average period of 1.4 years.

## **Long-Term Performance Share Plan**

The Long-term Performance Share Plan ( LTIP ) is intended to create incentives to allow the Company to attract and retain its executives who will contribute to its future success. It is further the intent of the Company that awards made under this plan will achieve the twin goals of aligning executive incentive compensation with increases in shareholder value by using equity compensation as a tool to retain key employees. The long-term performance period is a period of three consecutive years beginning on January 1 of the first year and ending on December 31 of the third year.

Awards are based upon the attainment of certain performance targets on specific performance measures selected by the Compensation Committee and approved by the board of directors. The performance-based share units granted will vest only if certain revenue and expense goals or service conditions, as defined under the LTIP, are achieved. Failure to achieve the goals and service conditions will result in all or a portion of the shares being forfeited.

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Compensation expense recognized in connection with the LTIP is presented in the following table:

	Year Ended December 31,		
	2011	2010	2009
Long-Term Performance Share Plan compensation expense	\$ 672	\$ 526	\$ 719
Related income tax benefit	\$ 235	\$ 184	\$ 251
Fair value of grants vested	\$ 570	\$ 327	\$

The following table presents a summary of the activity related to Long-Term Performance Share Plan for the period indicated:

	Long-Term Performance Share Plan Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2011	65,036	\$ 29.14
Granted	18,902	37.63
Vested	(20,385 )	27.95
Nonvested at December 31, 2011	63,553	\$ 32.05

Based on current performance levels, unrecognized stock compensation expense for the performance share awards was \$396,000 with a weighted-average remaining amortization period of 0.83 years at December 31, 2011.

**Defined Contribution Retirement Plan**

The Defined Contribution Retirement Plan (the "DCRP") is an unfunded deferred compensation plan for the benefit of certain senior management employees of the Company. The Company's Compensation Committee determines eligibility in the DCRP and annually, participants will receive a credit to an account administered by the Company of 10% of each participant's annual base salary and bonus for the prior performance period. Annual credits to a participant's account will be denominated in Deferred Stock Awards (the right to receive a share of common stock of the Company upon the satisfaction of certain restrictions) based on the fair market value of the common stock of the Company on the date of grant. Vesting occurs ratably from the date of participation until the participant reaches the age of 65, at which time the participant is 100% vested. Upon retirement or termination of employment, the

participant will receive shares of common stock equal to the Deferred Stock Awards in the account multiplied by the vested percentage, reduced by the amount to be withheld for income taxes. The Company granted 2,135 and 1,565 of Deferred Stock Awards during 2011 and 2010, respectively under the DCRP. Compensation expense totaled \$20,000, \$10,000, and \$4,000 for the years ended December 31, 2011, 2010, 2009, respectively. Unrecognized stock compensation expense for the Deferred Stock Awards was \$116,000 with a weighted-average remaining amortization period of 14 years at December 31, 2011.

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Detail of other expenses included in the Consolidated Statements of Income is as follows:

	Year Ended December 31,		
	2011	2010	2009
Prepayment penalty on borrowings	\$ 2,318	\$	\$
Communication costs	1,461	1,508	1,556
Debit and ATM related costs	1,425	1,276	1,152
Donations and marketing	1,347	1,240	1,133
Employee related costs	981	1,079	1,105
Office and branch supplies	767	785	710
Other expenses	2,666	2,732	3,321
Total	\$ 10,965	\$ 8,620	\$ 8,977

Communication costs include telephone and related costs, internet charges, and postage. Employee related costs include hiring, training, parking, meeting and business travel costs.

**16. Commitments and Contingencies****Legal Contingencies**

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

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

As of December 31, 2011, the Company did not have any loss contingencies that were both probable and estimable and, therefore, no accrued liability has been recognized.

## **Financial Instruments**

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

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The following is a summary of the contractual and notional amounts of the Company's financial instruments:

	December 31,	
	2011	2010
Lending-Related Instruments:		
Loan origination commitments and unadvanced lines of credit:		
Home equity	\$ 254,603	\$ 249,193
Commercial and commercial real estate	21,972	15,348
Residential	2,060	3,356
Letters of credit	1,178	1,929
Other commitments	1,932	76
Derivative Financial Instruments:		
Forward commitments to sell residential mortgage loans	7,773	9,355
Derivative mortgage loan commitments	2,356	
Customer loan swaps	12,240	
Interest rate swaps	43,000	30,000

