BAR HARBOR BANKSHARES
Form 10-K
March 16, 2009

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, 2008

____ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ___________ to ___________.

Commission File Number

: 0-13666

BAR HARBOR BANKSHARES

(*Exact name of registrant as specified in its charter*)

Maine		01-0393663
(*State or other jurisdiction of incorporation or organization*)		(*I.R.S. Employer Identification No.*)
P.O. Box 400, 82 Main Street Bar Harbor, Maine	04609-0400	(207) 288-3314
(*Address of principal executive offices*)	(*Zip Code*)	(*Registrant s telephone number, including area code*)

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

Title of class
Common Stock, $2.00 par value per share

Name of exchange on which registered
NYSE Alternext U.S.

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act: YES ___ NO_X_

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act: YES ___ NO_X_

Indicate by check mark if the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days: YES _X_ NO___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this

Form 10-K. ___

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act: Large accelerated filer ___ Accelerated filer _X_ Non-accelerated filer (do not check if a smaller reporting company) ___ Smaller reporting company ___

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

As of June 30, 2008, the aggregate market value of the 2,885,486 shares of Common Stock of the Registrant issued and outstanding on such date, excluding the approximately 56,542 shares held by all directors and executive officers of the Registrant as a group (which does not include unexercised stock options), was $80,447,350. This aggregate market value is based on the last sale price of $27.88 per share of the Registrant s Common Stock on June 30, 2008, as reported in *The Wall Street Journal* on July 1, 2008. Although directors of the Registrant and executive officers of the Registrant and its subsidiaries were assumed to be "affiliates" of the Registrant for purposes of this calculation, the classification is not to be interpreted as an affirmation of such status.

Number of shares of Common Stock par value $2.00 outstanding as of March 03, 2009: **2,870,221**

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 19, 2009 are incorporated by reference into Part III, Items 10-14 of this Annual Report on Form 10-K.

FORWARD-LOOKING STATEMENTS DISCLAIMER

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

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

(i) The Company's success is dependent to a significant extent upon general economic conditions in Maine, and Maine's ability to attract new business, as well as factors that affect tourism, a major source of economic activity in the Company s immediate market areas;

(ii) The Company's earnings depend to a great extent on the level of net interest income (the difference between interest income earned on loans and securities and the interest expense paid on deposits and borrowings) generated by the Company s wholly-owned banking subsidiary, Bar Harbor Bank & Trust, (the "Bank"), and thus the Company s results of operations may be adversely affected by increases or decreases in interest rates;

(iii) The banking business is highly competitive and the profitability of the Company depends on the Bank's ability to attract loans and deposits in Maine, where the Bank competes with a variety of traditional banking and nontraditional institutions, such as credit unions and finance companies;

(iv) A significant portion of the Bank's loan portfolio is comprised of commercial loans and loans secured by real estate, exposing the Company to the risks inherent in financings based upon analysis of credit risk, the value of underlying collateral, and other intangible factors which are considered in making commercial loans and, accordingly, the Company's profitability may be negatively impacted by judgment errors in risk analysis, by loan defaults, and the ability of certain borrowers to repay such loans during a downturn in general economic conditions;

(v) A significant delay in or inability to execute strategic initiatives designed to increase revenues and or control expenses;

(vi) The potential need to adapt to changes in information technology systems, on which the Company is highly dependent, could present operational issues or require significant capital spending;

(vii) Significant changes in the Company s internal controls, or internal control failures;

(viii) Acts or threats of terrorism and actions taken by the United States or other governments as a result of such threats, including military action, could further adversely affect business and economic conditions in the United States generally and in the Company s markets, which could have an adverse effect on the Company s financial performance and that of borrowers and on the financial markets and the price of the Company s common stock;

(ix) Significant changes in the extensive laws, regulations, and policies governing bank holding companies and their subsidiaries could alter the Company's business environment or affect its operations. Because of deterioration of the financial markets in 2008 and 2009, more laws and regulations imposing requirements and restrictions on banks and bank holding companies are expected to be adopted in 2009 which could have a significant effect on the business of the Bank and results of operations of the Company; and

(x) The effectiveness of the Emergency Economic Stabilization Act of 2008 ("EESA") and the other legislative and regulatory efforts to stabilize the U. S. financial markets.

