

FIRST NATIONAL LINCOLN CORP /ME/  
Form 10-Q  
August 09, 2006  
UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
  
WASHINGTON, DC 20549

**FORM 10-Q**

**X Quarterly Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934**

**For the quarterly period ended June 30, 2006**

**Commission File Number 0-26589**

**FIRST NATIONAL LINCOLN CORPORATION**

(Exact name of Registrant as specified in its charter)

**MAINE 01-0404322**

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

**MAIN STREET, DAMARISCOTTA, MAINE 04543**

(Address of principal executive offices) (Zip code)

**(207) 563-3195**

Registrant's telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject

Edgar Filing: FIRST NATIONAL LINCOLN CORP /ME/ - Form 10-Q

to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Yes  No

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of August 1, 2006

**Common Stock: 9,823,171 shares**

**Table of Contents**

<b><u>Part I. Financial Information</u></b>	1
<b><u>Selected Financial Data (Unaudited)</u></b>	1
<b><u>Item 1 Financial Statements</u></b>	2
<i>Report of Independent Registered Public Accounting Firm</i>	2
<i>Consolidated Balance Sheets (Unaudited)</i>	3
<i>Consolidated Statements of Income (Unaudited)</i>	4
<i>Consolidated Statements of Changes in Shareholders' Equity (Unaudited)</i>	5
<i>Consolidated Statements of Cash Flows (Unaudited)</i>	6
<b><u>Notes to Consolidated Financials Statements</u></b>	7
<i>Note 1 Basis of Presentation</i>	7
<i>Note 2 Common Stock</i>	7
<i>Note 3 Stock Options</i>	7
<i>Note 4 Earnings Per Share</i>	9
<i>Note 5 Postretirement Benefit Plans</i>	10
<i>Note 6 Goodwill</i>	10
<i>Note 7 Reclassifications</i>	10
<i>Note 8 Pro-Forma Financial Information</i>	11
<i>Note 9 Impact of Recently Issued Accounting Standards</i>	12
<b><u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	13
<i>Critical Accounting Policies</i>	13
<i>GAAP vs. Pro-Forma Results</i>	13
<i>Executive Summary</i>	14
<i>Net Interest Income</i>	14
<i>Provision for Loan Losses</i>	17
<i>Non-Interest Income</i>	17
<i>Non-Interest Expense</i>	17
<i>Income Taxes</i>	17
<i>Investments</i>	17
<i>Loans</i>	17
<i>Allowance for Loan Losses</i>	18
<i>Non-Performing Assets</i>	19
<i>Goodwill</i>	19
<i>Deposits</i>	20
<i>Borrowed Funds</i>	20
<i>Shareholders' Equity</i>	20
<i>Average Daily Balance Sheets</i>	21
<i>Off-Balance Sheet Financial Instruments</i>	22
<i>Sale of Loans</i>	22
<i>Contractual Obligations</i>	22
<i>Liquidity Management</i>	22
<i>Forward-Looking Statements</i>	22
<b><u>Item 3 Quantitative and Qualitative Disclosures About Market Risk</u></b>	23
<i>Market-Risk Management</i>	23
<i>Asset/Liability Management</i>	23
<i>Interest Rate Risk Management</i>	24
<b><u>Item 4: Controls and Procedures</u></b>	25
<b><u>Part II Other Information</u></b>	26
<b><u>Item 1 Legal Proceedings &amp; Risk Factors</u></b>	26
<b><u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	26
<b><u>Item 3 Default Upon Senior Securities</u></b>	27
<b><u>Item 4 Submission of Matters to a Vote of Security Holders</u></b>	27
<b><u>Item 5 Other Information</u></b>	27
<b><u>Item 6 Exhibits</u></b>	28

**Signatures**

**Part I. Financial Information****Selected Financial Data (Unaudited)**

First National Lincoln Corporation and Subsidiary

<i>Dollars in thousands, except for per share amounts</i>	<b>For the six months ended</b>		<b>For the quarters ended</b>	
	<b><u>June 30</u></b>		<b><u>June 30</u></b>	
	<b>2006</b>	2005	<b>2006</b>	2005
<b>Summary of Operations</b>				
Operating Income	<b>\$ 35,078</b>	\$ 27,082	<b>\$ 18,193</b>	\$ 14,522
Operating Expense	<b>26,519</b>	18,524	<b>13,769</b>	10,166
Net Interest Income	<b>15,242</b>	15,409	<b>7,495</b>	7,964
Provision for Loan Losses	<b>600</b>	100	<b>350</b>	100
Net Income	<b>6,148</b>	6,130	<b>3,172</b>	3,133
<b>Per Common Share Data</b>				
Basic Earnings per Share	<b>\$ 0.62</b>	\$ 0.63	<b>\$ 0.32</b>	\$ 0.32
Diluted Earnings per Share	<b>0.62</b>	0.62	<b>0.32</b>	0.31
Cash Dividends Declared	<b>0.295</b>	0.255	<b>0.150</b>	0.130
Book Value	<b>10.76</b>	10.24	<b>10.76</b>	10.24
Market Value	<b>16.83</b>	17.00	<b>16.83</b>	17.00
<b>Financial Ratios</b>				
Return on Average Equity <sup>1</sup>	<b>11.83%</b>	12.89%	<b>12.10%</b>	12.57%
Return on Average Tangible Equity <sup>1</sup>	<b>16.07%</b>	17.59%	<b>16.42%</b>	17.44%
Return on Average Assets <sup>1</sup>	<b>1.17%</b>	1.37%	<b>1.19%</b>	1.33%
Average Equity to Average Assets	<b>9.86%</b>	10.62%	<b>9.81%</b>	10.62%
Average Tangible Equity to Average Assets	<b>7.26%</b>	7.78%	<b>7.23%</b>	7.65%
Net Interest Margin Tax-Equivalent <sup>1</sup>	<b>3.33%</b>	3.95%	<b>3.21%</b>	3.92%
Dividend Payout Ratio	<b>47.58%</b>	40.48%	<b>46.88%</b>	40.63%
Allowance for Loan Losses/Total Loans	<b>0.73%</b>	0.91%	<b>0.73%</b>	0.91%
Non-Performing Loans to Total Loans	<b>0.31%</b>	0.35%	<b>0.31%</b>	0.35%
Non-Performing Assets to Total Assets	<b>0.23%</b>	0.26%	<b>0.23%</b>	0.26%
Efficiency Ratio <sup>2</sup>	<b>50.80%</b>	52.26%	<b>48.99%</b>	53.33%
<b>At Period End</b>				
Total Assets	<b>\$1,100,583</b>	\$ 958,572	<b>\$1,100,583</b>	\$ 958,572
Total Loans	<b>825,699</b>	718,376	<b>825,699</b>	718,376
Total Investment Securities	<b>189,718</b>	160,041	<b>189,718</b>	160,041
Total Deposits	<b>786,961</b>	672,254	<b>786,961</b>	672,254
Total Shareholders' Equity	<b>105,630</b>	100,572	<b>105,630</b>	100,572

<sup>1</sup>Annualized using a 365-day basis<sup>2</sup>The Company uses the following formula in calculating its efficiency ratio:

Non-Interest Expense - Loss on Securities Sales

Tax-Equivalent Net Interest Income + Non-Interest Income    Gains on Securities Sales



**Item 1 Financial Statements**

***Report of Independent Registered Public Accounting Firm***

The Board of Directors and Shareholders

First National Lincoln Corporation

We have reviewed the accompanying interim consolidated financial information of First National Lincoln Corporation and Subsidiary as of June 30, 2006 and 2005, for the three-month and six-month periods then ended. These financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with standards of the Public Company Accounting Oversight Board (United States), the objective of which is to express an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

/s/ Berry, Dunn, McNeil & Parker

Portland, Maine

August 4, 2006





**Consolidated Balance Sheets (Unaudited)**

First National Lincoln Corporation and Subsidiary

<i>In thousands of dollars, except per share amounts</i>	<b>June 30, 2006</b>	December 31, 2005	June 30, 2005
<b>Assets</b>			
Cash and due from banks	<b>\$ 22,606</b>	\$ 25,982	\$ 22,080
Overnight funds sold	-	-	-
Securities available for sale	<b>50,486</b>	54,743	52,348
Securitized to be held to maturity (market values \$136,317 at June 30, 2006, \$128,563 at December 31, 2005, and \$108,639 at June 30, 2005)	<b>139,232</b>	129,238	107,693
Loans held for sale (fair value approximates cost)	<b>240</b>	-	412
Loans	<b>825,699</b>	772,338	718,376
Less: allowance for loan losses	<b>6,021</b>	6,086	6,518
Net loans	<b>819,678</b>	766,252	711,858
Accrued interest receivable	<b>6,904</b>	5,005	5,492
Premises and equipment	<b>16,285</b>	16,712	16,949
Other real estate owned	<b>1,413</b>	-	-
Goodwill	<b>27,684</b>	27,684	27,960
Other assets	<b>16,055</b>	16,593	13,780
<b>Total Assets</b>	<b>\$1,100,583</b>	\$1,042,209	\$ 958,572
<b>Liabilities</b>			
Demand deposits	<b>\$ 60,941</b>	\$ 62,109	\$ 56,421
NOW deposits	<b>102,618</b>	109,124	106,105
Money market deposits	<b>110,313</b>	127,630	110,463
Savings deposits	<b>99,176</b>	109,615	111,990
Certificates of deposit	<b>161,418</b>	126,444	127,708
Certificates \$100,000 and over	<b>252,495</b>	179,042	159,567
Total deposits	<b>786,961</b>	713,964	672,254
Borrowed funds	<b>196,649</b>	215,189	177,729
Other liabilities	<b>11,343</b>	9,604	8,017
Total Liabilities	<b>994,953</b>	938,757	858,000
<b>Shareholders' Equity</b>			
Common stock	<b>99</b>	99	99
Additional paid-in capital	<b>46,917</b>	47,718	48,220
Retained earnings	<b>58,202</b>	54,901	50,773
Net unrealized gains on securities available for sale	<b>412</b>	734	1,480
Total Shareholders' Equity	<b>105,630</b>	103,452	100,572
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>\$1,100,583</b>	\$1,042,209	\$ 958,572
<b>Common Stock</b>			
Number of shares authorized	<b>18,000,000</b>	18,000,000	18,000,000
Number of shares issued and outstanding	<b>9,817,897</b>	9,832,777	9,819,801
Book value per share	<b>\$ 10.76</b>	\$ 10.52	\$ 10.24

See Report of Independent Registered Public Accounting Firm.

