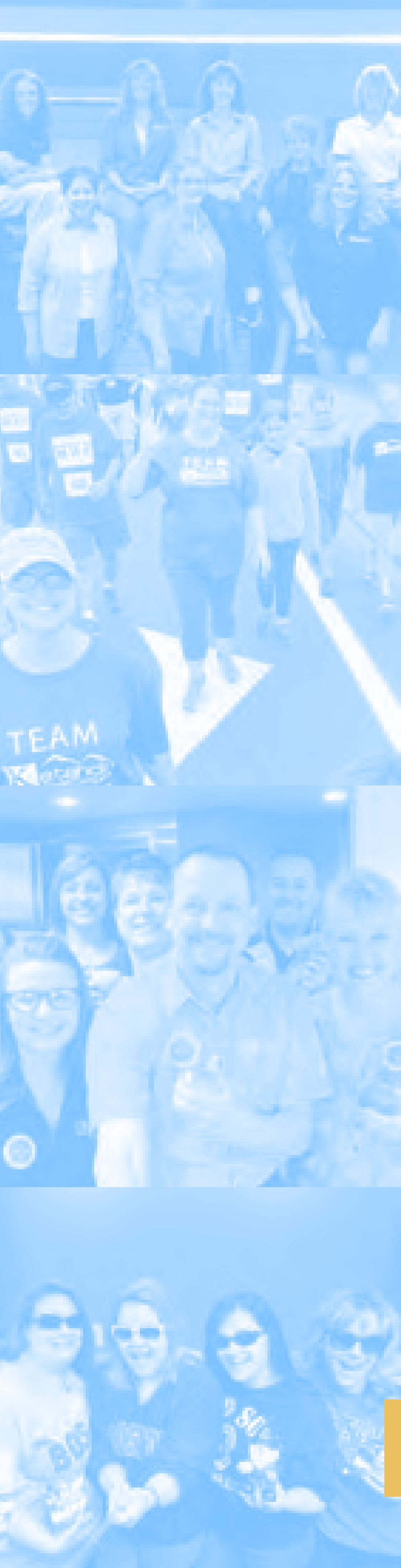

Katahdin Bankshares Corp.

2017

ANNUAL REPORT

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DEAR FELLOW SHAREHOLDERS

Net income before dividends paid on preferred stock totaled $4,353,000, a reduction from the prior year's mark of $4,814,000. A significant tax adjustment was required at the end of the fourth quarter because of the Tax Cuts and Jobs Act of 2017. However, going forward, our tax rate will be greatly reduced, which will benefit shareholders. The total tax adjustment in 2017 was $438,000.

Net interest income rose for the year to $25,462,000, helped by strong loan growth early in the year. Non-interest income dropped slightly from $4,464,000 to $4,421,000.

As you know, management has been focusing on a few strategic initiatives, beginning with deposit growth. I am pleased to report that local deposits grew substantially in 2017, by $41,245,000. Local deposit growth is increasingly valuable as alternative wholesale funding costs have risen with three Federal Reserve rate hikes since December, 2016. Core deposit growth, especially regular checking accounts, is a major priority for the Bank in 2018.

Another area of focus is expense control. During 2017 total non-interest expenses were actually lower than the previous year. While that will not continue, we are focused on reducing our efficiency ratio over the next few years by eliminating any unnecessary costs and growing with greater operational efficiency. Technology will continue to play an important role in this effort.

Credit quality will be another point of emphasis in the coming years. A handful of larger relationships and general weakness in sectors of our portfolio such as the logging and related industries have led to high provisions for loan losses. We feel we can improve in this area which leads directly to bottom-line improvement.

For a detailed commentary on our financials, please refer to the section of this report entitled "Company Overview and Results of Operations."

After years of near-zero interest rates, upward movement has begun to take place. With the aforementioned interest rate hikes by the Fed, deposit costs have increased, particularly for wholesale funding. Rates for longer terms have increased as well, although not at the same pace as shorter term rates. This has the effect of flattening the yield curve, which continues to put pressure on

our net interest margin. Last year we were able to hold our margin fairly constant, and doing so again or even widening the margin, while a tall order, will be critical to increasing net interest income.

Since the passage of the Dodd Frank Act in 2010 community banks such as ours have been encumbered with increased regulatory burden as a result of the systemic risks posed by larger institutions. Regulations meant to affect the largest banks in the country have nonetheless “trickled down” to impact us. As this is written, activity in Congress to alleviate at least some of the most costly and time consuming burden is being considered. If this passes in some form it could have a benefit for the Company; however it is too soon to tell if legislation will be enacted.

In 2017 we launched a new online mortgage application service. This new technology allows customers to apply for a home loan outside normal business hours while still having access to the expertise of a local loan officer to help guide them through the process.

I am pleased to share with you that Katahdin Bankshares Corp. has been named to the 2018 OTCQX® Best 50, a ranking of top performing companies traded on the OTCQX Best Market for 2017. The OTCQX Best 50 is an annual ranking of the top 50 U.S. and international companies traded on the OTCQX market. The ranking is calculated based on an equal weighting of one-year total return and average daily dollar volume growth in the previous calendar year. Companies in the 2018 OTCQX Best 50 were ranked based on their performance in 2017. Katahdin Bankshares Corp.’s total return for 2017 including price appreciation and dividends was 27.5%.

I encourage you to complete and return your proxy for this year’s annual meeting. Over the past few years many companies including Katahdin Bankshares Corp. have seen a lower level of voting by shareholders. Your votes are important to the Company; I hope that you will please take the time to review the proxy and vote by mail, telephone or online.

In closing, as I reflect on our 100th anniversary celebration in 2018, I am filled with gratitude for our employees and their contributions to our success. Each day I have the privilege of watching them fulfill our mission to serve the financial needs of our customers with superior service and attention to detail. In addition, they consistently demonstrate their commitment to our communities, volunteering nearly 8,000 hours of time to various organizations and causes in 2017.

Our success depends on our most important assets: our employees, our customers and you, our owners. We believe the best is yet to come and we thank you for being part of our journey as we enter our 100th year of community banking at its best.

Sincerely,

Jon J. Prescott
President & CEO

OUR MISSION

Katahdin Trust Company's mission is to provide a broad range of financial services to Maine communities. In providing these services we will endeavor to achieve the highest level of customer satisfaction possible.

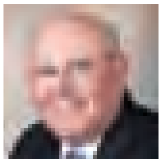
WE ARE COMMITTED TO:

- Providing quality financial service by giving each and every customer courteous, personal and professional attention. Our employees will be well trained; knowledgeable and motivated at all times to fulfill our customers' financial needs.
- Continued growth and increased shareholder value at levels in line with maintaining a strong capital position.
- Treating all people fairly and equally.
- Meeting the financial needs of the communities we serve, consistent with maintaining safe and sound banking practices.
- Remaining an independent, locally owned and managed community bank that adds to the quality of life of the communities we serve.
- Helping business grow and prosper.