(xi) Changes in general, national, international, regional or local economic conditions and credit markets which are less favorable than those anticipated by Company management, including fears of global economic depression and continued subprime loan and credit issues, impacting the Company's investment securities portfolio, quality of credits, or the overall demand for the Company's products or services; and

(xii) The Company s success in managing the risks involved in all of the foregoing matters.

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

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PART I

ITEM 1. BUSINESS

Organization

Bar Harbor Bankshares (the "Company") ("BHB") was incorporated under the laws of the state of Maine on January 19, 1984. As of March 3, 2009, the Company s authorized securities consisted of: 10,000,000 shares of common stock, par value of $2.00 per share, of which there were 2,870,221 shares outstanding held of record by approximately 1,001 shareholders; and 1,000,000 shares of preferred stock, of which 18,751 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, no par value per share, $1,000 per share liquidation, are issued and outstanding and entirely owned by the U.S. Treasury in connection with the Company s participation in the U.S. Treasury s Capital Purchase Program ("CPP").

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

The Company is a bank holding company ("BHC") registered under the Bank Holding Company Act of 1956, as amended (the "BHC Act"), and is subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve System (the "FRB"). The Company is also a Maine Financial Institution Holding Company for the purposes of the laws of the state of Maine, and as such is subject to the jurisdiction of the Superintendent (the "Superintendent") of the Maine Bureau of Financial Institutions ("BFI").

Bar Harbor Bank & Trust

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

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

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

The Bank has a broad deposit base and loss of any one depositor or closely aligned group of depositors would not have a material adverse effect on its business. Historically, the banking business in the Bank s market area has been seasonal, with lower deposits in the winter and spring, and higher deposits in the summer and autumn. These seasonal swings have been fairly predictable and have historically not had a material adverse impact on the Bank or its liquidity position. Approximately 90% of the Bank s deposits are in interest bearing accounts. The Bank has paid, and anticipates that it will continue to pay, competitive interest rates on all of the deposit account products it offers and does not anticipate any material loss of these deposits.

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

Retail Products and Services

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

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

Retail Brokerage Services:

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

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

Electronic Banking Services:

The Bank continues to offer free Internet banking services, including free check images and electronic bill payment, through its dedicated website at www.BHBT.com. Additionally, the Bank offers TeleDirect, an interactive voice response system through which customers can check account balances and activity, as well as initiate money transfers between their accounts. Automated Teller Machines (ATMs) are located at each of the Bank s twelve (12) branch locations, as well as two machines in non-Bank locations. These ATMs access major networks throughout the United States, including Plus, NYCE, and other major ATM and credit card companies. The Bank is also a member of Maine Cash Access, providing customers with surcharge-free access to 230 ATMs throughout the state of Maine. Visa debit cards are also offered, providing customers with free access to their deposit account balances at point of sale locations throughout most of the world.

Commercial Products and Services

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

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

Bar Harbor Trust Services

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

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

The staff includes credentialed investment and trust professionals with extensive experience. At December 31, 2008, Trust Services served 781 client accounts, with assets under management and held in custody amounting to $230 million and $17 million, respectively.

Competition

The Company competes principally in downeast and midcoast Maine, which can generally be characterized as rural areas. The Company considers its primary market areas to be in Hancock, Knox, and Washington counties, each in the state of Maine. According to the most recent Census Bureau Report (2006), the population of these three counties was 53,797, 41,096 and 33,288 respectively, representing a combined population of approximately 128,181. The economies in these three counties are based primarily on tourism, healthcare, fishing, aquaculture, agriculture, and small local businesses, but are also supported by a large contingent of retirees. Major competitors in these market areas include local independent banks, local branches of large regional bank affiliates, thrift institutions, savings and loan institutions, mortgage companies, and credit unions. Other competitors in the Company s primary market area include financing affiliates of consumer durable goods manufacturers, insurance companies, brokerage firms, investment advisors, and other non-bank financial service providers.