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



**Consolidated Statements of Income (Unaudited)**

First National Lincoln Corporation and Subsidiary

<i>In thousands of dollars, except per share amounts</i>	<b>For the six months ended June 30,</b>		<b>For the quarters ended June 30,</b>	
	<b>2006</b>	2005	<b>2006</b>	2005
<b>Interest income</b>				
Interest and fees on loans	<b>\$25,910</b>	\$19,462	<b>\$13,403</b>	\$10,377
Interest on deposits with other banks	-	5	-	5
Interest and dividends on investments	<b>4,735</b>	3,724	<b>2,430</b>	1,912
Total interest income	<b>30,645</b>	23,191	<b>15,833</b>	12,294
<b>Interest expense</b>				
Interest on deposits	<b>11,053</b>	5,067	<b>5,933</b>	2,856
Interest on borrowed funds	<b>4,350</b>	2,715	<b>2,405</b>	1,474
Total interest expense	<b>15,403</b>	7,782	<b>8,338</b>	4,330
Net interest income	<b>15,242</b>	15,409	<b>7,495</b>	7,964
Provision for loan losses	<b>600</b>	100	<b>350</b>	100
Net interest income after provision for loan losses	<b>14,642</b>	15,309	<b>7,145</b>	7,864
<b>Non-interest income</b>				
Investment management and fiduciary income	<b>973</b>	819	<b>477</b>	420
Service charges on deposit accounts	<b>1,350</b>	1,151	<b>728</b>	663
Mortgage origination and servicing income	<b>252</b>	375	<b>169</b>	247
Other operating income	<b>1,858</b>	1,546	<b>986</b>	898
Total non-interest income	<b>4,433</b>	3,891	<b>2,360</b>	2,228
<b>Non-interest expense</b>				
Salaries and employee benefits	<b>5,170</b>	5,474	<b>2,508</b>	2,848
Occupancy expense	<b>757</b>	697	<b>382</b>	348
Furniture and equipment expense	<b>997</b>	1,035	<b>492</b>	581
Amortization of identified intangibles	<b>142</b>	129	<b>71</b>	70
Other operating expense	<b>3,450</b>	3,307	<b>1,628</b>	1,889
Total non-interest expense	<b>10,516</b>	10,642	<b>5,081</b>	5,736
Income before income taxes	<b>8,559</b>	8,558	<b>4,424</b>	4,356
Applicable income taxes	<b>2,411</b>	2,428	<b>1,252</b>	1,223
<b>NET INCOME</b>	<b>\$ 6,148</b>	\$ 6,130	<b>\$ 3,172</b>	\$ 3,133
<b>Earnings per common share:</b>				
Basic earnings per share	<b>\$ 0.62</b>	\$ 0.63	<b>\$ 0.32</b>	\$ 0.32
Diluted earnings per share	<b>\$ 0.62</b>	\$ 0.62	<b>\$ 0.32</b>	\$ 0.31
Cash dividends declared per share	<b>\$ 0.295</b>	\$ 0.255	<b>\$ 0.150</b>	\$ 0.130
Weighted average number of shares outstanding	<b>9,847,364</b>	9,662,951	<b>9,837,416</b>	9,849,065
Incremental shares	<b>84,144</b>	151,800	<b>83,461</b>	150,741

See Report of Independent Registered Public Accounting Firm.

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

*Consolidated Statements of Changes in Shareholders' Equity (Unaudited)*

First National Lincoln Corporation and Subsidiary

<i>In thousands of dollars except number of shares</i>	Number of common shares	Common stock	Additional paid-in capital	Retained earnings	Net unrealized gains on securities available for sale	Treasury stock	Total shareholders' equity
<b>Balance at December 31, 2004</b>	<b>7,356,836</b>	<b>\$ 74</b>	<b>\$ 3,973</b>	<b>\$ 46,809</b>	<b>\$ 1,959</b>	<b>\$ -</b>	<b>\$ 52,815</b>
Net income	-	-	-	6,130	-	-	6,130
Net unrealized loss on securities available for sale, net of tax benefit of \$247	-	-	-	-	(479)	-	(479)
Comprehensive income	-	-	-	6,130	(479)	-	5,651
Cash dividends declared	-	-	-	(2,515)	-	-	(2,515)
Payment to repurchase common stock	(121,977)	(1)	(2,057)	-	-	-	(2,058)
Proceeds from sale of common stock	120,344	1	943	-	-	-	944
Tax benefit of disqualifying disposition of incentive stock option shares	-	-	-	349	-	-	349
Acquisition of FNB Bankshares	2,464,598	25	45,361	-	-	-	45,386
<b>Balance at June 30, 2005</b>	<b>9,819,801</b>	<b>\$ 99</b>	<b>\$ 48,220</b>	<b>\$ 50,773</b>	<b>\$ 1,480</b>	<b>\$ -</b>	<b>\$ 100,572</b>
<b>Balance at December 31, 2005</b>	<b>9,832,777</b>	<b>\$ 99</b>	<b>\$ 47,718</b>	<b>\$ 54,901</b>	<b>\$ 734</b>	<b>\$ -</b>	<b>\$ 103,452</b>
Net income	-	-	-	6,148	-	-	6,148
Net unrealized loss on securities available for sale, net of tax benefit of \$156	-	-	-	-	(322)	-	(322)
Comprehensive income	-	-	-	6,148	(322)	-	5,826
Cash dividends declared	-	-	-	(2,902)	-	-	(2,902)
Payment to repurchase common stock	(72,139)	-	(1,227)	-	-	-	(1,227)
Proceeds from sale of common stock	57,259	-	426	-	-	-	426
Tax benefit of disqualifying disposition of incentive stock option shares	-	-	-	55	-	-	55
<b>Balance at June 30, 2006</b>	<b>9,817,897</b>	<b>\$ 99</b>	<b>\$ 46,917</b>	<b>\$ 58,202</b>	<b>\$ 412</b>	<b>\$ -</b>	<b>\$ 105,630</b>

See Report of Independent Registered Public Accounting Firm.

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

*Consolidated Statements of Cash Flows (Unaudited)*

First National Lincoln Corporation and Subsidiary

<i>In thousands of dollars</i>	For six months ended June 30,	
	2006	2005
<b>Cash flows from operating activities</b>		
Net income	\$ 6,148	\$ 6,130
<b>Adjustments to reconcile net income to net cash provided by operating activities</b>		
Depreciation	683	657
Provision for loan losses	600	100
Loans originated for resale	(7,429)	(12,254)
Proceeds from sales and transfers of loans	7,189	12,433
Net loss on sale of other real estate owned	(28)	-
Net increase in other assets and accrued interest	(1,503)	(1,880)
Net increase in other liabilities	1,798	2,002
Net amortization (accretion) of premiums (discounts) on investments	(66)	206
Net acquisition amortization	130	98
Net cash provided by operating activities	7,522	7,492
<b>Cash flows from investing activities</b>		
Proceeds from maturities, payments and calls of securities available for sale	3,804	1,469
Proceeds from maturities, payments and calls of securities to be held to maturity	5,450	16,005
Proceeds from sales of other real estate owned	562	-
Purchases of securities available for sale	(8)	(683)
Purchases of securities to be held to maturity	(15,395)	(24,243)
Net increase in loans	(56,059)	(55,321)
Capital expenditures	(256)	(778)
Cash for acquisition, net of cash acquired	-	3,493
Net cash used in investing activities	(61,902)	(60,058)
<b>Cash flows from financing activities</b>		
Net increase (decrease) in demand deposits, savings, money market and club accounts	(35,430)	6,603
Net increase in certificates of deposit	108,514	103,006
Repayment on long-term borrowings	-	(37,118)
Net decrease in short-term borrowings	(18,529)	(9,384)
Payments to repurchase common stock	(1,227)	(2,058)
Proceeds from sale of common stock	426	944
Tax benefit from disqualifying disposition of stock options	55	
Dividends paid	(2,805)	(2,117)
Net cash provided by financing activities	51,004	59,876
Net increase (decrease) in cash and cash equivalents	(3,376)	7,310
Cash and cash equivalents at beginning of period	25,982	14,770
<b>Cash and cash equivalents at end of period</b>	<b>\$ 22,606</b>	<b>\$ 22,080</b>
Interest paid	\$ 14,762	\$ 7,507
Income taxes paid	1,943	2,150
<b>Non-cash transactions</b>		
Change in net unrealized gain on available for sale securities, net of tax benefit	\$ (322)	\$ (479)
Net transfers from loans to other real estate owned	1,947	-
Fair value of assets acquired	-	234,355
Less liabilities assumed	-	213,367

See Report of Independent Registered Public Accounting Firm.

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



**Notes to Consolidated Financial Statements**

First National Lincoln Corporation and Subsidiary

***Note 1 Basis of Presentation***

First National Lincoln Corporation (the Company) is a financial holding company that owns all of the common stock of The First, N.A. (the Bank). The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of Management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions and balances are eliminated in consolidation. On January 14, 2005, the Company completed the acquisition of FNB Bankshares (FNB) of Bar Harbor, Maine, and operating results include the effect of the FNB acquisition only after the closing date (see Note 8 Pro-Forma Financial Information).

The income reported for the 2006 period is not necessarily indicative of the results that may be expected for the year ending December 31, 2006. For further information, refer to the consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2005.

***Note 2 Common Stock***

On January 20, 2005, the Company announced that its Board of Directors had authorized the repurchase of up to 250,000 shares of the Company's common stock or approximately 2.5% of the outstanding shares. The Company expects such repurchases to be effected from time to time, in the open market, in private transactions or otherwise, during a period of up to 24 months. The amount and timing of shares to be purchased will be subject to market conditions and will be based on several factors, including the price of the Company's stock and the level of stock issuances under the Company's employee stock plans. No assurance can be given as to the specific timing of the share repurchases or as to whether and to what extent the share repurchase will be consummated. As of June 30, 2006, the Company had repurchased 248,375 shares under the new repurchase plan at an average price of \$17.15.