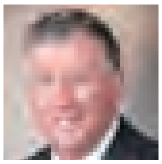
By adhering to our mission, Katahdin Trust Company will ensure that our customers, shareholders and employees alike will benefit from our continued growth and prosperity.

KATAHDIN TRUST BRANCH IN PATTEN, MAINE

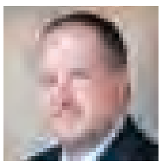
OUR BOARD



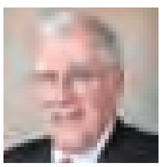
STEVEN L. RICHARDSON
CHAIRMAN
Partner, Richardson's True Value Hardware.
Patten, Maine. Director since 1978.



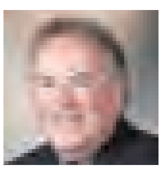
RICHARD J. YORK, SR.
VICE CHAIRMAN
General Sales Manager, York's of Houlton.
Houlton, Maine. Director since 1997.



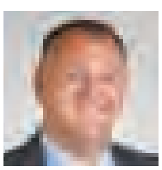
JON J. PRESCOTT
PRESIDENT & CEO
Katahdin Bankshares Corp. and Katahdin Trust.
Houlton, Maine. Director since 1997.



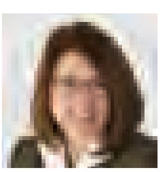
ROBERT E. ANDERSON
Chairman of the Board, FA Peabody Company.
Houlton, Maine. Director since 1989.



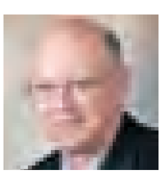
PETER F. BRIGGS
Retired from the wholesale beverage industry.
Kennebunk, Maine. Director since 1995.



RICHARD B. HARNUM, JR.
President, Webber Group.
Bangor, Maine. Director since 2017.



KIMBERLEY A. NILES
Owner and Director, State of Granite, LLC.
Founder, VC CFO Services, LLC.
Plaistow, New Hampshire. Director since 2015.



PAUL R. POWERS
Owner, Powers Roofing & Sheet Metal, Inc.
Owner, B.J.J. Powers Enterprises.
Caribou, Maine. Director since 2000.

IN REMEMBRANCE

We were deeply saddened by the passing of Arthur L. Shur in 2017. Arthur became a Director in 1983 and dedicated 34 years to Katahdin Trust, serving as Vice Chairman from 1995 until 2013. He was a friend, mentor and trusted advisor. We will miss Arthur for his steady leadership and commitment to the interests of the Bank and its customers. Retired from the farming industry, Arthur lived in Island Falls, Maine with his wife, Brenda.

In recognition of his countless contributions to Katahdin Trust Company's prosperity and growth for more than three decades, we humbly dedicate the 2017 Annual Report to Arthur Shur.

OUR EMPLOYEES

SENIOR MANAGEMENT

Jon J. Prescott
President & CEO

Bonnie C. Foster
Executive Vice President
Retail Services

William P. Lucy
Executive Vice President
Commercial Services

Matthew M. Nightingale
Executive Vice President
Treasurer & CFO

OFFICERS

Tori A. Barber
Branch Manager &
Retail Services Officer, Mars Hill

Annette J. Beaton
Vice President, Branch Manager &
Retail Services Officer, Houlton

Vicki L. Bessette
Vice President
Commercial Services Officer

Cindy L. Boot
Commercial Services Officer

Fred A. Brown
Vice President
Commercial Services Officer

Cale L. Burger
Vice President
Commercial Services Officer

Angela T. Butler
Senior Vice President
Commercial Services Officer

David H. Cambridge
Senior Vice President
Commercial Services Officer

Aaron J. Cannan
Senior Vice President
Commercial Services Officer

Robert J. Cawley
Assistant Vice President
Senior Credit Analyst

Karen L. Chapman
Vice President
Training Manager

Albert "Joe" Clukey II
Assistant Vice President
Retail Services Officer

Jennifer L. Craig
Branch Manager &
Retail Services Officer, Fort Fairfield

Janet M. Doak
Branch Manager &
Retail Services Officer, Ashland

Sunny G. Flannery
Branch Manager &
Retail Services Officer, Hampden

Angela M. Franck
Assistant Vice President
Branch Manager &
Retail Services Officer,
Fort Kent & Eagle Lake

John S. Frohock
Vice President,
Managed Assets Officer

Brian J. Gardiner
Senior Vice President
Commercial Services Officer

Leslie M. Gardner
Vice President, Retail Loans

Allissa M. Given
Branch Manager &
Retail Services Officer, Patten

Katherine Z. Goodwin
Project Manager

Alison N. Gould
Commercial Services Officer

Diane W. Green
Vice President, Branch Manager &
Retail Services Officer, Presque Isle
& Scarborough

Billi B. Griffeth
Assistant Vice President
Retail Services

Patricia A. Hersey
Vice President
Business Development Officer

Katherine H. Hill
Assistant Vice President
Bank Operations Manager

Susan B. Lunn
Vice President
Compliance Officer

Valerie J. Maynard
Senior Commercial Services Assistant

Natasha R. McCarthy
Human Resources Director

Jean E. Noyes
Vice President
Information Security Officer

Kevin B. Plourde
Senior Vice President
Credit Administration

Joseph M. Porter
Vice President
Controller

Andrew L. Putnam
Vice President
Chief Information Officer

Krista K. Putnam
Vice President
Marketing

Sherry L. Roberts
Vice President
Business Development Officer

Debra K. Schillinger
Branch Manager &
Retail Services Officer, Oakfield
& Island Falls

Sarah S. Silliboy
Assistant Vice President
BSA Officer

Peggy S. Smith
Assistant Vice President
Branch Manager &
Retail Services Officer,
Caribou & Van Buren