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

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

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

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

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

Management and Employees

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

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

As of December 31, 2008, the Bank employed 139 full-time equivalent employees, Trust Services employed 12 full-time equivalent employees, and the holding company employed 3 full-time employees, representing a full-time equivalent complement of 154

employees of the Company.

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

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

Supervision and Regulation

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

Some of the more significant statutory and regulatory provisions applicable to banks and BHCs, to which the Company and its subsidiaries are subject, are described more fully below, together with certain statutory and regulatory matters concerning the Company and its subsidiaries. The description of these statutory and regulatory provisions does not purport to be complete and is qualified in its entirety by reference to the particular statutory or regulatory provision. Any change in applicable law or regulation may have a material effect on the Company s business and operations, as well as those of its subsidiaries. Because of deterioration of the financial markets in 2008, more laws and regulations imposing requirements and restrictions on banks and bank holding companies are expected to be adopted in 2009. To the extent the following material describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statue or regulation.

Bank Holding Company Act

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

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

Bank Holding Company Support of Subsidiary Banks:

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

Regulatory Capital Requirements

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

The FRB risk-based guidelines define a three-tier capital framework. Tier 1 capital includes common shareholders equity and qualifying preferred stock, less goodwill and other adjustments. Tier 2 capital consists of preferred stock not qualifying as Tier 1 capital, mandatory convertible debt, limited amounts of subordinated debt, other qualifying term debt and the allowance for credit losses up to 1.25% of risk-weighted assets. Tier 3 capital includes subordinated debt that is unsecured, fully paid, has an original maturity of at least two years, is not redeemable before maturity without prior approval by the FRB and includes a lock-in clause precluding payment of either interest or principal if the payment would cause the issuing bank s risk-based capital ratio to fall or remain below the required minimum. The sum of Tier 1 and Tier 2 capital less investments in unconsolidated subsidiaries represents qualifying total capital. Risk-based capital ratios are calculated by dividing Tier 1 and total capital by risk-weighted assets. Assets and off-balance sheet exposures are assigned to one of four categories of risk-weights, based primarily on relative credit risk. The minimum Tier 1 capital ratio is 4% and the minimum total capital ratio is 8%. The Company s Tier 1 capital ratio as of December 31, 2008, was 9.95% and its total capital ratio was 11.60%.

The leverage ratio is determined by dividing Tier 1 capital by adjusted average total assets. Although the stated minimum ratio is 100 to 200 basis points above 3%, banking organizations are required to maintain a ratio of at least 5% to be classified as well-capitalized. The Company s leverage ratio as of December 31, 2008 was 6.61%.

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

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

- "well-capitalized" if it has a total risk based capital ratio of 10.0% or greater, has a Tier I risk based capital ratio of 6.0% or more, has a leverage ratio of 5.0% or greater and is not subject to any written agreement, order or capital directive or prompt corrective action directive;

- "adequately capitalized" if it has a total risk based capital ratio of 8.0% or greater, a Tier I risk based capital ratio of 4.0% or more, and a leverage ratio of 4.0% or greater (3.0% under certain circumstances) and does not meet the definition of a "well-capitalized bank;"

- "undercapitalized" if it has a total risk based capital ratio that is less than 8.0%, a Tier I risk based capital ratio that is less than 4.0% or a leverage ratio that is less than 4.0% (3.0% under certain circumstances);

- "significantly undercapitalized" if it has a total risk based capital ratio that is less than 6.0%, a Tier I risk based capital ratio that is less than 3.0% or a leverage ratio that is less than 3.0%; and

- "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%.

Regulators also must take into consideration (1) concentrations of credit risk; (2) interest rate risk (when the interest rate sensitivity of an institution s assets does not match the sensitivity of its liabilities or its off-balance-sheet position); and (3) risks from non-traditional activities, as well as an institution s ability to manage those risks, when determining the adequacy of an institution s capital. This evaluation will be made as a part of the institution s regular safety and soundness examination. In addition, the Company, and any bank with significant trading activity, must incorporate a measure for market risk into their regulatory capital calculations. At December 31, 2008, and at the time of this report, the Company s risk-based capital ratio and leverage ratio were well in excess of regulatory requirements, and its management expects these ratios to remain in excess of regulatory requirements. In addition, at December 31, 2008, and at the time of this report the Bank was well in excess of applicable FDIC requirements.