***Note 3 Stock Options***

The Company established a shareholder-approved stock option plan in 1995, under which the Company may grant options to its employees for up to 600,000 shares of common stock. The Company believes that such awards align the interests of its employees with those of its shareholders. Only incentive stock options may be granted under the plan. The option price of each option grant is determined by the Options Committee of the Board of Directors, and in no instance shall be less than the fair market value on the date of the grant. An option's maximum term is ten years from the date of grant, with 50% of the options granted vesting two years from the date of grant and the remaining 50% vesting five years from date of grant. As of January 16, 2005, all options under this plan had been granted.

In addition, options to acquire 40,630 FNB shares were converted into options to acquire an aggregate of 95,479 common shares of the Company at a purchase price of \$3.80 per share as a result of the FNB acquisition. As of June 30, 2006, all options converted as a result of the FNB acquisition had been exercised.



## Edgar Filing: FIRST NATIONAL LINCOLN CORP /ME/ - Form 10-Q

The Company applies the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004),

Share-Based Payment, to stock-based employee compensation for fiscal years beginning on or after January 1, 2006. As a result, \$19,000 in compensation cost, net of \$11,000 in taxes, is included in the Company's financial statements for the current year. The unrecognized compensation cost to be amortized over a weighted average remaining vesting period of 3.8 years is \$131,000, net of taxes of \$70,000, which is comprised of \$22,000 for 16,500 options granted in 2002 and \$109,000 for 42,000 options granted in 2005, net of taxes of \$12,000 and \$58,000, respectively.

The weighted average fair market value per share was \$2.77 for options granted in 2002 and \$4.41 for options granted in 2005. The fair market value was estimated using the Black-Scholes option pricing model and the following assumptions: quarterly dividends of \$0.07 in 2002 and \$0.12 in 2005, risk-free interest rate of 1.58% in 2002 and 4.20% in 2005, volatility of 37.73% in 2002 and 25.81% in 2005, and an expected life of 10 years for both years, the options' maximum term. Volatility is based on the actual volatility of the Company's stock during the quarter in which

Edgar Filing: FIRST NATIONAL LINCOLN CORP /ME/ - Form 10-Q

the options were granted. The risk free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve at the time of the option grant.

The following table summarizes the status of the Company's non-vested options as of June 30, 2006.

	Number of Shares	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2005	58,500	\$3.95
Granted in 2006	-	-
Vested in 2006	-	-
Forfeited in 2006	-	-
Non-vested at June 30, 2006	58,500	\$3.95

During 2006, 39,750 options were exercised, with total proceeds paid to the Company of \$124,000. The excess of the fair value of the stock issued upon option exercise over the exercise price was \$559,000. The Company recognized a tax benefit of \$55,000 on disqualifying dispositions related to stock option exercises during 2006. A summary of the status of the Company's Stock Option Plan as of June 30, 2006, and changes during the six months then ended, is presented below.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2005	205,750	\$7.61		
Granted in 2006	-	-		
Vested in 2006	-	-		
Exercised in 2006	(39,750)	3.13		
Forfeited in 2006	-	-		
Outstanding at June 30, 2006	166,000	\$8.69	4.0	\$1,401
Exercisable at June 30, 2006	107,500	\$4.95	2.0	\$1,277

In prior years, the Company applied Accounting Principles Board Opinion No. 25 and related interpretations in accounting for the stock option plan(s). Accordingly, no compensation cost was recognized in prior years. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 in prior years.

<i>In thousands of dollars</i>	<b>For the six months ended June 30,</b>		<b>For the quarters ended June 30,</b>	
	<b>2006</b>	2005	<b>2006</b>	2005
Net income				
As reported	<b>\$6,148</b>	\$6,130	<b>\$3,172</b>	\$3,133
Value of option grants, net of tax	-	129	-	-
Pro forma	<b>\$6,148</b>	\$6,001	<b>\$3,172</b>	\$3,133
Basic earnings per share				
As reported	<b>\$ 0.62</b>	\$ 0.63	<b>\$ 0.32</b>	\$ 0.32
Value of option grants, net of tax	-	0.01	-	-
Pro forma	<b>\$ 0.62</b>	\$ 0.62	<b>\$ 0.32</b>	\$ 0.32
Diluted earnings per share				
As reported	<b>\$ 0.62</b>	\$ 0.62	<b>\$ 0.32</b>	\$ 0.31
Value of option grants, net of tax	-	0.01	-	-
Pro forma	<b>\$ 0.62</b>	\$ 0.61	<b>\$ 0.32</b>	\$ 0.31



**Note 4 Earnings Per Share**

The following table sets forth the computation of basic and diluted earnings per share (EPS) for the six months ended June 30, 2006 and 2005:

<i>In thousands, except number of shares and per share data</i>	Income (Numerator)	Shares (Denominator)	Per-Share Amount
<b>For the six months ended June 30, 2006</b>			
Net income as reported	\$6,148		
Basic EPS: Income available to common shareholders	\$6,148	9,847,364	\$0.62
Effect of dilutive securities: incentive stock options		84,144	
Diluted EPS: Income available to common shareholders plus assumed conversions	\$6,148	9,931,508	\$0.62
<b>For the six months ended June 30, 2005</b>			
Net income as reported	\$6,130		
Basic EPS: Income available to common shareholders	\$6,130	9,662,951	\$0.63
Effect of dilutive securities: incentive stock options		151,800	
Diluted EPS: Income available to common shareholders plus assumed conversions	\$6,130	9,814,751	\$0.62

The following table sets forth the computation of basic and diluted earnings per share for the quarter ended June 30, 2006 and 2005:

<i>In thousands, except number of shares and per share data</i>	Income (Numerator)	Shares (Denominator)	Per-Share Amount
<b>For the quarter ended June 30, 2006</b>			
Net income as reported	\$3,172		
Basic EPS: Income available to common shareholders	\$3,172	9,837,416	\$0.32
Effect of dilutive securities: incentive stock options		83,461	
Diluted EPS: Income available to common shareholders plus assumed conversions	\$3,172	9,920,877	\$0.32
<b>For the quarter ended June 30, 2005</b>			
Net income as reported	\$3,133		
Basic EPS: Income available to common shareholders	\$3,133	9,849,065	\$0.32
Effect of dilutive securities: incentive stock options		150,741	
Diluted EPS: Income available to common shareholders plus assumed conversions	\$3,133	9,999,806	\$0.31

All earnings per share calculations have been made using the weighted average number of shares outstanding during the period. All of the dilutive securities are incentive stock options granted to certain key members of Management. The dilutive number of shares has been calculated using the treasury method, assuming that all granted options were exercisable at the end of each period.

**Note 5 Postretirement Benefit Plans**

The Bank sponsors postretirement benefit plans which provide certain life insurance and health insurance benefits for certain retired employees and health insurance for retired directors. None of these plans are pre-funded. The following table sets forth the accumulated post-retirement benefit obligation and funded status:

<i>In thousands of dollars</i>	<b>At June 30,</b>	
	<b>2006</b>	2005
<b>Change in benefit obligation</b>		
Benefit obligation at beginning of year	<b>\$ 1,705</b>	\$ 531
Plan assumed in FNB acquisition	-	1,392
Service cost	<b>6</b>	7
Interest cost	<b>60</b>	62
Benefits paid	<b>(43)</b>	(95)
Actuarial gain	-	-
Benefit obligation at end of period	<b>1,728</b>	1,897
<b>Funded status</b>		
Benefit obligation at end of period	<b>(1,728)</b>	(1,897)
Unamortized prior service cost	<b>(11)</b>	232
Unamortized net actuarial loss	<b>56</b>	40
Unrecognized transition obligation	<b>193</b>	214
Accrued benefit cost	<b>\$ (1,490)</b>	\$ (1,411)

The following table sets forth the net periodic pension cost:

<i>In thousands of dollars</i>	<b>For six months ended June 30,</b>		<b>For the quarters ended June 30,</b>	
	<b>2006</b>	2005	<b>2006</b>	2005
<b>Components of net periodic benefit cost</b>				
Service cost	<b>\$ 6</b>	\$ 7	<b>\$ 3</b>	\$ 4
Interest cost	<b>60</b>	62	<b>30</b>	31
Amortization of unrecognized transition obligation	<b>15</b>	23	<b>8</b>	11
Amortization of prior service cost	<b>(2)</b>	2	<b>(1)</b>	1
Amortization of accumulated losses	<b>3</b>	3	<b>1</b>	2
Net periodic benefit cost	<b>\$ 82</b>	\$ 97	<b>\$ 41</b>	\$ 49

A weighted average discount rate of 7.0% was used in determining both the accumulated benefit obligation and the net periodic benefit cost. The measurement date for benefit obligations was as of year-end for prior years presented. The estimated amount of benefits to be paid in 2006 is \$128,000. For years ending 2007 through 2010 the estimated amount of benefits to be paid is \$152,000 per year, and the total estimated amount of benefits to be paid for years ended 2011 through 2015 is \$1,032,000. Plan expense for 2006 is estimated to be \$175,000.

**Note 6 Goodwill**

Edgar Filing: FIRST NATIONAL LINCOLN CORP /ME/ - Form 10-Q

As of March 31, 2006, in accordance with SFAS No. 142, the Company completed its annual review of goodwill and determined there has been no impairment.

*Note 7 Reclassifications*

Certain items from the prior year were reclassified in the financial statements to conform with the current year presentation. These do not have a material impact on the balance sheet or income statement presentations.

Page 10

**Note 8 Pro-Forma Financial Information**

On August 25, 2004, the Company entered into an agreement to acquire FNB Bankshares (FNB) of Bar Harbor, Maine, and its subsidiary, The First National Bank of Bar Harbor. This acquisition was completed on January 14, 2005. In its 2004 Strategic Plan, the Company identified certain markets in which it would consider future growth opportunities, including the area served by FNB Bankshares. Management expects that the products and services available in the FNB Bankshares market area will be enhanced as a result of the combination of the two companies, and that this will also provide a larger capacity to lend money and a stronger overall funding base.