**Lending-Related Instruments**

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

**Derivative Financial Instruments**

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

The Company's derivative contracts contain provisions that require the Company to post cash collateral with the counterparties for contracts that are in a net liability position based on their fair values and the Company's credit rating. The Company had a notional amount of \$43.0 million in interest rate swap agreements on its junior subordinated debentures and \$10.9 million in cash held as collateral. The Company swapped the variable cost for a

fixed cost and the terms of the interest rate swap agreements are as follows:

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

The fair value of the swap agreements on our junior subordinated debentures at December 31, 2011 was a liability of \$11.2 million and, as this instrument qualifies as a highly effective cash flow hedge, the \$6.6 million decrease in fair value was recorded in other comprehensive income, net of tax, and other liabilities. Net payments under the swap transactions were \$839,000 in 2011, and have been classified as cash flows from operating activities in the statement of cash flows. The Company expects net payments of \$1.7 million in 2012, which will be reclassified from accumulated other comprehensive loss to earnings.

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

**16. Commitments and Contingencies (continued)**

At December 31, 2010, the Company had a notional amount of \$30.0 million in forward interest rate swap agreements on its junior subordinated debentures. In 2010, the Company swapped a portion of the variable cost for a fixed cost.

**Customer Derivatives**

The Company has a notional amount of \$6.1 million in an interest rate swap agreement with a commercial customer and an interest rate swap agreement of an equal notional amount with a dealer bank related to the Company's commercial loan level derivative program. As the two swap agreements have substantially equivalent and offsetting terms, they do not materially change the Company's interest rate risk.

**Forward Commitments to Sell Residential Mortgage Loans**

The Company enters into forward commitments to sell residential mortgages in order to reduce the market risk associated with originating loans for sale in the secondary market. Commitments totaled \$7.8 million and \$9.4 million at December 31, 2011 and 2010, respectively. At December 31, 2011, the Company recognized a \$37,000 gain on commitments to sell mortgages.

As part of originating residential mortgage and commercial loans, the Company may enter into rate lock agreements with customers, and may issue commitment letters to customers, which are considered interest rate lock or forward commitments. At December 31, 2011 and 2010, based upon the pipeline of mortgage loans with rate lock commitments and commercial loans with commitment letters, and the change in fair value of those commitments due to changes in market interest rates, the Company determined the impact on the consolidated financial statements was not material.

**17. Fair Value**

GAAP permits an entity to choose to measure eligible financial instruments and other items at fair value. The Company has not made any fair value elections as of December 31, 2011.

Pursuant to GAAP, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A three-level hierarchy exists in GAAP for fair value measurements based upon the inputs to the valuation of an asset or liability.

*Level 1:* Valuation is based on quoted prices in active markets for identical assets and liabilities.

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

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

When available, the Company attempts to use quoted market prices in active markets to determine fair value and classifies such items as Level 1 or Level 2. If quoted market prices in active markets are not available, fair value is often determined using model-based techniques incorporating various assumptions including interest rates, prepayment speeds and credit losses. Assets and liabilities valued using model-based techniques are classified as either Level 2 or Level 3, depending on the lowest level classification of an input that is considered significant to the overall valuation.

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(Amounts in Tables Expressed in Thousands, Except  
Number of Shares and per Share Data)****17. Fair Value (continued)**

The following table summarizes assets and liabilities measured at estimated fair value on a recurring basis:

	Readily Available Market Prices (Level 1)	Observable Market Prices (Level 2)	Company Determined Market Prices (Level 3)	Total
Fair Value Measurements at December 31, 2011				
Assets:				
Securities available-for-sale:				
Obligations of U.S. government sponsored enterprises	\$	\$ 30,107	\$	\$ 30,107
Obligations of states and political subdivisions		39,758		39,758
Mortgage-backed securities issued or guaranteed by U.S. government sponsored enterprises		505,384		505,384
Private issue collateralized mortgage obligations		10,641		10,641
Equity securities		4,146		4,146
Trading account assets	2,244			2,244
Liabilities:				
Interest rate swap agreements		11,387		11,387
Fair Value Measurements at December 31, 2010				
Assets:				
Securities available-for-sale:				
Obligations of U.S. government sponsored enterprises	\$	\$ 49,357	\$	\$ 49,357
Obligations of states and political subdivisions		14,220		14,220
Mortgage-backed securities issued or guaranteed by U.S. government sponsored enterprises		464,842		464,842
Private issue collateralized mortgage obligations		20,722		20,722
Equity securities		4,438		4,438
Trading account assets	2,304			2,304
Liabilities:				
Interest rate swap agreements		1,091		1,091



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(Amounts in Tables Expressed in Thousands, Except  
Number of Shares and per Share Data)****17. Fair Value (continued)**

The following table summarizes assets and liabilities measured at fair value on a non-recurring basis:

	Readily Available Market Prices (Level 1)	Observable Market Prices (Level 2)	Company Determined Market Prices (Level 3)	Total
Fair Value Measurements at December 31, 2011				
Assets:				
Impaired loans	\$	\$ 18,183	\$	\$ 18,183
Goodwill			276	276
Other real estate owned			1,682	1,682
Mortgage servicing rights		1,138		1,138
Fair Value Measurements at December 31, 2010				
Assets:				
Impaired loans	\$	\$ 19,262	\$	\$ 19,262
Other real estate owned			2,387	2,387
Mortgage servicing rights		1,381		1,381

The following table reconciles the beginning and ending balances of other real estate owned ( OREO ) measured at fair value on a non-recurring basis using significant unobservable (Level 3) inputs:

	Year Ended December 31,	
	2011	2010
Balance at beginning of year	\$ 2,387	\$ 5,479
Additions	1,989	1,479
Disposals	(2,506 )	(2,965 )
Write-downs	(188 )	(1,606 )
Balance at end of period	\$ 1,682	\$ 2,387

OREO properties acquired through foreclosure or deed-in-lieu of foreclosure are recorded at the fair value of the real estate, less costs to sell. Any write-down of the recorded investment in the related loan is charged to the allowance for loan losses upon transfer to OREO. Upon acquisition of a property, a current appraisal or a broker's opinion is used to

substantiate fair value for the property. After foreclosure, management periodically obtains updated valuations of the OREO assets and, if additional impairments are deemed necessary, the subsequent write-downs for declines in value are recorded through a valuation allowance and a provision for losses charged to other non-interest expense. A rollforward of goodwill activity for 2011 is presented in Note 4.



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(Amounts in Tables Expressed in Thousands, Except  
Number of Shares and per Share Data)****17. Fair Value (continued)**

The carrying amounts and estimated fair value for financial instrument assets and liabilities are presented in the following table:

	December 31, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and due from banks	\$ 39,325	\$ 39,325	\$ 31,009	\$ 31,009
Securities available-for-sale	590,036	590,036	553,579	553,579
Securities held-to-maturity			36,102	38,037
Trading account assets	2,244	2,244	2,304	2,304
Loans held for sale	6,061	6,268	5,528	5,575
FHLB and Federal Reserve Bank stock	21,962	21,962	21,962	21,962
Loans receivable, net of allowance	1,491,017	1,510,277	1,502,459	1,523,451
Mortgage servicing rights	768	1,138	898	1,381
Interest receivable	6,431	6,431	6,875	6,875
Financial liabilities:				
Deposits	1,591,366	1,600,222	1,515,811	1,522,899
FHLB advances	136,860	143,642	214,236	220,099
Commercial repurchase agreements	71,243	75,342	106,355	114,188
Other borrowed funds	204,413	204,413	195,714	195,714
Junior subordinated debentures	43,717	43,717	43,614	50,843
Interest payable	1,093	1,093	1,841	1,841
Interest rate swap agreements	11,387	11,387	1,091	1,091

The following assumptions, methods and calculations were used in determining the estimated fair value of financial instruments:

*Cash and Due from Banks:* The carrying amounts of cash and due from banks approximate their fair value.

*Securities Available-for-Sale and Trading Account Assets:* The fair value of debt securities available-for-sale and trading account assets is reported utilizing prices provided by an independent pricing service based on recent trading activity and other observable information including, but not limited to, dealer quotes, market spreads, cash flows, market interest rate curves, market consensus prepayment speeds, credit information, and the bond's terms and conditions. The fair value of equity securities available-for-sale was calculated using a discounted cash flow analysis

using observable information including, but not limited to, cash flows, risk-adjusted discount rates and market spreads.

*Securities Held-to-Maturity:* Fair values of securities held-to-maturity are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

*FHLB and Federal Reserve Bank Stock:* The carrying amount approximates fair value.

*Loans Held for Sale:* Loans held for sale are reported at the lower of cost or market in the aggregate, with any adjustment for net unrealized losses reported in non-interest income. Market is based on executed sales agreements for these loans.

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**CAMDEN NATIONAL CORPORATION**

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**17. Fair Value (continued)**

*Loans:* For variable rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. The fair value of other loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Loan impairment is deemed to exist when full repayment of principal and interest according to the contractual terms of the loan is no longer probable. Impaired loans are reported based on one of three measures: the present value of expected future cash flows discounted at the loan's effective interest rate; the loan's observable market price; or the fair value of the collateral if the loan is collateral dependent. If the fair value measure is less than an impaired loan's recorded investment, an impairment loss is recognized as part of the ALL. Accordingly, certain impaired loans may be subject to measurement at fair value on a non-recurring basis. Management has estimated the fair values of these assets using Level 2 inputs, such as the fair value of collateral based on independent third-party appraisals for collateral-dependent loans.