An institution generally must file a written capital restoration plan which meets specified requirements with an appropriate FDIC regional director within 45 days of the date that the institution receives notice or is deemed to have notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. An institution, which is required to submit a capital restoration plan, must concurrently submit a performance guaranty by each company that controls the institution. A critically undercapitalized institution generally is to be placed in conservatorship or receivership within 90 days unless the FDIC formally determines that forbearance from such action would better protect the deposit insurance fund. Immediately upon becoming undercapitalized, an institution becomes subject to the provisions of Section 38 of the Federal Deposit Insurance Act ("FDIA"), including for example, (i) restricting payment of capital distributions and management fees, (ii) requiring that the FDIC monitor the condition of the institution and its efforts to restore its capital, (iii) requiring submission of a capital restoration plan, (iv) restricting the growth of the institution s assets and (v) requiring prior approval of certain expansion proposals.

The federal banking agencies issued a final rule entitled "Risk Based Capital Standards: Advanced Capital Adequacy Framework-Basel II" ("Basel II") which became effective on April 1, 2008, and "core" banks ("core" banks are the approximately 20 largest U. S. bank holding companies) were required to adopt a board-approved plan to implement Basel II by October 1, 2008. Basel II will result in significant changes to the risk-based capital standards for "core" banks subject to Basel II and other banks that elect to use such rules to calculate their risk-based capital requirements. In connection with Basel II, the Agencies published a joint notice of proposed rulemaking entitled "Risk-Based Capital Guidelines: Capital Adequacy Guidelines: Standardized Framework" on July 29, 2008 (the "Standardized Approach Proposal"). The Standardized Approach Proposal, if adopted by the Agencies, would provide all non-core banks with an optional framework, based upon the standardized approach under the international Basel II Accord, for calculating their risk-based capital requirements. The Bank does not currently expect to calculate its capital ratios under Basel II or in accordance with the Standardized Approach Proposal. Accordingly, the Company is not yet in a position to determine the effect of such rules on its risk capital requirements.

Information concerning the Company and its subsidiaries with respect to capital requirements is incorporated by reference from Part II, Item 7, section entitled "Capital Resources" and from Part II, Item 8, Notes to Consolidated Financial Statements, Note 12 "Shareholders Equity," each in this Annual Report on Form 10-K for the year ended December 31, 2008.

Transactions with Affiliates:

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

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

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

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

Change in Bank Control Act

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

Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994

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

Declaration of Dividends

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

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

In addition to the foregoing, and as more fully described below under the caption "*Capital Purchase Program,"* the consent of the U. S. Treasury is generally required for any increase in common dividends per share.

Limitations on Bank Dividends

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

Activities and Investments of Insured State-Chartered Banks:

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

Safety and Soundness Standards:

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

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

Community Reinvestment:

The Community Reinvestment Act ("CRA") requires lenders to identify the communities served by the institution s offices and other deposit taking facilities and to make loans and investments and provide services that meet the credit needs of these communities. Regulatory agencies examine each of the banks and rate such institutions compliance with CRA as "Outstanding," "Satisfactory," "Needs to Improve" or "Substantial Noncompliance." Failure of an institution to receive at least a "Satisfactory" rating could inhibit such institution or its holding company from undertaking certain activities, including engaging in activities newly permitted as a financial holding company under the **Gramm-Leach-Bliley Act** ("GLBA") and acquisitions of other financial institutions. The FRB must take into account the record of performance of banks in meeting the credit needs of the entire community served, including low-and moderate-income neighborhoods. The Bank has achieved a rating of "Satisfactory" on their respective most recent examination. Maine also has enacted substantially similar community reinvestment requirements. The federal banking agencies adopted less burdensome CRA requirements, effective in 2006, for "intermediate small banks," which are banks with $250 million or more, but less than $1 billion in total assets, (including the Bank) under which such banks are being or will be examined using only two tests, a Lending Test and a new Community Development Test, and will be relieved of certain data collection and reporting requirements.