Rebecca J. Smith
Branch Manager &
Retail Services Officer, Bangor

Vicki J. Smith
Executive Assistant

Craig C. Staples
Vice President
Commercial Services Officer

Pamela J. Ward
Assistant Vice President
Credit Control

Danelle L. Weston
Regional Vice President
Bangor Market

Ashley M. Andrews
Michelle L. Bagley
Jennifer L. Blaisdell
Rhonda A. Blanchette
Lauren E. Bragan
Eva C. Brown
Jessica L. Buckley
Emily S. Bulley
Susan W. Cameron
Monica L. Campbell
Julie A. Chamberlain
Kelsey P. Charette
Wendy L. Clark
Samuel S. Clockedile
Susan M. Cone
Jane F. Conlogue
Lindsay M. Corey
Tabitha J. Corey
Clarissa H. Crandall
Debra L. Cyr
Melissa A. Dahlgren
Shelby A. Damboise
Kati Deane-Grant
Tory J. Delano
Carol A. Dow
Constance R. Drake
Cindy L. Drew
Lynn C. Dumond
Kimberly J. Embelton
April D. Emery
Kelly J. Emery
Sue A. Fox
Frederick E. Gagnon
Sarah J. Gardiner
Penny M. Garnett
Crystal A. Gastia
Loni R. Giberson
Vincent M. Gilmore
Jonathan P. Glazier
Julie A. Glidden
Candice L. Glover
Myka D. Graham
Lesia R. Grooms
Lorraine M. Guiggey
Cathy J. Haley
Trecia M. Hanning
Virginia L. Hartin
Wendy L. Henderson
Diane M. Hewett
Joshua D. Hitchcock
Sheila D. Hosford
Debra L. Jacques
Janet L. Jandreau
Lisa M. Jandreau
Julie M. Kaelin
Kelly J. Kilcollins
Jennifer L. King
Janet L. Lane
Rosemary A. Langer
Yancy J. LaPointe
Dawn M. Larrabee
Denise G. Lease
Hannah E. Lee
Crystal E. Levesque
Teresa S. Lincoln
Nicole L. Lockhart
Tannis B. Lundin
Jeremy K. MacArthur
Karen L. MacDonald
Joshua L. MacFarline
Ann M. Madore
Lita A. Madore
Brian A. Martin
Chelsea M. Martin
Eunice M. McAfee
Arianna E. McGraw
Shelly L. McHatten
Elizabeth M. Michaud
Susan M. Miller
Whitney J. Moran
Timothy D. Morris
Lori J. Nadeau
Rhonda M. Nicholson
Julie A. O'Hara
Connie M. Ouellette
Madison H. Outing
Robin M. Palmer
Whitney M. Palmer
Crystal L. Parent
Valerie J. Pelletier
Timothy W. Perry
Rebecca L. Potter
Deborah L. Powers
Kenneth F. Prescott
Mari E. Remeschatis
Jasmine M. Rockwell
Scott A. Rossignol
Courtney A. Sargent
Janet L. Saucier
Richard H. Schmidt III
Jana L. Shaw
Tyler P. Sherman
Abagale L. Stewart
Heidi J. Stewart
Dianne M. Tapley
Katelynn N. Tardie-Cyr
Kathy A. Thompson
Vickey J. Tilley
Lana J. Tucker
Amy L. Turner
Marie D. Vincent
Jolene L. Wallace
Kristen V. West
Lauren E. West
Susan M. White
Lisa M. Willigar
Miranda B. Wotton
Crystal L. Wright
Emerson M. Wright
Mindi A. Yates

MAINE FINANCIAL GROUP

W. Scott Dillon
President
James P. Amabile
Vice President
Commercial Services Officer
Susan L. McCarthy
Vice President
Commercial Services Officer

Christopher C. Case
Devin J. Rolph
Tamara J. Wheeler

KATAHDIN FINANCIAL SERVICES

Bradley A. Berthiaume
Vice President
Financial Consultant

Adam R. Bither
Kelly Jo Cole

Communities that **work together thrive** together.

7,800
VOLUNTEER HOURS

230
LOCAL NON-PROFITS

COMPANY OVERVIEW AND RESULTS OF OPERATIONS

Katahdin Bankshares Corp. (“KBS” or the “Company”) is a bank holding company, incorporated under the laws of the State of Maine in 1986 for the purpose of becoming the parent holding company of Katahdin Trust Company (the “Bank”). As of December 31, 2017, KBS had consolidated total assets of $794.6 million, total deposits of $647.8 million, and total shareholders’ equity of $66.8 million. Following is an overview of the Company, its strategy, and the results of 2017 operations.

Our Business

Established in 1918 and celebrating 100 years of service, the Bank provides a full line of banking services to individuals and businesses throughout Maine and online at KatahdinTrust.com.

The Bank conducts commercial and retail banking business that includes accepting deposits from the general public and utilizing those funds to originate commercial loans, commercial and residential real estate loans, and consumer loans. The Bank offers a wide range of business and personal banking services, including checking and savings accounts, money market accounts, certificates of deposits, and the convenience of debit cards, telephone banking, ATMs, online banking and bill payment, mobile and text banking, online account opening, and eCheck Deposit, a service which enables the customer to make remote deposits electronically.

Securities and insurance products are made available to the Bank’s customers through Katahdin Financial Services in partnership with a third party registered broker-dealer, with assets under management of $105.3 million as of December 31, 2017.

The Bank derives its income primarily from interest and fees earned on loans and investments and service charges and fees on deposit accounts. Its expenses consist primarily of interest paid on deposits and borrowed funds and operating expenses.

Our Strategy

The Bank’s goals include continuing as a leading financial institution throughout Maine. The Bank explores opportunities for profitable growth and expansion while seeking ways to increase net interest income, enhance non-interest income, while controlling operating costs, with the goal of maximizing long-term returns to our shareholders.

The Bank’s goal is to have a well-rounded loan portfolio which is served by an experienced team with the expertise to meet customer needs throughout the Bank’s market area. The Bank has a strong commitment to small business and has received the preferred lender designation from the U. S. Small Business Administration (SBA); a designation reserved for SBA’s most experienced and trusted lenders with a proven record of small business lending performance and excellence; and in 2017 received the Outstanding Partner Award for originating a significant number of SBA guaranteed loans.

The Bank has a strong commitment to traditional community banking. The Bank’s goal is to attract, as customers, small and medium sized businesses as well as individuals who wish to conduct business with a community bank that demonstrates an active interest in their businesses and communities. Our staff recognizes opportunities to offer additional products and services that will strengthen each customer relationship.

The Bank recognizes the importance of high quality customer service; its stated goal is to “Exceed Our Customers’ Expectations”. Management believes its ability to deliver products and services in a highly personalized manner with superior customer service sets the Bank apart from its competitors.

The Bank recognizes the changes in customer preference brought about through the use of various technology platforms, and seeks to deliver those technologies best suited to its customers in an effective and complementary way.

The foundation of the Bank’s business strategy is its employees. The Bank’s commitment to customer service enables us to attract and retain customer-focused employees with knowledge of and experience in the Bank’s market area. The Bank’s personnel reside in their respective market areas, know their customers, and are equipped to provide high quality service. The Bank’s lenders are experienced in the financial services industry and have operated in the Bank’s market area through different economic cycles and lending market conditions. The Bank encourages and supports management and staff to be active community volunteers. Every year the Bank’s employees contribute significant hours to a variety of community organizations ranging from charitable to civic.

SELECTED FINANCIAL DATA

The summary consolidated financial and other data should be read in conjunction with, and is qualified in its entirety by, the Company's current and prior years' annual reports and regulatory filings. Dollars in thousands, except share and per share data.