*Mortgage Servicing Rights:* The fair value of mortgage servicing rights is based on a valuation model that calculates the present value of estimated net servicing income. The Company obtains a third-party valuation based upon loan data including note rate, loan type and the term of the underlying loans. The model utilizes a variety of observable inputs for its assumptions, the most significant of which are loan prepayment assumptions and the discount rate used to discount future cash flows. Other assumptions include delinquency rates, servicing cost inflation and annual unit loan cost.

*Interest Receivable and Payable:* The carrying amounts approximate their fair value.

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

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

*Junior Subordinated Debentures:* At December 31, 2011, carrying amounts approximate their fair value. At December 31, 2010, the fair value was estimated using a discounted cash flow calculation that applies current rates for debentures of similar maturity.

*Derivatives:* The determination of the fair value of many derivatives is mainly derived from inputs that are observable in the marketplace. Such inputs include yield curves, publicly available volatilities, and floating indexes, and accordingly, are classified as Level 2 inputs. Valuations of derivative assets and liabilities reflect the value of the instruments including the values associated with counterparty risk. With the issuance of FASB Accounting Standards Codification Topic 820, these values must also take into account the Company's own credit standing, thus including in the valuation of the derivative instrument the value of the net credit differential between the counterparties to the derivative contract. The Company does not determine credit value adjustment on derivative assets and liabilities where the Company and/or its affiliates are the counterparties, because it believes there is no material exposure to counterparty credit risk.

## **18. Regulatory Capital Requirements**

The Company and its bank subsidiary are subject to various regulatory capital requirements administered by the FRB and the OCC. Failure to meet minimum capital requirements can result in mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's Consolidated Financial Statements. These capital requirements represent quantitative measures of the Company's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting

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(Amounts in Tables Expressed in Thousands, Except  
Number of Shares and per Share Data)****18. Regulatory Capital Requirements (continued)**

practices. The Company's capital classification is also subject to qualitative judgments by its regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total and Tier 1 capital (as defined in the applicable regulations) to risk-weighted assets (as defined in the applicable regulations) and of Tier 1 capital to average assets (as defined in the applicable regulations). In addition, the OCC requires a minimum level of \$2.5 million of Tier 1 capital to be maintained at Acadia Trust, N.A. Management believes that, as of December 31, 2011, the Company and its subsidiaries meet all capital requirements to which they are subject.

As of December 31, 2011, the Bank was categorized by its supervisory regulatory agencies as well capitalized. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events that management believes have changed the Bank's respective capital categories.

The Bank's actual capital amounts and ratios are presented in the following table:

	Actual Regulatory Capital		Minimum Regulatory Capital Required		Minimum Regulatory Provision To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2011						
Total risk-based capital	\$ 208,580	14.50 %	\$ 115,074	8.00 %	\$ 143,842	10.00 %
Tier 1 capital	190,538	13.25	57,537	4.00	86,305	6.00
Tier 1 leverage capital ratio	190,538	8.63	89,836	4.00	112,295	5.00
As of December 31, 2010						
Total risk-based capital	\$ 194,172	13.63 %	\$ 113,977	8.00 %	\$ 142,472	10.00 %
Tier 1 capital	176,307	12.37	56,989	4.00	85,483	6.00
Tier 1 leverage capital ratio	176,307	7.84	89,928	4.00	112,410	5.00

The Company's actual capital amounts and ratios are presented in the following table:

	Actual Regulatory Capital	Minimum Regulatory Capital Required	Minimum Regulatory Provision To Be
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	Amount	Ratio	Amount	Ratio	Well Capitalized	
					Amount	Ratio
As of December 31, 2011						
Total risk-based capital	\$ 232,339	15.95 %	\$ 116,567	8.00 %	\$ 145,709	10.00 %
Tier 1 capital	214,066	14.69	58,284	4.00	87,426	6.00
Tier 1 leverage capital ratio	214,066	9.59	91,056	4.00	113,820	5.00
As of December 31, 2010						
Total risk-based capital	\$ 216,516	15.05 %	\$ 115,097	8.00 %	\$ 143,871	10.00 %
Tier 1 capital	198,479	13.80	57,548	4.00	86,322	6.00
Tier 1 leverage capital ratio	198,479	8.77	90,539	4.00	113,174	5.00

