

A MESSAGE FROM THE PRESIDENT...

To our Shareholders, Customers and Employees:

Unaudited financial results through June 30, 2013 show net income before preferred stock dividends of \$2,005,000. This is a decline of \$140,000 from the first six months of 2012. Continued pressure on our net interest margin, as well as various one-time expenses related to our system changeover in June, accounted for much of the decline.

Although rates on the long end of the yield curve increased moderately during the quarter, the rate environment remains extremely low and flat, which leads to assets repricing at lower rates. This margin compression was offset by good loan growth of \$27,732,000 year over year, producing an increase of \$205,000 in net interest income. The investment portfolio also grew 9.6% as we added securities.

During the quarter, we resolved a problem loan that had been classified as Other Real Estate Owned. This accounted for a \$663,000 loss, as the price received for resolution was substantially less than our traditional conservative estimates used when assessing our book values. Although we were very disappointed in the outcome of this resolution, we do feel this is an isolated incident.

During the quarter we also credited our Reserve for Loan Losses by \$730,000 in order to reduce a substantial unallocated allowance position that had developed over the prior quarter. The unallocated position was positively impacted due to two very specific and material improvements in large loan relationships. Without an adjustment to release reserves to offset these improved loans, we judged our unallocated position to be excessive in light of regulatory and accounting guidance.

The net effect of these three unrelated events was a positive impact to pretax income of \$67,000.

Non-interest income for the year is up by \$74,000 or 4.5%, while non-interest expense for the same period is up by 8.1%. More than half of the expense increase consists of one-time costs associated with the completion of our technology system changeover that took place this quarter.

As previously mentioned, loan growth has picked up during the last few months, increasing by 5.8% over the prior year. Our loan pipeline is reasonably strong for the near term horizon. Year over year, local deposits (checking, savings, money markets and certificates of deposit) grew by \$18,952,000. Total Capital Increased to \$58,401,000 on a consolidated basis.

The board declared a cash dividend of \$.0975 per share for the second quarter, which was 8.3% above the second quarter of last year.

Twenty four of our employees reached out to nearly 700 students in 28 classrooms throughout northern Maine and the greater Bangor area as part of Teach Children to Save Day held in April. This marked the 17th consecutive year that we have participated in the nationwide event sponsored by the American Bankers Association to teach children their financial ABC's. This event is designed to start children off on the right path to saving for their future and is an important service that we provide in our community – to our friends, neighbors, and customers.

In May, we were extremely pleased to be named a Top 200 Community Bank for the 7th consecutive year by American Banker magazine. This rating was based on the Bank's three-year average Return on Equity (ROE) and included a review of public banks and thrifts with less than two billion in total assets as of Dec. 31, 2012. I commend our employees for their ongoing efforts and can-do attitudes that continue to enable us to achieve this type of recognition.

After several months of intense preparation, in mid-June we completed our system changeover to Fiserv, a leading technology company. This allows us to have one integrated software solution while providing access to more customer products, service and management information at a similar cost to our previous providers. We have already brought two new services to market with this changeover; UChoose rewards and mobile banking, including remote capture, a relatively new mobile feature throughout the banking industry.

As always, if you have questions regarding the Company or this report, please don't hesitate to contact us.

Sincerely,



Jon J. Prescott
President & CEO

DIRECTORS

Steven L. Richardson, *Chairman*
Arthur L. Shur, *Vice Chairman*
Robert E. Anderson
Robert H. Anderson
Peter F. Briggs

Paul R. Powers
Jon J. Prescott
Harold L. Stewart II, Esq.
Richard J. York

KATAHDIN TRUST COMPANY SENIOR MANAGEMENT

Jon J. Prescott, *President & CEO*
Bonnie C. Foster, *Senior Vice President, Retail Services*
Matthew M. Nightingale, *Senior Vice President, Treasurer & CFO*
Vicki J. Smith, *Senior Vice President, Marketing & Communications*
Peter P. St. John, *Senior Vice President, Commercial Services*

LOCATIONS

Ashland* 17 Main Street 435-6461	Hampden* 57 Western Avenue 862-2211	Patten* 11 Main Street 528-2211
Bangor* 609 Broadway 942-3146	Houlton* 65 North Street 532-4277	Presque Isle* 6 North Street 764-8000
52 Springer Drive 947-9674	Island Falls* 1007 Crystal Road 463-2228	Van Buren* 29 Main Street, Ste. 105 868-2728
Caribou* 105 Bennett Drive 498-4200	Limestone* 35 Main Street 325-4711	Washburn 1282 Main Street 455-8141
Eagle Lake 3440 Aroostook Road 444-5543	Mars Hill* 28 Main Street 429-8400	Commercial Loan Offices
Easton 82 Center Road 488-6642	Oakfield 200 Oakfield Smyrna Rd 757-8288	Scarborough 144 US Route One 510-7017
Fort Fairfield* 290 Main Street 472-3161		Maine Financial Group 144 US Route One Scarborough 885-5900

www.katahdintrust.com



*24-HOUR ATM



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2013

SECOND QUARTER REPORT

Consolidated Statement of Condition

(unaudited)