As of or for the Years Ended December 31,	**2017**	**2016**	**2015**	**2014**	**2013**
Balance Sheet Data					
Total assets	$ 794,638	$ 754,012	$ 702,289	$ 667,112	$ 646,287
Total investments (1)	90,445	88,965	74,836	60,597	57,506
Total loans	661,636	623,279	586,238	565,337	546,242
Allowance for loan losses	(6,048)	(6,032)	(5,330)	(5,899)	(6,097)
Total deposits	647,752	652,969	606,205	550,694	557,933
Shareholders' equity	66,799	64,415	62,357	71,086	58,961
Summary of Operations					
Interest and dividend income	$ 30,803	$ 29,350	$ 27,512	$ 27,031	$ 26,517
Interest expense	5,341	4,281	3,861	4,240	4,712
Net interest income	25,462	25,069	23,651	22,791	21,805
Provision for loan losses	1,225	1,316	50	548	798
Net interest income after the provision for loan losses	24,237	23,753	23,601	22,243	21,007
Non-interest income before impairment of investment securities	4,421	4,464	3,884	3,568	3,409
Net impairment of investment securities	5	4	2	17	19
Non-interest expense	21,529	21,535	20,372	19,621	18,815
Income before income taxes	7,124	6,678	7,111	6,173	5,582
Income taxes	2,771	1,864	2,301	1,918	1,733
Net income	$ 4,353	$ 4,814	$ 4,810	$ 4,255	$ 3,849
Less dividends on preferred stock	875	875	910	557	123
Net income available to common shareholders	$ 3,478	$ 3,939	$ 3,900	$ 3,698	$ 3,726
Per Common Shares and Common Shares Outstanding					
Net income, basic (2)	$ 1.03	$ 1.16	$ 1.15	$ 1.09	$ 1.09
Net income, diluted (2)	1.03	1.16	1.15	1.09	1.09
Book value (3)	16.94	16.17	15.47	14.93	14.09
Tangible book value (3)	15.24	14.48	13.80	13.26	12.41
Weighted average common shares outstanding: (4)					
Basic	3,737,220	3,399,826	3,404,367	3,404,367	3,400,505
Diluted	3,737,220	3,399,826	3,404,367	3,404,367	3,404,367
Common shares outstanding at period end	3,404,367	3,404,367	3,404,367	3,404,367	3,404,367
Adjusted common shares outstanding at period end (5)	3,361,298	3,380,173	3,404,367	3,404,367	3,404,367
Selected Performance Ratios					
Return on average assets	0.55%	0.66%	0.70%	0.66%	0.64%
Return on average common shareholders' equity	6.17	7.23	7.50	7.44	7.81
Net interest spread (6)	3.33	3.56	3.62	3.66	3.75
Net interest margin (7)	3.42	3.66	3.71	3.78	3.89
Efficiency ratio (8)	72.06	72.93	73.99	74.42	74.62
Asset Quality Ratios					
Allowance for loan losses to period end loans	0.91%	0.97%	0.91%	1.04%	1.12%
Allowance for loan losses to non-performing loans (9)	84.76	39.57	61.71	50.24	64.49
Non-performing loans to period end loans (9)	1.08	2.45	1.47	2.07	1.73
Non-performing assets to total assets (10)	0.95	2.11	1.31	1.83	1.50
Capital Ratios (Katahdin Trust Company)					
Total risk-based capital ratio	12.64%	13.02%	13.34%	13.38%	12.54%
Tier 1 risk-based capital ratio	11.63	11.95	12.33	12.23	11.29
Common equity tier 1 risk-based capital ratio	11.63	11.95	12.33	-	-
Tier 1 capital ratio (Leverage ratio)	8.88	9.15	9.48	9.68	8.89
Other Data					
Number of full and limited service banking offices	16	19	19	19	18
Number of full-time equivalent employees	174	186	195	196	191
Katahdin Financial Services Assets Under Management	$ 105,280	$ 90,160	$ 83,500	$ 87,200	$ 75,400

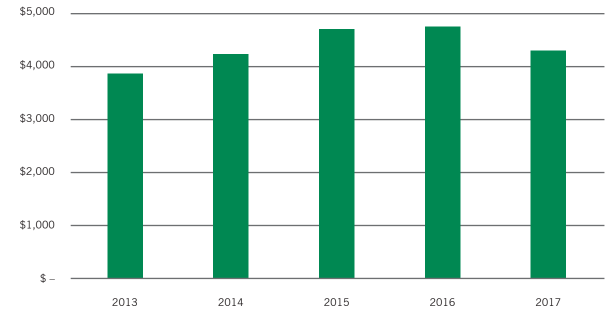
(1) Consists of investment securities and FHLB stock. (2) Computed based on the weighted average number of common shares outstanding during each period. (3) Book value and Tangible Book Value are calculated using Adjusted Common Shares Outstanding at period end. (4) Weighted Average Common Shares Outstanding less weighted average unallocated ESOP shares. Used for calculating Earnings per Common Share. (5) Common Shares Outstanding at period end less unallocated ESOP shares period end. Since unearned ESOP shares are deducted from capital, this adjustment deducts the unallocated shares from shares outstanding for calculating book value and tangible book value. (6) Net interest spread is the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities. (7) Net interest margin is the net interest income divided by the average interest-earning assets. (8) Efficiency ratio is non-interest expense divided by the sum of net interest income and non-interest income. (9) Non-performing loans consist of non-accrual loans and restructured loans, where applicable. (10) Non-performing assets consist of non-accrual loans, restructured loans, and foreclosed assets, where applicable.

COMPANY OVERVIEW AND RESULTS OF OPERATIONS

Net Income

Net Income before preferred stock dividends reached $4,353,000 in 2017. When adding back a one-time tax adjustment stemming from the Tax Cuts and Jobs Act of 2017, Net Income would have been $4,791,000 which is slightly behind last year's level of $4,814,000. Other non-recurring factors contributing to lower net income in 2017 vs. 2016 include a recovery of interest income in 2016 that totaled $749,000 not repeated in 2017 and branch closure costs totaling $285,000. If accounting for these one-time items, Net Income on a run-rate basis would have been greater in 2017 than 2016.

NET INCOME ($000)



Diluted earnings per common share totaled $1.03 per share, down from $1.16 per share for reasons previously mentioned. Return on Average Assets ended at 0.55% compared to 0.66% in 2016. Return on Average Common Equity was 6.17% as compared to 7.23% in 2016.

Net Interest Income

Net interest income reached $25,462,000, exceeding the prior year by $393,000 or 1.6%. Looking further at run rate growth due to the 2016 recovered interest mentioned above, core net interest income grew by 4.7% in 2017 or $1,142,000. Net interest income reflects revenues generated through income from earning assets plus loan fees, less interest paid on interest-bearing deposits and borrowings.

The Company's average net interest spread was 3.33% in 2017, compared to the prior year average spread of 3.56%. Importantly however, our net interest spread of 3.33% reflects both where the year started and the year to date average, showing some stabilization throughout 2017. While the flat yield curve has further developed and remained throughout 2017, managing through the next rate cycle with a solid margin is a top priority.