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Number of Shares and per Share Data)****19. Accumulated Other Comprehensive Income (Loss)**

The following table presents the components of accumulated other comprehensive income (loss) and the related tax effects allocated to each component for the years ended December 31, 2011, 2010 and 2009:

	Before-Tax Amount	Tax Effect	Accumulated Other Comprehensive Income (Loss)
Balance, December 31, 2008	\$(1,765 )	\$ 617	\$ (1,148 )
Unrealized gains on securities available for sale:			
Change in fair value of securities arising during period	11,076	(3,870 )	7,206
Net security gains realized during the period	(52 ) <sup>(a)</sup>	18	(34 )
Postretirement plans:			
Net actuarial gain	138	(48 )	90
Net prior service cost amortization	19	(7 )	12
Net change in fair value of cash flow hedges	1,136	(397 )	739
Balance, December 31, 2009	10,552	(3,687 )	6,865
Unrealized gains on securities available for sale:			
Change in fair value of securities arising during period	(1,714 )	594	(1,120 )
Net security losses realized during the period	409 <sup>(a)</sup>	(143 )	266
Postretirement plans:			
Net actuarial loss	(379 )	132	(247 )
Net prior service cost amortization	19	(6 )	13
Net change in fair value of cash flow hedges	(2,227 )	779	(1,448 )
Balance, December 31, 2010	6,660	(2,331 )	4,329
Unrealized gains on securities available for sale:			
Change in fair value of securities arising during period	9,613	(3,365 )	6,248
Net security gains realized during the period	(2,076 ) <sup>(a)</sup>	727	(1,349 )
Postretirement plans:			
Net actuarial loss	(960 )	336	(624 )
Net prior service cost amortization	19	(7 )	12
Net change in fair value of cash flow hedges	(10,085)	3,530	(6,555 )
Balance, December 31, 2011	\$3,171	\$(1,110 )	\$ 2,061

(a) Net security gains (losses) include before-tax OTTI credit related losses of \$109,000, \$221,000 and \$11,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

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(Amounts in Tables Expressed in Thousands, Except  
Number of Shares and per Share Data)****20. Parent Company Financial Statements**

Following are the condensed Statements of Condition, Income and Cash Flows for the Company:

**STATEMENTS OF CONDITION**

	December 31,	
	2011	2010
<b>ASSETS</b>		
Cash	\$ 18,661	\$ 12,574
Trading assets	2,244	2,304
Premises and equipment	4,896	5,432
Investment in subsidiaries:		
Bank subsidiary	239,953	221,136
Other subsidiary	11,205	12,682
Amounts receivable from subsidiaries	1,572	1,565
Investments in Camden Capital Trust A and Union Bankshares Capital Trust I	1,331	1,331
Other assets	8,049	4,307
Total assets	\$ 287,911	\$ 261,331
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Amounts due to subsidiaries	\$	\$ 14
Junior subordinated debentures	43,717	43,614
Accrued interest and other liabilities	25,318	11,708
Shareholders' equity	218,876	205,995
Total liabilities and shareholders' equity	\$ 287,911	\$ 261,331

**STATEMENTS OF INCOME**

	Years Ended December 31,		
	2011	2010	2009
Operating Income			
Dividend income from subsidiaries	\$ 15,400	\$ 12,400	\$ 12,000
Fees from subsidiaries	18,048	16,821	15,218

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Other income	13	188	256
Total operating income	33,461	29,409	27,474
Operating Expenses			
Interest on borrowings	2,614	2,817	2,845
Salaries and employee benefits	11,417	10,316	9,598
Net occupancy	473	461	483
Furniture, equipment and data processing	3,296	3,158	2,278
Other operating expenses	3,041	3,186	3,286
Total operating expenses	20,841	19,938	18,490
Income before equity in undistributed earnings of subsidiaries and income taxes	12,620	9,471	8,984
Equity in undistributed earnings of subsidiaries	12,441	14,372	12,792
Income before income taxes	25,061	23,843	21,776
Income tax benefit	1,116	923	997
Net Income	\$26,177	\$24,766	\$22,773

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(Amounts in Tables Expressed in Thousands, Except  
Number of Shares and per Share Data)****20. Parent Company Financial Statements (continued)****STATEMENTS OF CASH FLOWS**