As part of the acquisition, the Company issued 2.35 shares of its common stock to the shareholders of FNB in exchange for each of the 1,048,814 shares of the common stock outstanding of FNB. Cash in lieu of fractional shares of the Company's stock was paid at the rate of \$17.87 per share, which was the average high/low price of the Company's stock for the 30-day period ended January 9, 2005, under terms specified in the Merger Agreement. At the time of the acquisition, there were outstanding options to purchase 126,208 shares of FNB common stock under the FNB Bankshares Stock Option Plan. Of these, options to acquire 40,630 FNB shares were converted into options to acquire an aggregate of 95,479 common shares of the Company at a purchase price of \$3.80 per share. Unexercised options not converted were paid cash at the rate of \$42.00 for each share subject to the option, less the option exercise price per share. The total amount paid to retire the remaining options was approximately \$2.6 million.

The total value of the transaction was \$47,955,000, and all of the voting equity interest of FNB was acquired in the transaction. The Company assumed all outstanding liabilities of FNB, including liabilities under certain Employment Continuity Agreements and Split Dollar Agreements with executive officers of FNB. The acquisition was intended to qualify as a reorganization for federal income tax purposes and provide for a tax-free exchange of shares.

The transaction was accounted for as a purchase and the operations of FNB are included in the Company's consolidated financial statements from the date of acquisition. The purchase price was allocated to assets acquired and liabilities assumed at the date of acquisition. The excess of purchase price over the fair value of net tangible assets acquired was recorded as goodwill, none of which is expected to be deductible for tax purposes. The core deposit intangible is being amortized over its expected economic life, and goodwill is evaluated annually for possible impairment under the provisions of SFAS No. 142, Goodwill and Other Intangible Assets.

The pro forma statements of income in the following table show how the Company's results of operations would have been presented if the Company and FNB had operated as one entity for the entire periods presented. Management has made adjustments to incorporate FNB's results for the entire year in 2005.

<i>In thousands of dollars, except share and per share information</i>	<b>For six months ended June 30,</b>		<b>For quarters ended June 30,</b>	
	<b>2006</b>	2005	<b>2006</b>	<b>2005</b>
Interest income	<b>\$ 30,645</b>	\$ 23,572	<b>\$ 15,833</b>	\$ 12,294
Interest expense	<b>15,403</b>	7,890	<b>8,338</b>	4,330
Net interest income	<b>15,242</b>	15,682	<b>7,495</b>	7,964
Provision for loan losses	<b>600</b>	100	<b>350</b>	100
Net interest income after provision for loan losses	<b>14,642</b>	15,582	<b>7,145</b>	7,864
Other operating income	<b>4,433</b>	4,035	<b>2,360</b>	2,228
Other operating expenses	<b>10,516</b>	11,336	<b>5,081</b>	5,736
Income before income taxes	<b>8,559</b>	8,281	<b>4,424</b>	4,356
Applicable income taxes	<b>2,411</b>	2,326	<b>1,252</b>	1,223
Net Income	<b>\$ 6,148</b>	\$ 5,955	<b>\$ 3,172</b>	\$ 3,133
<b>Operating Statistics</b>				
Basic earnings per share	<b>\$ 0.62</b>	\$ 0.62	<b>\$ 0.32</b>	\$ 0.32
Diluted earnings per share	<b>\$ 0.62</b>	\$ 0.61	<b>\$ 0.32</b>	\$ 0.31
Cash dividends declared per share	<b>\$ 0.295</b>	\$ 0.255	<b>\$ 0.150</b>	\$ 0.130
Dividend payout ratio	<b>47.58%</b>	41.13%	<b>46.88%</b>	40.63%
Return on average assets	<b>1.17%</b>	1.32%	<b>1.19%</b>	1.33%
Return on average equity	<b>11.83%</b>	12.43%	<b>12.10%</b>	12.57%
Return on average tangible equity	<b>16.07%</b>	16.93%	<b>16.42%</b>	17.44%

Edgar Filing: FIRST NATIONAL LINCOLN CORP /ME/ - Form 10-Q

Efficiency ratio (tax equivalent)	<b>50.79%</b>	54.53%	<b>48.99%</b>	53.63%
-----------------------------------	---------------	--------	---------------	--------



**Note 9 Impact of Recently Issued Accounting Standards**

Statement of Financial Accounting Standards (SFAS) No. 156, Accounting for Servicing of Financial Assets-an amendment to FASB Statement No. 140, requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. Servicing assets and servicing liabilities will subsequently be reported using the amortization method or the fair value measurement method. An entity should adopt this Statement as of the beginning of its first fiscal year that begins after September 15, 2006 with earlier application permitted with certain restrictions. The initial application of the fair value measurement method would be reported as a cumulative effect adjustment to beginning retained earnings. The Statement requires certain disclosures about the basis for measurement and regarding risks, activity, and fair value of servicing assets and of servicing liabilities. Management does not expect this SFAS to have a material impact on the Company's financial statements.

The FASB has issued SFAS No. 123 (revised 2004) (SFAS No. 123(R)), Share-Based Payment. SFAS No. 123(R), with certain exceptions, requires entities that grant stock options and shares to employees to recognize the fair value of those options and shares as compensation cost over the service (vesting) period in their financial statements. The measurement of that cost is based on the fair value of the equity or liability instruments issued. The Securities and Exchange Commission (SEC) has issued Staff Accounting Bulletin (SAB) No. 107, which provides guidance regarding the interaction between the SFAS and certain SEC rules and regulations. The Company adopted SFAS No. 123(R) and applied the guidance in SAB 107 in the financial statements for the period ended March 31, 2006, the effect of which was limited to disclosure in Note 3 of the Company's financial statements.

In July, 2006 the FASB issued Financial Accounting Standards Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently analyzing the effects of FIN 48.

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

First National Lincoln Corporation and Subsidiary

***Critical Accounting Policies***

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

**Allowance for Loan Losses.** Management believes the allowance for loan losses requires the most significant estimates and assumptions used in the preparation of the consolidated financial statements. The allowance for loan losses is based on Management's evaluation of the level of the allowance required in relation to the estimated loss exposure in the loan portfolio. Management believes the allowance for loan losses is a significant estimate and therefore regularly evaluates it for adequacy by taking into consideration factors such as prior loan loss experience, the character and size of the loan portfolio, business and economic conditions and Management's estimation of potential losses. The use of different estimates or assumptions could produce different provisions for loan losses.

**Mortgage Servicing Rights.** The valuation of mortgage servicing rights also requires significant estimates and assumptions. The Bank often sells mortgage loans it originates and retains the ongoing servicing of such loans, receiving a fee for these services, generally 0.25% of the outstanding balance of the loan per annum. Mortgage servicing rights are recognized when they are acquired through sale of loans and are reported in other assets. They are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Management uses an independent firm that specializes in the valuation of mortgage servicing rights to determine the fair value, which is recorded on the balance sheet. This includes an evaluation for impairment based upon the fair value of the rights, which can vary depending upon current interest rates and prepayment expectations, as compared to amortized cost. The Company's assumptions are adjusted periodically to reflect current circumstances. Stratifying rights determine impairment by predominant characteristics, such as interest rates and terms. The use of different assumptions could produce a different valuation for both mortgage servicing rights and impairment.

**Goodwill.** Management utilizes numerous techniques to estimate the value of various assets held by the Company, including methods to determine the appropriate carrying value of goodwill as required under SFAS No. 142. In addition, goodwill from a purchase acquisition is subject to ongoing periodic impairment tests, which include an evaluation of the ongoing assets, liabilities and revenues from the acquisition and an estimation of the impact of business conditions.

**Acquired Assets and Liabilities.** Different estimates or assumptions are also utilized to determine the appropriate carrying value of other assets including, but not limited to, premises and equipment, overall collectibility of loans and receivables. The use of different estimates or assumptions could produce different estimates of carrying value. Management prepares the valuation analyses, which are then reviewed by the Board of Directors of the Company.

***GAAP vs. Pro-Forma Results***

## Edgar Filing: FIRST NATIONAL LINCOLN CORP /ME/ - Form 10-Q

Operating results for the Company are prepared using accounting principles generally accepted in the United States of America (GAAP) which, under the purchase method of accounting, exclude FNB Bankshares results prior to the closing date of the acquisition on January 14, 2005. This discussion also includes pro-forma information which shows how the Company's results of operations would have been presented if the Company and FNB had operated as one entity for the entire periods presented (for a presentation of pro-forma results, see Note 8 to the Consolidated Financial Statements Pro-Forma Financial Information).

Page 13

**Executive Summary**

Net income for the six months ended June 30, 2006 was \$6,148,000, an increase of 0.3% over net income of \$6,130,000 for the comparable period of 2005. While the company has had excellent growth in earning assets in 2006, liability costs have increased more rapidly than yield on assets. This has led to lower net interest income as a result of margin compression.

Net income for the three months ended June 30, 2006 was \$3,172,000, an increase of 1.2% from net income of \$3,133,000 for the comparable period of 2005.

On a pro-forma basis, net income for the six months ended June 30, 2006, was \$6,148,000, an increase of \$193,000 or 3.2% over pro-forma net income of \$5,955,000 for the first six months of 2005. Pro-forma fully diluted earnings per share for the first six months of 2006 were \$0.62, and increase of \$0.01 or 1.6% over the \$0.61 reported for the first six months of 2005.

On a pro-forma basis, net income for the three months ended June 30, 2006 and 2005 was the same as that reported in the Company's consolidated financial statements.

**Net Interest Income**

Total interest income of \$30,645,000 for the six months ended June 30, 2006 is a 32.1% increase from total interest income of \$23,191,000 in the comparable period of 2005. Rising interest rates resulted in significantly higher asset yields in 2006 compared to 2005. Total interest expense of \$15,403,000 for the first six months of 2006 is a 97.9% increase from total interest expense of \$7,782,000 for the first six months of 2005. This was a direct result of the rising interest rate climate and increased volume in certificates of deposit. Net interest income decreased 1.1% to \$15,242,000 for the six months ended June 30, 2006, from the \$15,409,000 reported for the same period in 2005.

Total interest income of \$15,833,000 for the three months ended June 30, 2006, is a 28.8% increase from total interest income of \$12,294,000 in the comparable period of 2005. This increase was due to rising interest rates which resulted in higher asset yields in 2006 compared to 2005. Total interest expense of \$8,338,000 for the three months ended June 30, 2006, is a 92.6% increase from total interest expense of \$4,330,000 in the comparable period of 2005. This was a direct result of the rising interest rate climate and increased volume in certificates of deposit. Net interest income decreased 5.9% to \$7,495,000 for the three months ended June 30, 2006, from the \$7,964,000 reported for the same period in 2005.