Provision and Asset Quality

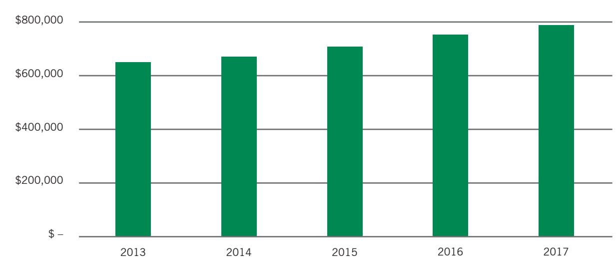
We're pleased to have shown a big improvement in asset quality numbers at year end compared to prior year. This is mainly due to the resolution of a large credit in the fourth quarter. Overall asset quality is sound. Non-performing loans to period end loans ended the year at 1.08%, a decrease from 2.45% at the end of 2016. Non-performing assets to total assets ended the year at 0.95%, down from 2.11% at year-end 2016.

The allowance for loan loss was funded with a provision of $1,225,000 in 2017, down by $91,000 from last year. As a result, our allowance for loan losses to period end loans ratio ended at 0.91% as compared to 0.97% at year end 2016. Management continuously monitors the Bank's reserve for loan losses compared to asset quality in order to match our reserves with a reasonable estimate of risk. Detailed information regarding our allowance for loan loss can be found in the footnotes to the audited financial statements.

Non-Interest Income and Expense

Non-interest income totaled $4,421,000, a slight decrease of $43,000 from 2016. Non-interest income consists largely of service charges on loans, deposits, and electronic banking activity. The Bank continued to have good success with service and interchange fee income as well as generating revenues from interest rate swaps put in place with commercial real estate loan customers.

ASSETS ($000)



Non-interest expense dropped by $6,000 to $21,529,000. The Bank has implemented strategies to reduce overhead expenses throughout 2017 which have begun to yield results. Non-interest expense included a one-time branch closure cost of $285,000 mentioned above. Other increases over last year included an additional FDIC premium of $87,000 due to a change in the calculation for assessing fees on brokered deposits. We're pleased that solid deposit growth and a shift to less costly borrowings have helped us nearly eliminate this extra assessment. Further, elevated debit card fraud in early 2017 totaled $51,000 over last year. Because of enhanced monitoring introduced during the year, these losses have been mitigated since that point.

Key management goals have been to find operating efficiencies where possible, as well as searching for revenue generation.

COMPANY OVERVIEW AND RESULTS OF OPERATIONS

Assets

Total assets reached $794,638,000, an increase over the prior year of $40,626,000 or 5.4%. Asset growth was achieved from a mix of loan growth and investment growth. The investment portfolio ended the year at $90,445,000, representing an increase of $1,480,000 over 2016.

Loans

Total loans increased to $661,636,000, rising $38,357,000 or 6.2% year over year. Much of our growth last year was in the Commercial real estate loan category which increased by $34.6 million to a portfolio balance of $331,373,000. Commercial equipment loans totaled $164,431,000 and grew by $3.4 million. Residential 1- 4 family loans grew $1 million to a portfolio level of $141,429,000. Approximately 76% of the Bank's loan portfolio consists of municipal, commercial and commercial real estate loans.

Deposits

Local deposits grew significantly in 2017. While total deposits were down by $5.2 million to $647,752,000, this represents a large reduction of brokered deposit funding that was replaced by local deposit funding of $41,245,000. Growth has come from local deposit initiatives throughout our market area. Local deposits increased in all areas of checking, savings, money markets and CD's. Offsetting some of the brokered deposit reduction was an increase in secured borrowings from the Federal Home Loan Bank (FHLB) and other sources totaling $44,689,000. This change in funding strategy allowed us to significantly reduce our reliance on brokered deposits. After accounting for this shift, local deposit growth funded all of the Bank's loan growth in 2017.

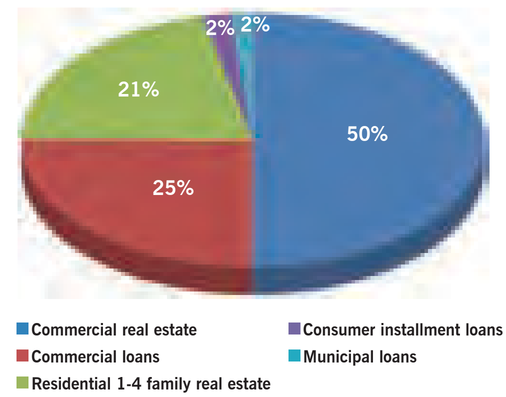
Brokered CDs and secured borrowings enable the Bank to fund asset growth when our ability to grow local deposits at any given time does not keep pace with loan growth opportunities. These alternative funding sources provide the Bank flexibility with term structures in order to appropriately balance interest rate risk positions as needed.

Capital

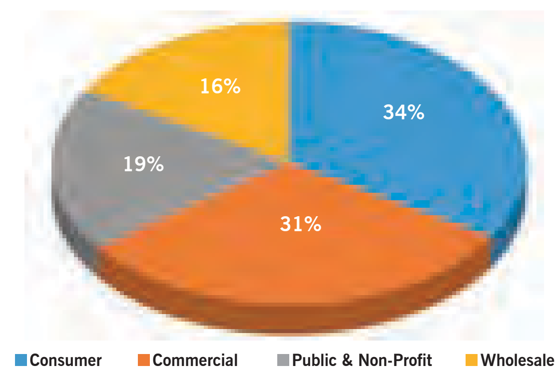
Total Shareholders' Equity stood at $66,799,000, an increase of $2,384,000 from year end 2016. Capital ratios for the Bank remain well above the minimums to be well-capitalized per regulatory capital requirements. The Bank's leverage ratio at year-end 2017 was 8.88%, compared to 9.15% at the end of 2016. Total risk-based capital stood at 12.64% as compared to 13.02% in 2016.

Tangible book value of $15.24 was an increase of $0.76 or 5.2% over year end 2016. The Company paid out a total of $0.40 per share in common stock dividends representing a 38.8% payout ratio of 2017 net income available to common shareholders.

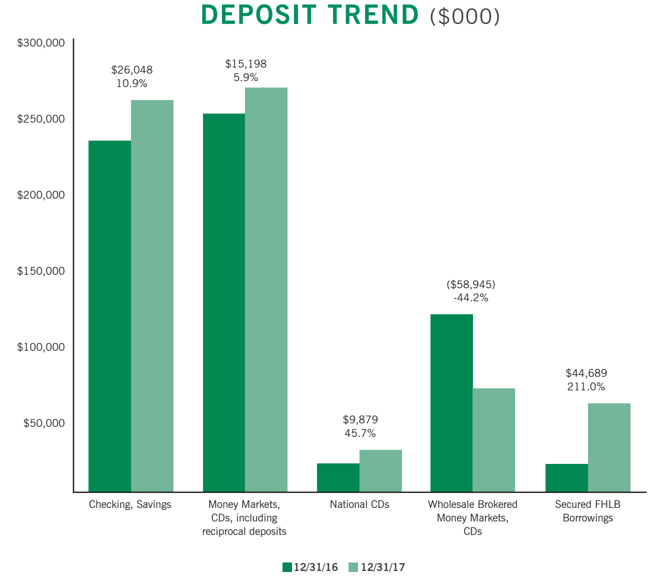
LOAN MIX



DEPOSIT SOURCES



DEPOSIT TREND ($000)