ASSETS	June 30,	
	2013	2012
Cash & Due from Banks	\$ 17,342	\$ 10,478
Investments	60,237	54,943
Total Loans	505,176	477,444
Reserve for Loan Loss	(5,416)	(6,575)
Fixed Assets	13,363	11,033
Other Assets	20,954	22,026
Total Assets	\$611,656	\$569,349
LIABILITIES		
Deposits	\$ 529,715	\$471,478
Repurchase Agreements	829	7,850
Borrowings	11,715	22,461
Other Liabilities	10,996	10,824
Total Liabilities	\$ 553,255	\$512,613
SHAREHOLDERS' EQUITY		
Preferred Shareholders' Equity	\$ 11,000	\$ 11,000
Common Shareholders' Equity	47,705	44,851
Net Unrealized Appreciation/(Depreciation) on Securities Available-for-Sale, Net of Tax	68	1,367
Net Unrealized Appreciation/(Depreciation) on Derivative Investments at Fair Value, Net of Tax	(372)	(482)
Total Shareholders' Equity	\$ 58,401	\$ 56,736
Total Liabilities & Shareholders' Equity	\$611,656	\$569,349
Letters of Credit	\$ 2,629	\$ 2,427

Consolidated Statements of Income

(unaudited)

	For 3 Months Ended June 30,		For 6 Months Ended June 30,	
	2013	2012	2013	2012
Interest Income	\$ 6,596	\$ 6,759	\$ 13,012	\$ 13,391
Interest Expense	1,183	1,420	2,405	2,989
Net Interest Income	\$ 5,413	\$ 5,339	\$ 10,607	\$ 10,402
Less: Provision for Loan Losses	(730)	201	(730)	421
Net Interest Income After Provisions	\$ 6,143	\$ 5,138	\$ 11,337	\$ 9,981
Non-Interest Income	883	851	1,719	1,645
Non-Interest Expense	4,780	4,373	9,447	8,740
Loss on Other Real Estate Owned	675	4	675	4
Impairment of Investment Securities	8	-	19	42
Net Operating Income	\$ 1,563	\$ 1,612	\$ 2,915	\$ 2,840
Less: Provision for Income Taxes	496	470	910	695
Net Income	\$ 1,067	\$ 1,142	\$ 2,005	\$ 2,145
Less: Dividends Paid on Preferred Stock	27	55	68	83
Net Income Available to Common Shareholders	\$ 1,040	\$ 1,087	\$ 1,937	\$ 2,062
Earnings Per Common Share	\$ 0.31	\$ 0.32	\$ 0.57	\$ 0.61
Annualized Return on Average Assets	0.72%	0.82%	0.69%	0.79%
Annualized Return on Average Common Equity	8.76%	9.60%	8.21%	9.19%
Book Value Per Share at period end ¹			\$ 13.92	\$ 13.43
Tangible Book Value Per Share at period end ²			\$ 12.24	\$ 11.73
Weighted Average Common Shares Outstanding			3,404,367	3,403,858
Common Shares Outstanding period end			3,404,367	3,404,367
Allowance for Loan Losses to period end Loans			1.07%	1.38%
Non-Performing Loans to period end Loans ³			1.62%	2.03%
Non-Performing Assets to Total Assets ⁴			1.40%	1.74%

1) Common equity per common share.

2) Tangible common equity per common share.

3) Non-performing loans consist of non-accrual loans and restructured loans, where applicable.

4) Non-performing assets consist of non-accrual loans, restructured loans, and foreclosed assets, where applicable.

SHAREHOLDER INFORMATION

SHAREHOLDER RELATIONS

Katahdin Bankshares Corp. and Katahdin Trust Company welcome shareholder and public interest in our services and activities. Questions or comments pertaining to this report and requests for other information should be directed to:

Jon J. Prescott, President & CEO
Katahdin Trust Company
PO Box 450 • Patten, Maine 04765
(207) 521-0455 Ext. 30211 • j.prescott@katahdintrust.com

STOCK

Katahdin Bankshares Corp. stock is quoted on the OTC Markets quote board OTCQB under the symbol KTHN.

TRANSFER AGENT

Shareholder inquiries regarding change of address or title should be directed to:

Investor Relations
Registrar and Transfer Company
10 Commerce Drive • Cranford, NJ 07016-3572
(800) 368-5948 • info@rtco.com • www.rtco.com

Northern Maine Photos by Paul A. Cyr – Presque Isle, Maine