The Company's net interest margin on a tax-equivalent basis decreased from 3.95% in the first six months of 2005 to 3.33% for the six months ended June 30, 2006. For the three months ended June 30, 2006, the Company's net interest margin was 3.21%, a decrease from the 3.92% in the same period of 2005. This is due to the current flat yield curve and liability costs increasing at a faster rate than the yield on assets. These results are consistent with the Company's expectations for changes in its net interest income in the current rate environment.

Tax-exempt interest income amounted to \$1,771,000 and \$1,616,000 for the six months ended June 30, 2006 and 2005, respectively. For the three months ended June 30, 2006 and 2005, tax-exempt interest income amounted to \$895,000 and \$852,000, respectively. Tax equivalency is calculated using a 35% effective tax rate. The following table presents the effect of tax-exempt income on the calculation of the net interest margin, using a 35.0% tax rate in 2006 and 2005:

	<b>For the six months ended June 30,</b>		<b>For the quarter ended June 30,</b>	
	<b>2006</b>	2005	<b>2006</b>	2005
Net interest income as presented	<b>\$15,242</b>	\$15,409	<b>\$7,495</b>	\$7,964
Effect of tax-exempt income	<b>953</b>	870	<b>482</b>	459
Net interest income, tax equivalent	<b>\$16,195</b>	\$16,279	<b>\$7,977</b>	\$8,423



The following table presents the amount of interest earned or paid, as well as the average yield or rate on an annualized basis, for each major category of assets or liabilities for the six months ended June 30, 2006 and 2005. Tax-exempt income is calculated on a tax-equivalent basis, using a 35.0% tax rate in 2006 and 2005.

<b>Six months ended June 30,</b>	<u><b>2006</b></u>	<b>Average</b>	<u><b>2005</b></u>	<b>Average</b>
<i>Dollars in thousands</i>	<b>Amount of interest</b>	<b>Yield/Rate</b>	<b>Amount of interest</b>	<b>Yield/Rate</b>
<b>Interest on earning assets</b>				
Interest-bearing deposits	\$ -	0.00%	\$ 5	2.81%
Investments	5,441	5.85%	4,359	5.64%
Loans held for sale	1	6.26%	13	7.10%
Loans	26,156	6.64%	19,684	5.88%
Total interest-earning assets	31,598	6.49%	24,061	5.83%
<b>Interest-bearing liabilities</b>				
Deposits	11,053	3.23%	5,067	1.90%
Other borrowings	4,350	4.36%	2,715	2.66%
Total interest-bearing liabilities	15,403	3.49%	7,782	2.11%
<b>Net interest income</b>	<b>\$16,195</b>		<b>\$16,279</b>	
Interest rate spread		3.01%		3.73%
Net interest margin		3.33%		3.95%

The following table presents changes in interest income and expense attributable to changes in interest rates and volume for interest-earning assets and interest-bearing liabilities for the six months ended June 30, 2006 compared to 2005. Tax-exempt income is calculated on a tax-equivalent basis, using a 35.0% tax rate in 2006 and 2005.

<b>Six months ended June 30, 2006 compared to 2005</b>				
<i>Dollars in thousands</i>	Volume	Rate	Rate/Volume <sup>1</sup>	Total
<b>Interest on earning assets</b>				
Interest-bearing deposits	\$ (5)	\$ (5)	\$ 5	\$ (5)
Investment securities	889	160	33	1,082
Loans held for sale	(11)	(2)	1	(12)
Loans	3,458	2,564	450	6,472
Total interest income	4,331	2,717	489	7,537
<b>Interest expense</b>				
Deposits	1,422	3,564	1,000	5,986
Other borrowings <sup>2</sup>	(63)	1,739	(41)	1,635
Total interest expense	1,359	5,303	959	7,621
Change in net interest income	\$ 2,972	\$ (2,586)	\$ (470)	\$ (84)

<sup>1</sup> Represents the change attributable to a combination of change in rate and change in volume.

<sup>2</sup> Includes federal funds purchased.



The following table presents the amount of interest earned or paid, as well as the average yield or rate on an annualized basis, for each major category of assets or liabilities for the quarter ended June 30, 2006 and 2005. Tax-exempt income is calculated on a tax-equivalent basis, using a 35.0% tax rate in 2006 and 2005.

Quarters ended June 30,	2006		2005	
	Amount of interest	Average Yield/Rate	Amount of interest	Average Yield/Rate
<i>Dollars in thousands</i>				
<b>Interest on earning assets</b>				
Interest-bearing deposits	\$ -	0.00%	\$ 5	2.83%
Investments	2,784	5.86%	2,248	5.70%
Loans held for sale	1	5.79%	10	5.45%
Loans	13,530	6.72%	10,490	5.98%
Total interest-earning assets	16,315	6.56%	12,753	5.93%
<b>Interest-bearing liabilities</b>				
Deposits	5,933	3.16%	2,856	1.84%
Other borrowings	2,405	4.60%	1,474	2.84%
Total interest-bearing liabilities	8,338	3.47%	4,330	2.09%
<b>Net interest income</b>	<b>\$ 7,977</b>		<b>\$ 8,423</b>	
Interest rate spread		3.09%		3.84%
Net interest margin		3.21%		3.92%

The following table presents changes in interest income and expense attributable to changes in interest rates and volume for interest-earning assets and interest-bearing liabilities for the quarter ended June 30, 2006 compared to 2005. Tax-exempt income is calculated on a tax-equivalent basis, using a 35.0% tax rate in 2006 and 2005.

Quarter ended June 30, 2006 compared to 2005				
<i>Dollars in thousands</i>	Volume	Rate	Rate/Volume <sup>1</sup>	Total
<b>Interest on earning assets</b>				
Interest-bearing deposits	\$ (5)	\$ (5)	\$ 5	\$ (5)
Investment securities	454	68	14	536
Loans held for sale	(9)	1	(1)	1
Loans	1,516	1,320	194	3,040
Total interest income	1,956	1,394	212	3,562
<b>Interest expense</b>				
Deposits	588	2,064	425	3,077
Other borrowings <sup>2</sup>	6	921	4	931
Total interest expense	594	2,985	429	4,008
Change in net interest income	\$ 1,372	\$ (1,591)	\$ (217)	\$ (446)

<sup>1</sup> Represents the change attributable to a combination of change in rate and change in volume.

<sup>2</sup> Includes federal funds purchased.

On a pro-forma basis, net interest income for the first six months of 2006 was \$15,242,000, a decrease of \$440,000 or 2.8% compared to net interest income of \$15,682,000 for the first six months of 2005. The growth in earning assets was offset by margin compression as a result of the flat yield curve. On a pro-forma basis, net interest income for the three months ended June 30, 2006 and 2005 was the same as that reported in the Company's consolidated financial statements.





***Provision for Loan Losses***

A \$600,000 provision to the allowance for loan losses was made during the first six months of 2006, compared to a \$100,000 provision made for the same period of 2005. The increase in provision is a result of increased volume in loans during 2006 and the Company's calculation of the adequacy of its allowance for loan losses as of June 30, 2006.

***Non-Interest Income***

Non-interest income was \$4,433,000 for the six months ended June 30, 2006, an increase of 13.9% from the \$3,891,000 reported for the first six months of 2005. The increase in non-interest income was primarily due to increases in investment management and fiduciary income as well as increased levels of revenue on deposit accounts. On a pro-forma basis, non-interest income increased by \$397,000 or 9.8% from \$4,036,000 in 2005 to \$4,433,000 in 2006.

Non-interest income was \$2,360,000 for the three months ended June 30, 2006, an increase of 5.9% from the \$2,228,000 reported in the same period for 2005. Although investment management and fiduciary income increased by 13.6%, income from mortgage origination declined due to higher interest rates and lower levels of loans sold to the secondary market. On a pro-forma basis, non-interest income for the three months ended June 30, 2006 and 2005 was the same as that reported in the Company's consolidated financial statements.

***Non-Interest Expense***

Non-interest expense of \$10,516,000 for the six months ended June 30, 2006, is a decrease of 1.2% compared to non-interest expense of \$10,642,000 for the same period in 2005. This decline was attributable to lower employee costs through attrition as well as a reduction in the accrual for the Company's Stakeholder bonus program and lower health insurance costs. In addition, savings were realized from outsourced services that were absorbed into existing in-house operations. On a pro-forma basis, non-interest expense decreased by \$820,000 or 7.2% during the six months ended June 30, 2006 compared to the six months ended June 30, 2005, with the largest decrease in salaries and employee benefits, which were down by 10.1%.

Non-interest expense of \$5,081,000 for the three months ended June 30, 2006, is a decrease of 11.4% compared to non-interest expense of \$5,736,000 for the three months ended June 30, 2005. This level of decrease in non-interest expense for the quarter was for the same reasons cited above as well as a decrease in other operating expenses. On a pro-forma basis, non-interest expense for the three months ended June 30, 2006 and 2005 was the same as that reported in the Company's consolidated financial statements.

***Income Taxes***

Income taxes on operating earnings were \$2,411,000 for the six months ended June 30, 2006, virtually the same as the period a year ago.

***Investments***

The Company's investment portfolio increased by \$5.7 million or 3.1% to \$189.7 million between December 31, 2005, and June 30, 2006. At June 30, 2006, the Company's available-for-sale portfolio had an unrealized gain, net of taxes, of \$0.4 million. Between June 30, 2005, and June 30, 2006, the Company's investment portfolio increased by \$29.7 million or 18.5%. This was due to increased investing activities.

***Loans***

Loans grew by \$53.4 million or 6.9% during the first six months of 2006. The growth in commercial loans was \$25.9 million or 8.3% and municipal loans increased \$3.1 million or 15.2%. The residential mortgage portfolio increased by \$19.6 million or 6.2%, and home equity lines of credit decreased \$4.7 million or 5.6% year-to-date. Between June 30, 2005 and June 30, 2006, the loan portfolio increased \$107.3 million or 14.9%, as a result of strong customer demand.

### *Allowance for Loan Losses*

The allowance for loan losses represents the amount available for credit losses inherent in the Company's loan portfolio. Loans are charged off when deemed uncollectible, after giving consideration to factors such as the customer's financial condition, underlying collateral and guarantees, as well as general and industry economic conditions.