Customer Information Security:

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

Privacy:

The FDIC and other regulatory agencies have published final privacy rules pursuant to provisions of the GLBA ("Privacy Rules"). The Privacy Rules, which govern the treatment of nonpublic personal information about consumers by financial institutions, require a financial institution to provide notice to customers (and other consumers in some circumstances) about its privacy policies and practices, describe the conditions under which a financial institution may disclose nonpublic personal information to nonaffiliated third parties, and provide a method for consumers to prevent a financial institution from disclosing that information to most nonaffiliated third parties by "opting-out" of that disclosure, subject to certain exceptions.

USA Patriot Act:

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

Identity Theft Red Flags

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

Fair Credit Reporting Affiliate Marketing Regulations

: In November 2007, the federal banking agencies (the "Agencies") published final rules to implement the affiliate marketing provisions in section 214 of the FACT Act, which amends the Fair Credit Reporting Act. The final rules 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. These rules were effective January 1, 2008. The mandatory compliance date for these rules was October 1, 2008. Management believes the Company is in full compliance with the final rules implementing the affiliate marketing provisions in section 214 of the FACT Act.

Insurance of Accounts and FDIC Regulation

: The Bank pays deposit insurance premiums to the FDIC based on an assessment rate established by the FDIC. In 2006, the FDIC enacted various rules to implement the provisions of the Federal Deposit Insurance Reform Act of 2005 (the "FDI Reform Act"). Pursuant to the FDI Reform Act, in 2006 the FDIC merged the Bank Insurance Fund with the Savings Association Insurance Fund to create a newly named Deposit Insurance Fund (the "DIF") that covers both banks and savings associations. The FDIC also revised, effective January 1, 2007, the risk-based premium system under which the FDIC classifies institutions based on the factors described below and generally assesses higher rates on those institutions that tend to pose greater risks to the DIF. For most banks and savings associations, including the Bank, FDIC rates will 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 interest rate risk. For large banks and savings associations that have long-term debt issuer ratings, assessment rates will depend upon such ratings, and CAMELS component ratings. For institutions that are in the lowest risk category, assessment rates will vary initially from five (5) to seven (7) basis points per $100 of insured deposits. Beginning January 1, 2009, the FDIC assessment rates were raised seven (7) basis points and vary initially from twelve (12) to fourteen (14) basis points per $100 of insured deposits. Further rate changes will likely take effect on April 1, 2009, after which assessment rates will vary initially from then (10) to fourteen (14) basis points per $100 of insured deposits with additional adjustments that could result in total base assessment rates of eight (8) to twenty-one (21) basis points per $100 of insured deposits.

The Federal Deposit Insurance Act ("FDIA") as amended by the FDI Reform Act requires the FDIC to set a ratio of deposit insurance reserves to estimated insured deposits, the designated reserve ratio (the "DRR") for a particular year within a range of 1.15% to 1.50%. For 2008, the FDIC has set the initial DRR at 1.25%. Under the FDI Reform Act and the FDIC s revised premium assessment program, every FDIC-insured institution will pay some level of deposit insurance assessments regardless of the level of the DRR. In 2008, FDIC deposit insurance was temporarily increased from $100,000 to $250,000 per depositor through December 31, 2009.

In 2008, the Bank was classified in the lowest risk category with an insurance premium rate of $0.05 per $100 of deposits. The Company cannot predict whether, as a result of an adverse change in economic conditions or other reasons, the FDIC will be required in the future to increase deposit insurance assessments above 2008 levels. In 2008, in response to the level of claims against the Bank Insurance Fund, the FDIC announced it would raise the lowest rate from 5 cents to 12 cents per $100 of assessable deposits beginning with the first quarter of 2009. In addition, beginning with the second quarter of 2009, the FDIC will add four new factors to the assessment rate calculation, including factors for brokered deposits, secured liabilities and unsecured liabilities. These changes will dramatically increase FDIC insurance expenses for all insured institutions, including the Bank.