	Years Ended December 31,		
	2011	2010	2009
Operating Activities			
Net income	\$26,177	\$24,766	\$22,773
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiaries	(12,441)	(14,372)	(12,792 )
Depreciation and amortization	1,194	1,182	944
Stock-based compensation expense	1,025	809	1,072
(Increase) decrease in amount receivable from subsidiaries	(22 )	(573 )	2,945
Increase in other assets	(35 )	(1,962 )	(1,068 )
Increase in accrued expenses	3,522	1,992	1,318
Net cash provided by operating activities	19,420	11,842	15,192
Investing Activities			
Purchase of premises and equipment	(1,286 )	(2,759 )	(865 )
Net cash used by investing activities	(1,286 )	(2,759 )	(865 )
Financing Activities			
Exercise of stock options and restricted stock, net	(134 )	114	6
Common stock repurchase	(389 )	(49 )	(55 )
Cash dividends paid on common stock	(11,524)	(7,664 )	(7,654 )
Net cash used by financing activities	(12,047)	(7,599 )	(7,703 )
Net increase in cash	6,087	1,484	6,624
Cash at beginning of year	12,574	11,090	4,466
Cash at end of year	\$18,661	\$12,574	\$11,090

**21. Quarterly Results of Operations (Unaudited)**

The following table presents a summary of the quarterly results of operations for 2011 and 2010:

2011				2010			
First	Second	Third	Fourth	First	Second	Third	Fourth

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Interest income	\$24,860	\$25,645	\$24,386	\$23,481	\$26,171	\$26,326	\$26,278	\$25,732
Interest expense	6,301	6,082	5,739	5,031	8,106	7,771	7,399	6,941
Net interest income	18,559	19,563	18,647	18,450	18,065	18,555	18,879	18,791
Provision for credit losses	1,119	970	1,182	1,464	1,996	1,950	1,291	1,062
Non-interest income	5,118	5,006	5,825	7,104	4,539	4,419	6,824	5,043
Non-interest expense	13,285	13,272	13,307	15,715	12,889	12,851	13,484	13,713
Income before income taxes	9,273	10,327	9,983	8,375	7,719	8,173	10,928	9,059
Income tax expense	2,934	3,257	3,054	2,536	2,406	2,587	3,487	2,633
Net income	\$6,339	\$7,070	\$6,929	\$5,839	\$5,313	\$5,586	\$7,441	\$6,426
Per common share:								
Basic	\$0.83	\$0.92	\$0.90	\$0.76	\$0.69	\$0.73	\$0.97	\$0.84
Diluted	\$0.83	\$0.92	\$0.90	\$0.76	\$0.69	\$0.73	\$0.97	\$0.84

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# REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Shareholders and Board of Directors  
Camden National Corporation

We have audited the accompanying consolidated statements of condition of Camden National Corporation and Subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. We have also audited Camden National Corporation's internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Camden National Corporation's management is responsible for these financial statements, 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's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting 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 audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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 U.S. 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 U.S. 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Camden National Corporation and Subsidiaries as of December 31, 2011 and 2010, and the consolidated results of their operations and their consolidated cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, Camden National Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in COSO.

/s/ Berry Dunn McNeil & Parker, LLC

Berry Dunn McNeil & Parker, LLC  
Bangor, Maine  
March 2, 2012

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## **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

During the past two fiscal years, the Company has not made changes in, and has not had disagreements with, its independent accountant on accounting and financial disclosures.

### **Item 9A. Controls and Procedures**

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the Exchange Act), the Company's management conducted an evaluation with the participation of the Company's Chief Executive Officer and Chief Financial Officer & Principal Financial and Accounting Officer, regarding the effectiveness of the Company's disclosure controls and procedures, as of the end of the last fiscal year. In designing and evaluating the Company's disclosure controls and procedures, the Company and its management recognize that any controls and procedures, no matter how well designed and operated, can provide only a reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer & Principal Financial and Accounting Officer concluded that they believe the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. We intend to continue to review and document our disclosure controls and procedures, including our internal controls and procedures for financial reporting, and we may from time to time make changes to the disclosure controls and procedures to enhance their effectiveness and to ensure that our systems evolve with our business.

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

## **MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Management of the Company is responsible for the preparation and fair presentation of the financial statements and other financial information contained in this Form 10-K. Management is also responsible for establishing and maintaining adequate internal control over financial reporting and for identifying the framework used to evaluate its effectiveness. Management has designed processes, internal controls and a business culture that foster financial integrity and accurate reporting. The Company's comprehensive system of internal control over financial reporting was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the consolidated financial statements of the Company in accordance with accounting principles generally accepted in the United States of America. The Company's accounting policies and internal control over financial reporting, established and maintained by management, is under the general oversight of the Company's board of directors, including the board of directors' Audit Committee.