INDEPENDENT AUDITOR'S REPORT

BerryDunn

Board of Directors and Shareholders
Katahdin Bankshares Corp. and Subsidiary

We have audited the accompanying consolidated financial statements of Katahdin Bankshares Corp. and Subsidiary (the Company), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Katahdin Bankshares Corp. and Subsidiary as of December 31, 2017 and 2016, and the consolidated results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Berry Dunn McNeil & Parker, LLC

Bangor, Maine
February 14, 2018

CONSOLIDATED BALANCE SHEETS

December 31, 2017 and 2016

ASSETS	2017	2016
Cash and due from banks	$ 7,895,000	$ 6,450,000
Interest bearing deposits in banks	6,089,000	4,873,000
Securities available-for-sale	86,872,000	87,271,000
Securities held-to-maturity	9,000	12,000
Federal Home Loan Bank stock, at cost	3,564,000	1,682,000
Loans receivable, net of allowance for loan losses of $6,048,000 in 2017 and $6,032,000 in 2016	655,588,000	617,247,000
Bank premises and equipment, net	11,049,000	12,162,000
Goodwill	5,559,000	5,559,000
Other assets	18,013,000	18,756,000
	$ 794,638,000	$ 754,012,000

LIABILITIES AND SHAREHOLDERS' EQUITY	2017	2016
Deposits		
Demand deposits	$ 114,730,000	$ 102,851,000
NOW and money market deposits	275,938,000	267,384,000
Savings deposits	63,568,000	58,817,000
Certificates of deposit $250,000 and over	97,704,000	137,183,000
Other certificates of deposit	95,812,000	86,734,000
Total deposits	647,752,000	652,969,000
Advances from Federal Home Loan Bank	65,867,000	21,178,000
Other borrowed funds	118,000	889,000
Accrued expenses and other liabilities	6,885,000	7,344,000
Junior subordinated debentures	7,217,000	7,217,000
Total liabilities	727,839,000	689,597,000
Shareholders' equity		
Preferred stock, 20,000 shares authorized Series D, 4,000 shares issued and outstanding	9,859,000	9,766,000
Common stock, $.10 par value; 20,000,000 shares authorized, 3,404,367 shares issued and outstanding on December 31, 2017 and 2016	339,000	339,000
Surplus	8,778,000	8,778,000
Undivided profits	49,141,000	46,980,000
Accumulated other comprehensive loss		
Net unrealized depreciation on securities available-for-sale, net of deferred income taxes	(778,000)	(856,000)
Net unrealized gain (loss) on derivative instruments, net of deferred income taxes	17,000	(319,000)
Unearned ESOP shares	(557,000)	(273,000)
Total shareholders' equity	66,799,000	64,415,000
	$ 794,638,000	$ 754,012,000

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

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31, 2017 and 2016

	2017	2016
Interest and dividend income		
Loans	$ 28,702,000	$ 27,558,000
Investment securities	2,093,000	1,783,000
Other interest-earning assets	8,000	9,000
Total interest and dividend income	30,803,000	29,350,000
Interest expense		
Deposits	4,464,000	3,778,000
Borrowed funds and junior subordinated debentures	877,000	503,000
Total interest expense	5,341,000	4,281,000
Net interest income	25,462,000	25,069,000
Provision for loan losses	1,225,000	1,316,000
Net interest income after provision for loan losses	24,237,000	23,753,000
Noninterest income		
Service charges and fees	1,968,000	1,862,000
Realized gain on sale of securities available-for-sale	-	59,000
Other	2,453,000	2,543,000
Total noninterest income before impairment of investment securities	4,421,000	4,464,000
Total other-than-temporary impairment losses	(9,000)	(16,000)
Portion of loss recognized in other comprehensive income	4,000	12,000
Net impairment losses recognized in net income	(5,000)	(4,000)
Net noninterest income	4,416,000	4,460,000
Noninterest expenses		
Salaries and employee benefits	12,594,000	12,993,000
Net occupancy expense	1,566,000	1,617,000
Furniture and equipment expense	1,753,000	1,796,000
Data processing	1,281,000	1,242,000
Marketing	792,000	783,000
FDIC deposit assessment	648,000	561,000
Other general and administrative	2,895,000	2,543,000
Total noninterest expenses	21,529,000	21,535,000
Income before income taxes	7,124,000	6,678,000
Income tax expense	2,771,000	1,864,000
Net income	$ 4,353,000	$ 4,814,000
Less dividends on preferred stock	$ 875,000	$ 875,000
Net income available to common shareholders	$ 3,478,000	$ 3,939,000
Basic earnings per common share	$ 1.03	$ 1.16
Diluted earnings per common share	$ 1.03	$ 1.16
Diluted weighted average common shares outstanding	3,373,220	3,399,826

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2017 and 2016

	2017	2016
Net income	$ 4,353,000	$ 4,814,000
Other comprehensive income (loss), net of related tax effects		
Unrealized appreciation (depreciation) on available-for-sale securities		
Unrealized appreciation (depreciation) on available-for-sale securities arising during period	307,000	(1,077,000)
Reclassification adjustment for (gains) losses realized in net income	5,000	(55,000)
Tax effect	(106,000)	385,000
Net change in unrealized depreciation on available-for-sale securities, net of tax	206,000	(747,000)
Unrealized gain on derivative instruments, net of tax	334,000	499,000
Total other comprehensive income (loss)	540,000	(248,000)
Comprehensive income	$ 4,893,000	$ 4,566,000

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Years Ended December 31, 2017 and 2016

	Preferred Stock	Common Stock	Surplus	Undivided Profits	Net Unrealized Depreciation on Securities	Net Unrealized Gain (Loss) on Derivative Instruments	Unearned ESOP Shares	Total
Balance, December 31, 2015	$ 9,673,000	$ 339,000	$ 8,776,000	$ 44,496,000	$ (109,000)	$ (818,000)	$ -	$ 62,357,000
Net income	-	-	-	4,814,000	-	-	-	4,814,000
Change in net unrealized depreciation on securities available-for-sale, net of deferred income taxes of $(385,000)	-	-	-	-	(747,000)	-	-	(747,000)
Change in net unrealized loss on derivative instruments, at fair value, net of taxes of $257,000	-	-	-	-	-	499,000	-	499,000
Total comprehensive income	-	-	-	4,814,000	(747,000)	499,000	-	4,566,000
Cash dividends declared on common stock, $0.40 per share	-	-	-	(1,362,000)	-	-	-	(1,362,000)
Accretion on preferred stock issuance	93,000	-	-	(93,000)	-	-	-	-
Cash dividends declared on preferred stock	-	-	-	(875,000)	-	-	-	(875,000)
Shares purchased by ESOP (25,500 shares)	-	-	-	-	-	-	(287,000)	(287,000)
Common stock held by ESOP committed to be released (1,306 shares)	-	-	2,000	-	-	-	14,000	16,000
Balance, December 31, 2016	9,766,000	339,000	8,778,000	46,980,000	(856,000)	(319,000)	(273,000)	64,415,000
Net income	-	-	-	4,353,000	-	-	-	4,353,000
Change in net unrealized depreciation on securities available-for-sale, net of deferred income taxes of $106,000	-	-	-	-	206,000	-	-	206,000
Change in net unrealized gain on derivative instruments, at fair value, net of taxes of $171,000	-	-	-	-	-	334,000	-	334,000
Total comprehensive income	-	-	-	4,353,000	206,000	334,000	-	4,893,000
Cash dividends declared on common stock, $0.40 per share	-	-	-	(1,350,000)	-	-	-	(1,350,000)
Accretion on preferred stock issuance	93,000	-	-	(93,000)	-	-	-	-
Reclassification adjustment for effect of enacted tax law changes	-	-	-	126,000	(128,000)	2,000	-	-
Cash dividends declared on preferred stock	-	-	-	(875,000)	-	-	-	(875,000)
Shares purchased by ESOP (27,000 shares)	-	-	-	-	-	-	(371,000)	(371,000)
Common stock held by ESOP committed to be released (8,125 shares)	-	-	-	-	-	-	87,000	87,000
Balance, December 31, 2017	$ 9,859,000	$ 339,000	$ 8,778,000	$ 49,141,000	$ (778,000)	$ 17,000	$ (557,000)	$ 66,799,000