On February 27, 2009, the FDIC adopted an interim rule, with request for comment, which would institute a one-time special assessment of 20 cents per $100 of domestic deposits on FIDC insured institutions as of June 30, 2009. The assessment would be payable on September 30, 2009. If the assessment is approved, the Bank estimates its assessment would total approximately $1.2 million. This rule would also allow the FDIC to impose additional special assessments of up to 10 cents per $100 of domestic deposits at the end of any calendar quarter after June 30, 2009, to restore the Deposit Insurance Fund.

The FDI Reform Act required the FDIC to establish a one-time historical assessment credit that provides banks a credit that can be used to offset insurance assessments in 2007 and 2008. This one-time, historical assessment credit was established to benefit banks that had funded deposit insurance funds prior to December 31, 1996. This one-time, historical assessment credit is based upon the Bank s insured deposits as of December 31, 1996. The Bank s one-time, historical assessment credit was $344,785 when the credit was established in 2006. During 2007, the Bank utilized a portion of this credit to entirely offset $130,530 of Federal deposit insurance assessments. The remaining credit of $214,244 was completely used in 2008.

Regulatory Enforcement Authority: The enforcement powers available to federal banking regulators include, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities. Under certain circumstances, federal and state law requires public disclosure and reports of certain criminal offenses and also final enforcement actions by the federal banking agencies.

Securities Regulation:

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

Temporary Liquidity Guarantee Program:

The Bank is participating in the FDIC s Temporary Liquidity Guarantee Program ("TLGP"), which consists of the Transaction Account Guarantee Program ("TAGP") and Debt Guarantee Program ("DGP"). Through the TAGP, the FDIC will provide unlimited deposit insurance coverage for all noninterest-bearing transaction accounts through December 31, 2009. This includes traditional non-interest bearing checking accounts, certain types of attorney trust accounts, and NOW accounts as long as the interest rate does not exceed 0.50%. Through the DGP, the Bank will have the option to issue senior unsecured debt (fully guaranteed by the FDIC) on or before June 30, 2009, with a maturity of June 30, 2012, or sooner. If the Bank chooses to issue debt under the DGP program it will be limited to two percent of its liabilities as of September 30, 2008, or approximately $17,565.

Capital Purchase Program ("CPP"):

In 2008, the U.S. Treasury instituted the Troubled Asset Relief Program ("TARP") in response to adverse economic conditions in the financial markets, particularly the inability of creditworthy borrowers to obtain credit. Under the TARP, the U.S. Treasury developed the Capital Purchase Program ("CPP"), whereby it purchased non-voting senior preferred shares of participating financial institutions. The Company sold $18,751 of Senior Fixed Rate Cumulative Perpetual Preferred Shares, Series A, no par value per share, liquidation preference $1,000 per share (the "CPP Shares"), to the Treasury under the CPP in January 2009. The CPP Shares will pay cumulative dividends at a rate of five percent (5%) per year for the first five (5) years and will reset to a rate of nine percent (9%) per year after the fifth year. The CPP Shares are callable at par after three (3) years, including any accrued and unpaid dividends, and may be redeemed with the proceeds from a qualified equity offering of any Tier 1 perpetual preferred or common stock (a "Qualified Equity Offering") prior to the end of three (3) years. For as long as any CPP Shares are outstanding, no dividend may be declared or paid on any junior preferred shares, preferred shares ranking *pari passu* with the CPP Shares, or common shares unless all the accrued and unpaid dividends for the cumulative CPP Shares are fully paid. Dividends may be declared on *pari passu* preferred shares on a pro rata basis with the CPP Shares. The Company may not repurchase or redeem any junior preferred shares, preferred shares ranking *pari passu* with the CPP Shares or common shares unless all the accrued and unpaid dividends for the CPP Senior Preferred Shares are fully paid.

In addition, the consent of the Treasury will be required for any increase in common dividends per share for the first three (3) years (other than regular quarterly cash dividends of not more than $0.26 per share of common stock), unless prior to the end of three (3) years the CPP Shares have been redeemed in full or the Treasury has transferred all of the CPP Shares to third parties. The consent of the Treasury will also be required for repurchase of any shares or common shares in connection with any benefit plan in the ordinary course of business consistent with past practice, for the first three (3) years, unless prior to the end of three years the CPP Shares have been redeemed in full or the Treasury has transferred all of the CPP Senior Preferred Shares to third parties. No repurchases of junior preferred shares, preferred shares ranking *pari passu* with the CPP Shares or common shares will be allowed if such repurchase is prohibited by a restriction on dividends.