Adequacy of the allowance for loan losses is determined using a consistent, systematic methodology, which analyzes the risk inherent in the loan portfolio. In addition to evaluating the collectibility of specific loans when determining the adequacy of the allowance for loan losses, Management also takes into consideration other factors such as changes in the mix and size of the loan portfolio, historic loss experience, the amount of delinquencies and loans adversely classified, and economic trends. The adequacy of the allowance for loan losses is assessed by an allocation process whereby specific loss allocations are made against certain adversely classified loans, and general loss allocations are made against segments of the loan portfolio that have similar attributes. The Company's historical loss experience, industry trends, and the impact of the local and regional economy on the Company's borrowers, are considered by Management in determining the adequacy of the allowance for loan losses.

The allowance for loan losses is increased by provisions charged against current earnings. Loan losses are charged against the allowance when Management believes that the collectibility of the loan principal is unlikely. Recoveries on loans previously charged off are credited to the allowance. While Management uses available information to assess possible losses on loans, future additions to the allowance may be necessary based on increases in non-performing loans, changes in economic conditions, growth in loan portfolios, or for other reasons. Any future additions to the allowance would be recognized in the period in which they were determined to be necessary. In addition, various regulatory agencies periodically review the Company's allowance for loan losses as an integral part of their examination process. Such agencies may require the Company to record additions to the allowance based on judgments different from those of Management.

Credit quality of the commercial portfolios is quantified by a credit rating system designed to parallel regulatory criteria and categories of loan risk. Individual loan officers monitor their loans to ensure appropriate rating assignments are made on a timely basis. Risk ratings and quality of the commercial loan portfolio are also assessed on a regular basis by an independent loan review consulting firm. Ongoing portfolio trend analyses and individual credit reviews to evaluate loan risk and compliance with corporate lending policies are also performed. The level of allowance allocable to each group of risk-rated loans is then determined by applying a loss factor that estimates the amount of probable loss in each category. The assigned loss factor for each risk rating is based upon Management's assessment of historical loss data, portfolio characteristics, economic trends, overall market conditions and past experience.

Consumer loans, which include residential mortgages, home equity loans/lines, and direct/indirect loans, are generally evaluated as a group based on product type and on the basis of delinquency data and other credit data available due to the large number of such loans and the relatively small size of individual credits. Allocations for these loan categories are principally determined by applying loss factors that represent Management's estimate of inherent losses. In each category, inherent losses are estimated based upon Management's assessment of historical loss data, portfolio characteristics, economic trends, overall market conditions and past experience. In addition, certain loans in these categories may be individually risk-rated if considered necessary by Management.

The other method used to allocate the allowance for loan losses entails the assignment of reserve amounts to individual loans on the basis of loan impairment. Certain loans are evaluated individually and are judged to be impaired when Management believes it is probable that the Company will not collect all of the contractual interest and principal payments as scheduled in the loan agreement. Under this method, loans are selected for evaluation based on internal risk ratings or non-accrual status. A specific reserve is allocated to an individual loan when that loan has been deemed impaired and when the amount of a probable loss is estimable on the basis of its collateral value, the present value of anticipated future cash flows, or its net realizable value. At June 30, 2006, impaired loans with specific reserves totaled \$416,000 (all of these loans were on non-accrual status) and the amount of such reserves were \$109,000.

All of these analyses are reviewed and discussed by the Directors' Loan Committee, and recommendations from these processes provide Management and the Board of Directors with independent information on loan portfolio condition. As a result of these analyses, the Company has concluded that the level of the allowance for loan losses was adequate as of June 30, 2006. As of that date, the balance of \$6,021,000 was 0.73% of total loans, compared to 0.79% at December 31, 2005 and 0.91% at June 30, 2005. Loans considered to be impaired according to SFAS 114/118 totaled \$2,543,000 at June 30, 2006 compared to \$3,081,000 at December 31, 2005. The portion of the allowance for loan losses allocated to impaired loans at June 30, 2006, was \$109,000 compared to \$392,000 at December 31, 2005.



In Management's opinion, the level of the Company's allowance for loan losses is adequate. Although the allowance is lower as a percentage of loans than many peers, the Bank's loan portfolio has a higher percentage of residential mortgage loans than peers, and the overall credit quality of the portfolio and historically low level of chargeoffs support this.

### *Non-Performing Assets*

At June 30, 2006, loans on non-accrual status totaled \$2.5 million, which compares to non-accrual loans of \$3.1 million as of December 31, 2005. In addition to loans on non-accrual status at June 2006, loans past due 90 days or more and accruing (calculated on a constant 30-day month basis) totaled \$588,000 which compares to \$325,000 as of December 31, 2005. The Company continues to accrue interest on these loans because it believes collection of the interest is reasonably assured.

### *Goodwill*

On January 14, 2005, the Company completed the acquisition of FNB Bankshares ( FNB ) of Bar Harbor, Maine, and its subsidiary, The First National Bank of Bar Harbor, which was merged into the Bank. Management believes that the products and services offered in FNB's market have been enhanced by the combination of the two companies, providing a larger capacity to lend money and a stronger overall funding base. In 2005, the combined entity realized approximately \$1.0 million in initial cost savings from redundant expenses, such as regulatory fees, audit costs, legal costs, and outsourced costs.

The total value of the transaction was \$47,955,000, and all of the voting equity interest of FNB was acquired in the transaction. As required under GAAP, the purchase price was allocated to assets acquired and liabilities assumed at the date of acquisition. The excess of purchase price over the fair value of net tangible and identified intangible assets acquired was recorded as goodwill, which totaled \$27,559,000 and included \$972,000 in direct expenses.

The following table shows the adjusted fair value of assets and liabilities recorded on the Company's balance sheet from the FNB acquisition, including the associated goodwill in the transaction:

*In thousands of dollars*

<b>Assets</b>	
Cash and due from banks	\$ 6,963
Investments	26,562
Loans held for sale (fair value approximates cost)	591
Loans	185,357
Less: allowance for loan losses	(2,164)
Net loans	183,193
Bank premises and equipment	7,767
Goodwill	27,559
Other assets	9,311
<b>Total Assets</b>	<b>\$ 261,946</b>
<b>Liabilities &amp; Shareholders' Equity</b>	
Deposits	\$ 192,860
Borrowed funds	17,044
Other liabilities	4,086
Total liabilities	213,990
Shareholders' equity	47,956

**Total Liabilities & Shareholders Equity** **\$ 261,946**

The majority of the \$1,830,000 difference between actual goodwill booked and the \$26,005,000 of goodwill estimated in the Company's December 31, 2004 financial statements was due to deferred income taxes. During the fourth quarter of 2005, goodwill and other liabilities were reduced by \$276,000, net of tax, as a result of changes in employment continuity agreements with FNB employees who became employees of the Bank, which resulted in lower reserves for these agreements.

### ***Deposits***

During the first six months of 2006, total deposits increased by \$73.0 million or 10.2% over December 31, 2005. Although core deposits (demand, NOW, savings and money market accounts) decreased by \$35.4 million or 8.7% in the first six months of 2006, during the same period, certificates of deposit increased \$108.4 million or 35.5%. Between June 30, 2005, and June 30, 2006, deposits grew by 17.1%, or \$114.7 million. Demand deposits grew \$4.5 million, and certificates of deposit also grew by \$126.6 million, while NOW accounts decreased by \$3.5 million, money market accounts decreased by \$.2 million and savings decreased by \$12.8 million. The majority of the growth in certificates of deposit, both year-to-date and year-over-year, was from wholesale and brokered sources. The Company saw a decline in core deposits in the first six months of 2006 due to the seasonality of deposit flows and transfers to higher-yielding certificates of deposit due to higher interest rates.

### ***Borrowed Funds***

The Company's funding includes borrowings from the Federal Home Loan Bank of Boston, the Federal Reserve System, and repurchase agreements, enabling it to grow its balance sheet and, in turn, grow its revenues. They may also be used to carry out interest rate risk management strategies, and are increased to replace or supplement other sources of funding, including core deposits and certificates of deposit. During the six months ended June 30, 2006, borrowed funds decreased by \$18.5 million or 8.6% from December 31, 2005, as a result of the deposit growth previously noted. Between June 30, 2005 and June 30, 2006, borrowed funds increased \$18.9 million or 10.6%.

### ***Shareholders' Equity***

Shareholders' equity as of June 30, 2006 was \$105.6 million, compared to \$103.4 million as of December 31, 2005. The Company's earnings performance in the first six months of 2006, net of dividends paid, added to shareholders' equity. The net unrealized loss on available-for-sale securities, presented in accordance with SFAS 115, decreased by \$0.3 million from December 31, 2005, as a result of a recent rise in interest rates.

In 2006, a cash dividend of 15 cents per share was declared in the second quarter compared to 13 cents in the second quarter of 2005. The dividend payout ratio was 46.88% in the second quarter of 2006 compared to 40.63% in the second quarter of 2005. In determining future dividend payout levels, the Board of Directors carefully analyzes capital requirements and earnings retention, as set forth in the Company's Dividend Policy. The ability of the Company to pay cash dividends to its shareholders depends on receipt of dividends from its subsidiary, the Bank. The subsidiary may pay dividends to its parent out of so much of its net profits as the Bank's directors deem appropriate, subject to the limitation that the total of all dividends declared by the Bank in any calendar year may not exceed the total of its net profits of that year combined with its retained net profits of the preceding two years. The amount available for dividends in 2006 is this year's net income plus \$9.8 million.

Regulatory leverage capital ratios for the Company were 7.19% and 7.66% at June 30, 2006 and December 31, 2005, respectively. The Company had a tier one risk-based capital ratio of 10.13% and tier two risk-based capital ratio of 10.94% at June 30, 2006, compared to 10.74% and 11.61%, respectively, at December 31, 2005. These are comfortably above the standards to be rated "well-capitalized" by regulatory authorities qualifying the Company for lower deposit-insurance premiums.