Management has made a comprehensive review, evaluation, and assessment of the Company's internal control over financial reporting as of December 31, 2011. The standard measures adopted by management in making its evaluation are the measures in *Internal Control - Integrated Framework* published by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO). Based upon its review and evaluation, management concluded that, as of

December 31, 2011, the Company's internal control over financial reporting was effective and that there were no material weaknesses. However, Management recognizes a control system, no matter how well designed and operated, has inherent limitations and can provide only reasonable, not absolute, assurance that the control system's objectives will be met and may not prevent or detect all error and fraud. Therefore, even a system determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Berry Dunn McNeil & Parker, LLC, an independent registered public accounting firm, which has audited and reported on the consolidated financial statements contained in this Form 10-K, has issued its written attestation report on management's assessment of the Company's internal control over financial reporting which precedes this report.

## **Item 9B. Other Information**

None

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TABLE OF CONTENTS**PART III****Item 10. Directors, Executive Officers and Corporate Governance**

The information required by this item is incorporated by reference from the material responsive to such item in the Company's Proxy Statement for the 2012 Annual Meeting of Shareholders to be held on May 1, 2012.

**Item 11. Executive Compensation**

The information required by this item is incorporated by reference from the material responsive to such item in the Company's Proxy Statement for the 2012 Annual Meeting of Shareholders to be held on May 1, 2012.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Securities authorized for issuance under equity compensation plans are as follows:

	Number of Securities to Be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance (Excluding Securities in Column a) (c)
Equity compensation plans approved by shareholders	239,383	\$ 21.80	498,326
Equity compensation plans not approved by shareholders			
Total	239,383	\$ 21.80	498,326

Refer to Notes 1 and 14 to the Consolidated Financial Statements within Item 8. Financial Statements and Supplementary Data for further information related to the Company's equity compensation plans.

Other information required by this item is incorporated by reference from the material responsive to such item in the Company's Proxy Statement for the 2012 Annual Meeting of Shareholders to be held on May 1, 2012.

**Item 13. Certain Relationships, Related Transactions and Director Independence**

The information required by this item is incorporated by reference from the material responsive to such item in the Company's Proxy Statement for the 2012 Annual Meeting of Shareholders to be held on May 1, 2012.

## **Item 14. Principal Accounting Fees and Services**

The information required by this item is incorporated by reference from the material responsive to such item in the Company's Proxy Statement for the 2012 Annual Meeting of Shareholders to be held on May 1, 2012.

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## (a) 1. Index to 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:

<u>Consolidated Statements of Condition</u>	Page <u>51</u>
<u>Consolidated Statements of Income</u>	<u>52</u>
<u>Consolidated Statements of Changes in Shareholders' Equity</u>	<u>53</u>
<u>Consolidated Statements of Cash Flows</u>	<u>54</u>
<u>Notes to Consolidated Financial Statements</u>	<u>55</u>
<u>Report of Independent Registered Public Accounting Firm</u>	<u>99</u>

## 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:

Exhibit No.	Definition
(2.1)	Agreement and Plan of Merger, dated as of August 13, 2007, by and between the Company and Union Bankshares Company (incorporated herein by reference to Exhibit 2.1 to the Company's Form 8-K filed with the Commission on August 14, 2007).
(3.i.1)	Articles of Incorporation of Camden National Corporation, as amended (incorporated herein by reference to Exhibit 3.i.1 to the Company's Form 10-K filed with the Commission on March 2, 2011).
(3.ii)*	The Bylaws of Camden National Corporation, as amended to date
(10.1)	The Bank's 1993 Stock Option Plan (incorporated herein by reference to Exhibit 10.1 to the Company's Form 10-Q filed with the Commission on November 3, 2006).
(10.2)	Amendment No. 1 to the 1993 Stock Option Plan (incorporated herein by reference to Exhibit 10.2 to the Company's Form 10-Q filed with the Commission on November 3, 2006).
(10.3)	The Company's 2003 Stock Option and Incentive Plan (incorporated by reference to Exhibit 10.1 to the Company's Form 10-Q filed with the Commission on August 8, 2008).
(10.4)	The Company's form of Incentive Stock Option Agreement (incorporated herein by reference to Exhibit 10.4 to the Company's Form 10-K filed with the Commission on March 2, 2011).
(10.5)	The Company's form of Restricted Stock Award Agreement (incorporated herein by reference to Exhibit 10.5 to the Company's Form 10-K filed with the Commission on March 2, 2011).
(10.6)	Management Stock Purchase Plan, as amended April 29, 2008 (incorporated herein by

reference to Exhibit 10.3 to the Company's Form 8-K filed with the Commission on May 1, 2008).

(10.7) The Company's Defined Contribution Retirement Plan (incorporated herein by reference to Exhibit 99.1 to the Company's Form 8-K filed with the Commission on February 4, 2008).