In conjunction with the purchase of CPP Shares, the Treasury received warrants to purchase 104,910 shares of common stock with an aggregate market price equal to 15 percent of its investment in the CPP Senior Preferred Shares (the "CPP Warrants"). The exercise price on the CPP Warrants is $26.81 per share. The CPP Warrants have a term of 10 years and will be immediately exercisable, in whole or in part. The CPP Warrants will be freely transferable; however, the Treasury may only transfer or exercise an aggregate of one-half of the warrants prior to the earlier of (i) the date on which the Company has received aggregate gross proceeds of at least one hundred percent of the issue price of the CPP Shares from one or more Qualified Equity Offerings, or (ii) December 31, 2009. In the event that the participating financial institution has received aggregate gross proceeds of at least one hundred percent of the issued price of the CPP Shares from one or more Qualified Equity Offerings on or prior to December 31, 2009, the number of shares of common stock underlying the CPP Warrants then held by the Treasury shall be reduced by a number of shares equal to the product of (i) the number of shares originally underlying the CPP Warrants (taking into account all adjustments), and (ii) 0.5.

Rules issued by Treasury and certain provisions of the American Recovery and Reinvestment Act of 2009 require participating institutions in the CPP, including the Company, to adopt certain standards for executive compensation and corporate governance rules for the period during which Treasury holds CPP Senior Preferred Shares. These standards include: (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2) requiring "clawback" of any bonus or incentive compensation paid to a senior executive based on statement of earnings, gains, or other criteria that are later proven to be materially inaccurate; (3) prohibiting the financial institution from making any golden parachute payment to a senior executive (generally, severance payment in excess of three times the senior executive s prior five-year average compensation); and (4) agreeing not to deduct for tax purposes executive compensation in excess of $500,000 for each senior executive. These standards generally apply to the chief executive officer, chief financial officer, plus the next three (3) most highly compensated executive officers. The Company and the officers covered by these standards have granted the Treasury a waiver releasing the Treasury from any claims that the Company or such officer may otherwise have as a result of the issuance of any regulation which modify the terms of benefits plans, arrangements and agreements to eliminate any provisions that would not be in compliance with these executive compensation, and corporate governance standards. In addition, the American Recovery and Reinvestment Act requires CPP participants to hold a non-binding "say-on-pay" shareholder vote to approve the compensation of their executives.

Importantly, the CPP Securities Purchase Agreement may be unilaterally amended by the Treasury to the extent required to comply with any changes after January 16, 2009 (the "signing date") in applicable federal statutes. Accordingly, the Company or the Bank may be subject to further restrictions or obligations as a result of participation in the CPP.

Other Proposals:

Other legislative and regulatory proposals regarding changes in banking, and the regulation of banks and other financial institutions, are regularly considered by the executive branch of the federal government, Congress and various state governments, including Maine and state and federal regulatory authorities. It cannot be predicted what additional legislative and/or regulatory proposals, if any, will be considered in the future, whether any such proposals will be adopted or, if adopted, how any such proposals would affect the Company or the Bank.

Taxation:

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

Financial Information about Industry Segments

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

Availability of Information Company Website

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

ITEM 1A. RISK FACTORS

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

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

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

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

- The Company expects to face increased regulation of the banking and financial services industry. Compliance with such regulation may increase the Company s costs and limit its ability to pursue business opportunities.

- Market developments may affect customer confidence levels and may cause increases in loan delinquencies and default rates, which the Company expects could impact the Bank s charge-offs and provision for loan losses.

- Market developments may affect the Bank s securities portfolio by causing other than temporary impairments, prompting write-downs and securities losses.

- The Company s and the Bank s ability to borrow from other financial institutions or to access the debt or equity capital markets on favorable terms or at all could be adversely affected by further disruptions in the capital markets or other events, including actions by rating agencies and deteriorating investor expectations.

- Competition in banking and financial services industry could intensify as a result of the increasing consolidation of financial services companies in connection with current market conditions.