On January 20, 2005, the Company announced that its Board of Directors had authorized the repurchase of up to 250,000 shares of the Company's common stock or approximately 2.5% of the outstanding shares. The Company expects such repurchases to be effected from time to time, in the open market, in private transactions or otherwise, during a period of up to 24 months. The amount and timing of shares to be purchased will be subject to market conditions and will be based on several factors, including the price of the Company's stock and the level of stock issuances under the Company's employee stock plans. No assurance can be given as to the specific timing of the share repurchases or as to whether and to what extent the share repurchase will be consummated. As of June 30, 2006 the Company had repurchased 248,375 shares under



the new repurchase plan at an average price of \$17.15.

*Average Daily Balance Sheets*

The following table shows the Company's average daily balance sheets for the six month and three month periods ended June 30, 2006 and 2005.

<i>In thousands of dollars</i>	<b>For the six months ended June 30,</b>		<b>For the quarters ended June 30,</b>	
	<b>2006</b>	2005	<b>2006</b>	2005
<b>Assets</b>				
Cash and due from banks	<b>\$ 20,268</b>	\$ 18,524	<b>\$ 20,136</b>	\$ 17,486
Interest-bearing deposits	-	359	-	711
<b>Investments</b>				
U.S. Treasury & government agency securities	<b>91,104</b>	63,948	<b>94,572</b>	64,055
Obligations of states and political subdivisions	<b>55,895</b>	49,348	<b>55,744</b>	52,402
Other securities	<b>40,617</b>	42,530	<b>40,356</b>	42,161
Total investments	<b>187,616</b>	155,826	<b>190,672</b>	158,618
Loans held for sale	<b>46</b>	369	<b>45</b>	734
<b>Loans</b>				
Commercial	<b>325,091</b>	271,479	<b>332,272</b>	289,944
Consumer	<b>42,263</b>	34,396	<b>44,182</b>	35,350
State and municipal	<b>21,205</b>	22,591	<b>21,893</b>	23,162
Real estate	<b>405,232</b>	346,710	<b>408,769</b>	356,719
Total loans	<b>793,791</b>	675,176	<b>807,116</b>	705,175
Allowance for loan losses	<b>(6,136)</b>	(6,523)	<b>(6,104)</b>	(6,570)
Net loans	<b>787,655</b>	668,653	<b>801,012</b>	698,604
Premises and equipment	<b>16,525</b>	16,324	<b>16,422</b>	16,928
Goodwill	<b>22,752</b>	17,754	<b>15,869</b>	20,645
Other assets	<b>27,684</b>	25,652	<b>27,684</b>	27,960
<b>Total assets</b>	<b>\$1,062,546</b>	\$ 903,461	<b>\$1,071,841</b>	\$ 941,686
<b>Liabilities and shareholders' equity</b>				
<b>Deposits</b>				
Demand	<b>\$ 58,092</b>	\$ 54,210	<b>\$ 57,522</b>	\$ 54,318
NOW	<b>100,057</b>	102,000	<b>98,553</b>	107,436
Money market	<b>119,513</b>	110,850	<b>112,106</b>	114,399
Savings	<b>103,212</b>	109,089	<b>99,751</b>	113,178
Certificates of deposit	<b>149,989</b>	107,553	<b>155,934</b>	98,868
Certificates of deposit over \$100,000	<b>217,198</b>	109,276	<b>229,837</b>	136,796
Total deposits	<b>748,061</b>	592,978	<b>753,703</b>	624,994
Borrowed funds	<b>200,975</b>	205,780	<b>209,480</b>	208,570
Other liabilities	<b>8,696</b>	8,788	<b>3,467</b>	8,121
<b>Total liabilities</b>	<b>957,732</b>	807,546	<b>966,651</b>	841,686
Common stock	<b>99</b>	98	<b>98</b>	101
Additional paid-in capital	<b>47,449</b>	45,342	<b>47,215</b>	48,690
Retained earnings	<b>56,628</b>	48,721	<b>57,333</b>	49,881
Unrealized gain on securities available for sale	<b>638</b>	1,754	<b>544</b>	1,329
<b>Total shareholders' equity</b>	<b>104,814</b>	95,915	<b>105,190</b>	100,001
<b>Total liabilities and shareholders' equity</b>	<b>\$1,062,546</b>	\$ 903,461	<b>\$1,071,841</b>	\$ 941,686



***Off-Balance Sheet Financial Instruments***

No material off-balance sheet risk exists that requires a separate liability presentation.

***Sale of Loans***

No recourse obligations have been incurred in connection with the sale of loans.

***Contractual Obligations***

The following table sets forth the contractual obligations of the Company as of June 30, 2006:

<i>In thousands of dollars</i>	<b>Total</b>	<b>Less than 1 year</b>	<b>1-3 years</b>	<b>3-5 years</b>	<b>More than 5 years</b>
Borrowed funds	<b>\$196,649</b>	179,384	2,000	15,063	202
Operating leases	<b>561</b>	131	264	113	53
Certificates of deposit	<b>413,913</b>	350,142	49,966	13,805	-
Total	<b>\$611,123</b>	529,657	52,230	28,981	255
Total loan commitments and unused lines of credit	<b>\$152,069</b>	152,069	-	-	-

***Liquidity Management***

As of June 30, 2006 the Bank had primary sources of liquidity of \$171.6 million. It is Management's opinion this is adequate. In its Asset/Liability policy, the Bank has guidelines for liquidity. The Company is not aware of any recommendations by the regulatory authorities which, if they were to be implemented, would have a material effect on the Company's liquidity, capital resources or results of operations.

***Forward-Looking Statements***

Certain disclosures in Management's Discussion and Analysis of Financial Condition and Results of Operations contain certain forward-looking statements (as defined in the Private Securities Litigation Reform Act of 1995). In preparing these disclosures, Management must make assumptions, including, but not limited to, the level of future interest rates, prepayments on loans and investment securities, required levels of capital, needs for liquidity, and the adequacy of the allowance for loan losses. These forward-looking statements may be subject to significant known and unknown risks uncertainties, and other factors, including, but not limited to, those matters referred to in the preceding sentence.

## Edgar Filing: FIRST NATIONAL LINCOLN CORP /ME/ - Form 10-Q

Although First National Lincoln Corporation believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the results discussed in these forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers are also urged to carefully review and consider the various disclosures made by the Company, which attempt to advise interested parties of the facts that affect the Company's business.

Page 22

**Item 3 Quantitative and Qualitative Disclosures About Market Risk****Market-Risk Management**

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates. First National Lincoln Corporation's market risk is composed primarily of interest rate risk. The Bank's Asset/Liability Committee (ALCO) is responsible for reviewing the interest rate sensitivity position of the Company and establishing policies to monitor and limit exposure to interest rate risk. All guidelines and policies established by ALCO have been approved by the Board of Directors.

**Asset/Liability Management**

The primary goal of asset/liability management is to maximize net interest income within the interest rate risk limits set by ALCO. Interest rate risk is monitored through the use of two complementary measures: static gap analysis and earnings simulation modeling. While each measurement has limitations, taken together they represent a reasonably comprehensive view of the magnitude of interest rate risk in the Company, the level of risk through time, and the amount of exposure to changes in certain interest rate relationships.

Static gap analysis measures the amount of repricing risk embedded in the balance sheet at a point in time. It does so by comparing the differences in the repricing characteristics of assets and liabilities. A gap is defined as the difference between the principal amount of assets and liabilities that reprice within a specified time period. The Bank's cumulative one-year gap, at June 30, 2006, was -13.13% of total assets. Core deposits with non-contractual maturities are presented based upon historical patterns of balance attrition and pricing behavior, which are reviewed at least annually.

The gap repricing distributions include principal cash flows from residential mortgage loans and mortgage-backed securities in the time frames in which they are expected to be received. Mortgage prepayments are estimated by applying industry median projections of prepayment speeds to portfolio segments based on coupon range and loan age.

A summary of the Bank's static gap, as of June 30, 2006 is presented in the following table:

	<b>0-90 Days</b>	<b>90-365 Days</b>	<b>1-5 Years</b>	<b>5+ Years</b>
Investment securities at amortized cost	\$24,223	\$ 22,731	\$79,958	\$ 61,740
Loans held for sale	240	-	-	-
Loans	293,895	126,533	324,350	80,921
Other interest-earning assets	-	8,347	-	-
Non-rate-sensitive assets	71	213	1,134	46,459
<b>Total assets</b>	<b>318,429</b>	<b>157,824</b>	<b>405,442</b>	<b>189,120</b>
Interest-bearing deposits <sup>1</sup>	263,224	182,657	90,249	203,266
Borrowed funds <sup>1</sup>	133,486	32,349	17,085	146
Non-rate-sensitive liabilities and equity	1,281	3,843	23,058	120,171
<b>Total liabilities and equity</b>	<b>397,991</b>	<b>218,849</b>	<b>130,392</b>	<b>323,583</b>
<b>Period gap</b>	<b>\$(79,562)</b>	<b>\$(61,025)</b>	<b>\$275,050</b>	<b>\$(134,463)</b>
Percent of total assets	-7.43%	-5.70%	25.69%	-12.56%
Cumulative gap (current)	(79,562)	(140,587)	134,463	-
Percent of total assets	-7.43%	-13.13%	12.56%	0.00%

<sup>1</sup> Certain liabilities were reclassified between interest-bearing deposits and borrowed funds in the modeling process.

The earnings simulation model forecasts capture the impact of changing interest rates on one-year and two-year net interest income. The modeling process calculates changes in interest income received and interest expense paid on all interest-earning assets and interest-bearing liabilities reflected on the Company's balance sheet. None of the assets used in the simulation are held for trading purposes. The modeling is done for a variety of scenarios that incorporate changes in the absolute level of interest rates as well as basis risk, as represented by changes in the shape of the yield curve and changes in interest rate relationships. Management evaluates the effects on income of alternative interest rate scenarios

against earnings in a stable interest rate environment. This analysis is also most useful in determining the short-run earnings exposures to changes in customer behavior involving loan payments and deposit additions and withdrawals.