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2017 and 2016

	2017	2016
Cash flows from operating activities		
Net income	$ 4,353,000	$ 4,814,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	1,921,000	1,849,000
Net amortization of securities	276,000	231,000
Provision for loan losses	1,225,000	1,316,000
Provision for losses on other real estate owned	48,000	29,000
Amortization of investments in limited partnerships	69,000	69,000
Impairment of investment securities	5,000	4,000
Gain on sale of securities available-for-sale	-	(59,000)
Deferred income tax provision	154,000	514,000
Increase in cash value of life insurance	(330,000)	(309,000)
Loss on sale of other real estate and property owned	212,000	41,000
ESOP compensation expense	87,000	16,000
Decrease in accrued income receivable and other assets	297,000	540,000
(Decrease) increase in accrued expenses and other liabilities	(350,000)	227,000
Net cash provided by operating activities	7,967,000	9,282,000
Cash flows from investing activities		
Additions to premises and equipment	(504,000)	(385,000)
Loan originations and principal collections, net	(39,858,000)	(38,205,000)
Purchase of securities available-for-sale	(11,178,000)	(28,631,000)
Maturities of securities available-for-sale	11,608,000	10,149,000
Maturities of securities held-to-maturity	3,000	4,000
Proceeds from sales of other real estate and property owned	400,000	444,000
Redemption of FHLB stock	308,000	1,405,000
Purchase of FHLB stock	(2,190,000)	(768,000)
Proceeds from sale of securities available-for-sale	-	2,404,000
Purchase of bank-owned life insurance	-	(1,500,000)
Net cash used by investing activities	(41,411,000)	(55,083,000)
Cash flows from financing activities		
Net (decrease) increase in deposits	(5,217,000)	46,764,000
Net (decrease) increase in securities sold under agreements to repurchase	(771,000)	349,000
Net increase in short-term borrowings	64,700,000	21,000,000
Repayment of long-term debt	(20,011,000)	(20,010,000)
Cash dividends paid on preferred stock	(875,000)	(875,000)
Cash dividends paid on common stock	(1,350,000)	(1,362,000)
Cash provided to ESOP for purchase of shares	(371,000)	(287,000)
Net cash provided by financing activities	36,105,000	45,579,000
Net increase (decrease) in cash and cash equivalents	2,661,000	(222,000)
Cash and cash equivalents, beginning of year	11,323,000	11,545,000
Cash and cash equivalents, end of year	$ 13,984,000	$ 11,323,000
Supplementary cash flow information:		
Interest paid on deposits and borrowed funds	$ 5,270,000	$ 4,255,000
Income taxes paid	2,405,000	2,041,000
Noncash transactions		
Transfer from loans to other real estate and property owned	292,000	550,000
Preferred stock dividends declared but not paid	219,000	219,000

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

Nature of Business

Katahdin Bankshares Corp. (the Company) is a bank holding company. A subsidiary, Katahdin Trust Company (the Bank), is a state chartered commercial bank whose deposits are insured by the Federal Deposit Insurance Corporation (FDIC). The Bank's primary business is to loan funds to and accept deposits from consumers and small businesses in Aroostook and Penobscot counties and the Portland area. The Bank has full-service branches throughout Aroostook and northern Penobscot counties, the greater Bangor area of central Maine in Penobscot county and in the Portland metro area of Cumberland County. The Scarborough location also houses Maine Financial Group (MFG), which the Bank purchased in 2007. MFG, a division of the Bank, provides equipment financing for individuals and businesses in the trucking, construction, forest products, and marine industries throughout northern New England. The Company and its subsidiary are subject to regulation and periodic examination by the FDIC, the Maine Bureau of Financial Institutions, and the Federal Reserve System.

1. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The consolidated financial statements include the accounts of Katahdin Bankshares Corp. and its wholly owned subsidiary, Katahdin Trust Company. All significant intercompany balances and transactions have been eliminated in consolidation.

Pursuant to the criteria established by U.S. generally accepted accounting principles (GAAP), the Company has not consolidated the trusts which it formed for the purposes of issuing trust preferred securities to unaffiliated parties and investing the proceeds from the issuance thereof and the common securities of the trust in junior subordinated debentures issued by the Company. The trusts are considered affiliates (see Note 10).

Use of Estimates

In preparing consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of other real estate and property owned. In connection with the determination of the allowance for loan losses and the carrying value of other real estate and property owned, management obtains independent appraisals for significant properties.

While management uses all available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in the economy. In addition, regulatory agencies, as a part of their examination process, periodically review the Bank's loan portfolio and may require the Bank to make additions to the allowance for loan losses based on judgments about information available to them at the time of the examination. Because of these factors, it is reasonably possible that the allowance for loan losses may change materially in the near term.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and due from banks and interest bearing deposits in banks.

The Company's due from bank accounts and interest bearing deposits in banks, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant risk on cash and cash equivalents.

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" and recorded at amortized cost. Securities not classified as held-to-maturity, including equity securities with readily determinable fair values, are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income or loss.

Purchase premiums and discounts are recognized in interest income using a method approximating the interest method over the terms of the securities. Declines in the fair value of individual equity securities that are deemed to be other-than-temporary are reflected in earnings when identified. For individual debt securities where the Company does not intend to sell the security and it is more-likely-than-not that the Company will not be required to sell the security before recovery of its amortized cost basis, the other-than-temporary decline in the fair value of the debt security related to 1) credit loss is recognized in earnings and 2) other factors are recognized in other comprehensive income or loss. Credit loss is deemed to exist if the present value of expected future cash flows is less than the amortized cost basis of the debt security. For individual debt securities where the Company intends to sell the security or more-likely-than-not will be required to sell the security before recovery of its amortized cost, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the balance sheet date. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Loans and Allowance for Loan Losses

Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses and deferred loan fees and costs. Interest on loans is calculated by applying the simple interest method to daily balances of the principal amount outstanding.