- The Bank may be required to pay significantly higher Federal Deposit Insurance Corporation premiums because market developments have significantly depleted the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits.

There can be no assurance that recent actions by governmental agencies and regulators, as well as recently enacted legislation authorizing the U.S. government to invest in, and purchase large amounts of illiquid assets from, financial institutions will help stabilize the U.S. financial system.

In recent periods, various Federal agencies and bank regulators have taken steps to stabilize and stimulate the financial services industry. Changes also have been made in tax policy for financial institutions. In addition, on October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (the "EESA"). The EESA reflects an initial legislative response to the financial crises affecting the banking system and financial markets and going concern threats to financial institutions. Pursuant to the EESA, the U.S. Treasury has the authority to, among other things, purchase up to $700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets. There can be no assurance, however, as to the actual impact that the EESA will have on the financial markets, including the extreme levels of volatility and limited credit availability currently being experienced. The failure of the EESA to help stabilize the financial markets and a continuation or worsening of current financial market conditions could materially and adversely affect our business, financial condition, results of operations, access to credit or the trading price of our common stock.

There are risks and uncertainties associated with the Company s participation in Treasury s Capital Purchase Program.

In 2008 as a part of the EESA, the U. S. Treasury instituted the Troubled Asset Relief Program ("TARP") in response to adverse economic conditions in the financial markets, particularly the inability of creditworthy borrowers to obtain credit. Under the TARP, the U. S. Treasury developed the Capital Purchase Program ("CPP"), whereby it purchased non-voting senior preferred shares ("CPP Shares") of participating financial institutions. Healthy banks were encouraged to apply for participation in the CPP. The Company elected to apply for participation in the CPP in November 2008 and its application was accepted by the Treasury in December 2008. In January 2009 the Company sold $18,751 of Senior Fixed Rate Cumulative Perpetual Preferred Shares, Series A, no par value per share, liquidation preference $1,000 per share ("CPP Shares") to the Treasury under the CPP. In conjunction with the purchase of CPP Shares, the Treasury received warrants to purchase 104,910 shares of common stock with an aggregate market price equal to 15 percent of its investment in the CPP Senior Preferred Shares (the "CPP Warrants"). The exercise price on the CPP Warrants is $26.81 per share. There are a number of risks and uncertainties associated with the Company s participation in the CPP that could have a material adverse effect on its results of operations from those anticipated by Management. These risks and uncertainties include but are not limited to:

(a) The Company s ability to increase its common share dividend is generally limited for up to three (3) years and this restriction could negatively impact the market for the Company s common shares of stock;

(b) Possible future unilateral changes in the agreements between Treasury and the Company based on changes to applicable laws and regulations, all of which could materially impact the Company s ability to deploy CPP capital in the manner originally anticipated by management at the time of issuing the CPP Shares to Treasury;

(c) The terms and conditions of the CPP Shares could pose some risk to the Company s ability to participate in future acquisitions and mergers transactions;

(d) Existing and possible future limits imposed on executive compensation under the CPP and other laws and regulations applicable to participants under the CPP could have a negative impact on the Company s ability to attract and retain quality executive officers;

(e) The consent of Treasury is generally required for the Company to repurchase its common stock, which could have a negative impact on the Company s ability to manage its capital plan;

(f) Future potential ownership and earnings dilution associated with the CPP Shares and CPP Warrants;

(g) The possibility of negative public opinion regarding the Company s participation in the CPP could adversely affect the Company s ability to attract and keep customers and/or the market for its shares of common stock; and

(h) The Company may not be able to deploy the CPP capital received from the Treasury in a manner that is accretive to earnings.

Federal and state governments could pass legislation responsive to current credit conditions.

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

If the Company is unable to redeem the CPP Shares after five years, the cost of this capital to the Company will increase substantially.

If the Company is unable to redeem the SPP Shares prior to February 15, 2014, the cost of this capital to the Company will increase substantially on that date, from 5.0% per annum to 9.0% per annum. Depending on the Company s financial condition at the time, this increase in the annual dividend rate on the CPP Shares could have a material negative effect on the Company s income available to common shareholders.

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

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

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