The Bank's most recent simulation model projects net interest income would increase by approximately 5.65% of stable-rate net interest income if short-term rates affected by Federal Open Market Committee actions fall gradually by two percentage points over the next year, and decrease by approximately 8.57% if rates rise gradually by two percentage points. Both scenarios are well within ALCO's policy limit of a decrease in net interest income of no more than 10.0% given a 2.0% move in interest rates, up or down. Management believes this reflects a reasonable interest rate risk position. In year two, and assuming no additional movement in rates, the model forecasts that net interest income would be higher than that earned in a stable rate environment by 17.80% in a falling-rate scenario, and lower than that earned in a stable rate environment by 17.81% in a rising rate scenario, when compared to the year-one base scenario. A summary of the Bank's interest rate risk simulation modeling, as of June 30, 2006 is presented in the following table:

<b>Changes in Net Interest Income</b>	<b>2006</b>
<b>Year 1</b>	
Projected change if rates decrease by 2.0%	+5.65%
Projected change if rates increase by 2.0%	-8.57%
<b>Year 2</b>	
Projected change if rates decrease by 2.0%	+17.80%
Projected change if rates increase by 2.0%	-17.81%

This dynamic simulation model includes assumptions about how the balance sheet is likely to evolve through time and in different interest rate environments. Loans and deposits are projected to maintain stable balances. All maturities, calls and prepayments in the securities portfolio are assumed to be reinvested in similar assets. Mortgage loan prepayment assumptions are developed from industry median estimates of prepayment speeds for portfolios with similar coupon ranges and seasoning. Non-contractual deposit volatility and pricing are assumed to follow historical patterns. The sensitivities of key assumptions are analyzed annually and reviewed by ALCO.

The information for static gap and changes in net interest income presented in this section pertains to the Bank only and does not include goodwill and a small volume of assets and liabilities owned by the Company and included in its consolidated financial statements as of June 30, 2006. This sensitivity analysis does not represent a Company forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions including, 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, the Company cannot make any assurances as to the predictive nature of these assumptions, including how customer preferences or competitor influences might change.

### ***Interest Rate Risk Management***

A variety of financial instruments can be used to manage interest rate sensitivity. These may include investment securities, interest rate swaps, and interest rate caps and floors. Frequently called interest rate derivatives, interest rate swaps, caps and floors have characteristics similar to securities but possess the advantages of customization of the risk-reward profile of the instrument, minimization of balance sheet leverage and improvement of liquidity. As of June 30, 2006, the Company was not using any derivative instruments for interest rate risk management.

The Company engages an independent consultant to periodically review its interest rate risk position, as well as the effectiveness of simulation modeling and reasonableness of assumptions used. As of June 30, 2006, there were no significant differences between the views of the independent consultant and Management regarding the Company's interest rate risk exposure. Management expects interest rates will continue to rise in the near term and believes that the current level of interest rate risk is acceptable.





**Item 4: Controls and Procedures**

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as of June 30, 2006, the end of the quarter covered by this report, the Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. 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 reasonable assurance of achieving the desired control objectives, and the Company's 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 concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. There was no change in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. The Company reviews its disclosure controls and procedures, which may include its internal controls over financial reporting on an ongoing basis, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that the Company's systems evolve with its business.



**Part II Other Information**

**Item 1 Legal Proceedings**

The Company was not involved in any legal proceedings requiring disclosure under Item 103 of Regulation S-K during the reporting period.

**Item 1A Risk Factors**

There have been no material changes to the Risk Factors previously disclosed in Item 1A of the Company's Annual Report on Form 10-K for the period ended December 31, 2005.

**Item 2 Unregistered Sales of Equity Securities and Use of Proceeds**

a. The Company issues shares to the Bank's 401k Investment and Savings Plan pursuant to an exemption from registration under the Securities Act of 1933, as amended (the "Securities Act"), contained in Section 3(a)(11) thereof and Rule 147 promulgated thereunder, as presented in the following table:

<b>Month</b>	<b>Shares</b>	<b>Average Price Proceeds</b>	
January 2006	599	\$17.41	\$10,000
February 2006	2,275	17.51	40,000
March 2006	454	17.55	8,000
April 2006	633	17.21	11,000
May 2006	451	16.84	8,000
June 2006	456	17.25	8,000
<b>Total</b>	<b>4,868</b>	<b>\$17.38</b>	<b>\$85,000</b>

b. None

c. On January 20, 2005, the Company announced that its Board of Directors had authorized the repurchase of up to 250,000 shares of the Company's common stock or approximately 2.5% of the outstanding shares. The Company expects such repurchases to be effected from time to time, in the open market, in private transactions or otherwise, during a period of up to 24 months. The amount and timing of shares to be purchased will be subject to market conditions and will be based on several factors, including the price of the Company's stock and the level of stock issuances under the Company's employee stock plans. No assurance can be given as to the specific timing of the share repurchases or as to whether and to what extent the share repurchase will be consummated. As of June 30, 2006 the Company had repurchased 248,375 shares under the new repurchase plan at an average price of \$17.15. Repurchases during the six months ended June 30, 2006, are detailed in the following table.

**Total**

**Number of**

<b>Month</b>	<b>Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of a Publicly Announced Plan or Program</b>
January 2006	26	\$16.89	26
February 2006	21,025	17.77	21,025
March 2006	11,836	17.58	11,836
April 2006	-	-	-
May 2006	39,033	16.53	39,033
June 2006	219	17.06	219
<b>Total</b>	<b>72,139</b>	<b>\$17.07</b>	<b>72,139</b>

**Item 3 Default Upon Senior Securities**

None.

**Item 4 Submission of Matters to a Vote of Security Holders**

The Annual Meeting of Shareholders of First National Lincoln Corporation, the one-bank holding company of The First, N.A., was held at The Samoset Resort, 200 Warrenton Street, Rockport, Maine 04856, on Wednesday, April 26, 2006 at 11:00 a.m. Eastern Daylight Time, for the following purposes:

To ratify the Board of Directors' vote to fix the number of directors at ten.

To elect as directors of the Company the three (3) nominees listed in the Proxy Statement dated March 24, 2006, as noted.

To ratify the Audit Committee's selection of Berry, Dunn, McNeil & Parker as independent auditors of the Company for 2006.

To transact such other business as may properly come before the meeting or any adjournment thereof.

Only shareholders of record at the close of business on February 15, 2006 (the Voting Record Date) were entitled to vote at the Annual Meeting. On the Voting Record Date, there were 9,875,097 shares of Common Stock of the Company, \$0.01 par value per share, issued and outstanding, and the Company had no other class of equity securities outstanding. Each share of Common Stock was entitled to one vote at the Annual Meeting on all matters properly presented thereat.

The results of voting at the meeting are summarized in the following table:

	<b>For</b>	<b>Against</b>	<b>Abstain</b>	<b>Total Votes</b>
<b>Article # 1 Fixed # of Directors</b>	8,667,335	113,047	36,118	8,816,500
<b>Article # 2 Director Election</b>				
Daniel R. Daigneault	8,696,823	103,264	16,413	8,816,500
Robert B. Gregory	8,758,898	41,189	16,413	8,816,500
Tony C. McKim	8,639,320	160,767	16,413	8,816,500
<b>Article # 3 Independent Auditor</b>	8,705,185	100,328	10,987	8,816,500

**Item 5 Other Information**

A. None.

B. None.



**Item 6 Exhibits**

Exhibit 2.1 Agreement and Plan of Merger With FNB Bankshares Dated August 25, 2004, incorporated by reference to Exhibit 2.1 to the Registrant's Form 8-K dated August 25, 2004, filed under item 1.01 on August 27, 2004.

Exhibit 3.1 Conformed Copy of the Registrants Articles of Incorporation, incorporated by reference to Exhibit 3.1 to the Company's Form 8-K filed under item 5.03 on October 7, 2004.

Exhibit 3.2 Conformed Copy of the Registrant's Bylaws, incorporated by reference to Exhibit 3.2 to the Company's Form 8-K filed under item 5.03 on October 7, 2004.

Exhibit 10.1(a) FNB Bankshares' Stock Option Plan. incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed under item 5.03 on October 7, 2004.

Exhibit 10.1(b) Specimen FNB Bankshares Non-Qualified Stock Option Agreement entered into with Messrs. Rosborough, McKim, Wrobel, Dalrymple and Lay, whose FNB Bankshares options have been converted into options to purchase 5,287, 34,086, 15,275, 11,750 and 21,150 shares of the Registrant's stock, respectively, all at \$3.80 per share, incorporated by reference to Exhibit 10.1(b) to the Company's Form 8-K filed under item 1.01 on January 14, 2005.

Exhibit 10.2(a) Specimen Employment Continuity Agreement entered into with Messrs. McKim, Wrobel, Dalrymple and Lay, incorporated by reference to Exhibit 10.2(a) to the Company's Form 8-K filed under item 1.01 on January 14, 2005.

Exhibit 10.2(b) Specimen Amendment to Employment Continuity Agreement entered into with Messrs. McKim, Wrobel, Dalrymple and Lay, incorporated by reference to Exhibit 10.2(b) to the Company's Form 8-K filed under item 1.01 on January 14, 2005.

Exhibit 10.3(a) Specimen Split Dollar Agreement entered into with Messrs. McKim, Wrobel, Dalrymple and Lay. For Mr. McKim, the amount of the death benefit is \$250,000; for Messrs. Lay, Dalrymple and Wrobel, the death benefit is \$150,000. Incorporated by reference to Exhibit 10.3(a) to the Company's Form 8-K filed under item 1.01 on January 14, 2005.

Exhibit 10.3(b) Specimen Amendment to Split Dollar Agreement entered into with Messrs. McKim, Wrobel, Dalrymple and Lay, incorporated by reference to Exhibit 10.3(b) to the Company's Form 8-K filed under item 1.01 on January 14, 2005.



Edgar Filing: FIRST NATIONAL LINCOLN CORP /ME/ - Form 10-Q

Exhibit 10.4 Specimen Amendment to Employment Continuity Agreement entered into with Messrs. McKim and Wrobel, incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed under item 1.01 on January 31, 2005.

Exhibit 31.1 Certification of Chief Executive Officer Pursuant to Rule 13A-14(A) of The Securities Exchange Act of 1934

Exhibit 31.2 Certification of Chief Financial Officer Pursuant to Rule 13A-14(A) of The Securities Exchange Act of 1934

Exhibit 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002

Exhibit 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002

**Signatures**

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

FIRST NATIONAL LINCOLN CORPORATION

/s/ Daniel R. Daigneault

Daniel R. Daigneault

President & Chief Executive Officer

Date: August 9, 2006

/s/ F. Stephen Ward

F. Stephen Ward

Executive Vice President & Chief Financial Officer

Date: August 9, 2006