(10.8) The Company's Supplemental Executive Retirement Program (incorporated herein by reference to Exhibit 99.1 to the Company's Form 8-K filed with the Commission on February 4, 2008).

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Exhibit No.	Definition
(10.9)	Union Trust Company's Amended and Restated Deferred Compensation Agreement (incorporated herein by reference to Exhibit 10.1 to the Company's Form 10-Q filed with the Commission on May 12, 2008).
(10.10)	Executive Deferred Compensation Plan (incorporated herein by reference to Exhibit 10.9 to the Company's Form 10-K filed with the Commission on March 17, 2008).
(10.11)	Director Deferred Compensation Plan (incorporated herein by reference to Exhibit 10.10 to the Company's Form 10-K filed with the Commission on March 17, 2008).
(10.12)	The Company's Audit Committee Complaint Procedures (incorporated herein by reference to Exhibit 10.12 to the Company's Form 10-K filed with the Commission on March 2, 2011).
(10.13)	The Company's 2010 Executive Incentive Compensation Program (incorporated herein by reference to Exhibit 10.19 to the Company's Form 10-K filed with the Commission on March 12, 2010).
(10.14)	Form of Change in Control Agreement for chief executive officer (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed with the Commission on April 14, 2009).
(10.15)	Form of Change in Control Agreement for named executive officers (incorporated herein by reference to Exhibit 10.2 to the Company's Form 8-K filed with the Commission on April 14, 2009).
(10.16)	Amended and Restated Employment Agreement between Camden National Corporation and Robert W. Daigle, dated as of April 29, 2008 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed with the Commission on May 1, 2008).
(10.17)	The Company's Amended and Restated Long-Term Performance Share Plan (incorporated herein by reference to Exhibit 10.17 to the Company's Form 8-K filed with the Commission on March 30, 2011).
(11.1)	Statement re computation of per share earnings is provided in Note 12 to the Notes to Consolidated Financial Statements in this report.
(14)	The Company's Code of Business Conduct and Ethics (incorporated herein by reference to Exhibit 14 to the Company's Form 10-K filed with the Commission on March 2, 2011).
(21)*	Subsidiaries of the Company.
(23)*	Consent of Berry Dunn McNeil & Parker, LLC relating to the Company's financial statements.
(31.1)*	Certification of President and Chief Executive Officer required by Section 302 of the Sarbanes-Oxley Act of 2002.
(31.2)*	Certification of Principal Financial and Accounting Officer required by Section 302 of the Sarbanes-Oxley Act of 2002.
(32.1)*	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as required by Section 906 of the Sarbanes-Oxley Act of 2002.
(32.2)*	Certification of Principal Financial and Accounting Officer pursuant to 18 U.S.C. Section 1350, as required by Section 906 of the Sarbanes-Oxley Act of 2002.

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Exhibit  
No.      Definition

(101)\*\*\*      The following materials from the Company's Annual Report on Form 10-K for the year ended December 31, 2011 formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Stockholders' Equity, (iv) the Consolidated Statements of Comprehensive Income (v) the Consolidated Statements of Cash Flows, and (vi) related notes to these financial statements.

\*

Filed herewith

\*\*

Furnished herewith

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

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Pursuant to the requirement 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.

**CAMDEN NATIONAL CORPORATION**

/s/ Gregory A. Dufour

Gregory A. Dufour

President and Chief Executive Officer

Date: March 2, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name	Position	Date
/s/ Gregory A. Dufour Gregory A. Dufour	President, Director and Chief Executive Officer	February 28, 2012
/s/ Deborah A. Jordan Deborah A. Jordan	Chief Financial Officer and Principal Financial and Accounting Officer	February 28, 2012
/s/ Karen W. Stanley Karen W. Stanley	Chairman and Director	February 28, 2012
/s/ Ann W. Bresnahan Ann W. Bresnahan	Director	February 28, 2012
/s/ Robert J. Campbell Robert J. Campbell	Director	February 28, 2012
/s/ David C. Flanagan David C. Flanagan	Director	February 28, 2012
/s/ Craig S. Gunderson Craig S. Gunderson	Director	February 28, 2012
/s/ John W. Holmes John W. Holmes	Director	February 28, 2012
/s/ Rendle A. Jones Rendle A. Jones	Director	February 28, 2012
/s/ James H. Page James H. Page	Director	February 28, 2012
/s/ John M. Rohman John M. Rohman	Director	February 28, 2012
/s/ Robin A. Sawyer Robin A. Sawyer	Director	February 28, 2012