The allowance for loan losses is established through a provision for loan losses charged to expense.

The allowance for loan losses is reviewed periodically throughout the year to determine the appropriate level based on factors such as the methodology of allocating standard reserves to categories of loans, assigning specific reserves based on valuations of certain credits and a review of the appropriateness of the unallocated reserve.

There are several factors related to the allowance for loan losses that are individually reviewed to determine the level of specific reserves, such as the economic condition and outlook for certain industry or loan type concentrations, non-accrual loans, impaired loans, real estate under foreclosure, and classified loans. These reserves are assigned to meet the probable losses related to specific loans that have been identified as impaired.

The standard reserve is determined through an analysis of past performance including historical loan losses within groups of loans. Consideration is given to adjusting formulas based on an assessment of various qualitative factors related to the loan portfolio, including but not limited to performance of the portfolio, lender experience, new loan products or strategies, and economic factors. Management follows a similar process to estimate its liability for off-balance-sheet commitments to extend credit. The unallocated reserve position represents the margin of imprecision of the allowance after the standard and specific reserve allocations have been met.

Loans past due 30 days or more are considered delinquent. Loans are charged against the allowance for loan losses when management believes that the collection of the principal is unlikely. The allowance is based on management's evaluation of the collectability of the loan portfolio, including the nature of the loans, the estimated value of underlying collateral, credit concentrations, trends in historical loss experience, specific impaired loans, and economic conditions. The allowance is an amount that management believes is appropriate to absorb possible losses on existing loans.

Management considers loans to be impaired when it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the agreement. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or based on the fair value of the underlying collateral if the loan is collateral-dependent. Small balance homogeneous loans are collectively evaluated for impairment.

The accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts that the borrower's financial condition is such that collection of interest is doubtful. Interest income on nonaccrual loans is recognized only to the extent that interest payments are received. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loan origination fees and certain direct loan origination costs are deferred and amortized as an adjustment to income over the lives of the related loans.

Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend

1. Summary of Significant Accounting Policies (cont.)

credit, including commitments under credit card arrangements, commercial letters-of-credit, and standby letters-of-credit. Such financial instruments are recorded when they are funded.

Other Real Estate and Property Owned (OREO)

Assets acquired through, or in lieu of, loan foreclosure or repossession are held for sale and are initially recorded at fair value at the date of foreclosure or repossession. Subsequent to foreclosure or repossession, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from other real estate and property owned.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation computed on the straight line and declining balance methods over the estimated useful lives of the assets.

Goodwill

On January 1, 2002, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 350, *Intangibles - Goodwill and Other*. Prior to the adoption of ASC Topic 350, goodwill related to branch acquisitions was amortized using the straight-line method over ten years. Goodwill amortization has been discontinued. Goodwill related to branch acquisitions and MFG is reviewed for impairment annually, or more frequently upon the occurrence of certain events.

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

ASC Topic 740, *Income Taxes*, defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. ASC Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2014 through 2016.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

Employee Stock Ownership Plan

Shares of the Company's common stock purchased by the Katahdin Trust Company Employee Stock Ownership Plan (ESOP) are held in a suspense account until released for allocation to participants. Shares released are allocated to each eligible participant based on the ratio of each participant's compensation, as defined in the ESOP, to the total compensation of all eligible plan participants. As the unearned shares are released from suspense, the Company recognizes compensation expense equal to the fair value of the ESOP shares committed to be released during the period. To the extent that the fair value of the ESOP shares differs from the cost of such shares, the difference is charged or credited to equity as surplus. Allocated and committed-to-be-released ESOP shares are considered outstanding for earnings per share calculations based on debt service payments. Other ESOP shares are excluded from earnings per share. The cost of unearned shares to be allocated to ESOP participants for future services not yet performed is reflected as a reduction of stockholders' equity.

Earnings Per Share

Basic earnings per share data is computed based on the weighted average number of the Company's common shares outstanding during the year, which excludes the unallocated shares of the ESOP. Potential common stock related to unvested restricted stock awards are considered in the calculation of weighted average shares outstanding for diluted earnings per share.

Derivative Financial Instruments Designated as Hedges

The Company recognizes all derivatives in the consolidated balance sheet at fair value. On the date the Company enters into the derivative contract, the Company designates the derivative as a hedge of either a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge") or a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"). The Company formally documents relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Company also assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in cash flows or fair values of hedged items. Changes in fair value of a derivative that is effective and that qualifies as a cash flow hedge are recorded in other comprehensive income or loss and are reclassified into earnings when the forecasted transaction or related cash flows affect earnings. Changes in fair value of a derivative that qualifies as a fair value hedge and the change in fair value of the hedged item are both recorded in earnings and offset each other when the transaction is effective. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item, that it is unlikely that the forecasted transaction will occur, or that the designation of the derivative as a hedging instrument is no longer appropriate.

Recently Issued Accounting Pronouncements

In January 2016, FASB issued Accounting Standards Update (ASU) No. 2016-01, *Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*. The ASU was issued to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. This ASU changes how entities account for equity investments that do not result in consolidation and are not accounted for under the equity method of accounting. The ASU also changes certain disclosure requirements and other aspects of GAAP, including a requirement for public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The ASU will not have a material effect on the Company's consolidated financial statements.

In February 2016, FASB issued ASU No. 2016-02, *Leases*. The ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The ASU is effective for fiscal years beginning after December 15, 2018. Management is reviewing the guidance in the ASU to determine whether it will have a material effect on the Company's consolidated financial statements.

In March 2016, FASB issued ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*. The ASU was issued to simplify several aspects of share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in this ASU are effective for fiscal years beginning after December 15, 2016. The ASU did not have a material effect on the Company's consolidated financial statements.

In June 2016, FASB issued ASU No. 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. Under the new guidance, which will replace the existing incurred loss model for recognizing credit losses, banks, and other lending institutions will be required to recognize the full amount of expected credit losses. The new guidance, which is referred to as the current expected credit loss model, requires that expected credit losses for financial assets held at the reporting date that are accounted for at amortized cost be measured and recognized based on historical experience and current and reasonably supportable forecasted conditions to reflect the full amount of expected credit losses. A modified version of these requirements also applies to debt securities classified as available-for-sale. The ASU is effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. Management is evaluating the potential impact of the ASU and anticipates that it may have a material impact on the Company's consolidated financial statements.

In January 2017, FASB issued ASU No. 2017-04, *Intangibles, Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. The ASU was issued to reduce the cost and complexity of the goodwill impairment test. To simplify the subsequent measurement of goodwill, step two of the goodwill impairment test was eliminated. Instead, a Company will recognize an impairment of goodwill should the carrying value of a reporting unit exceed its fair value (i.e. step one). The ASU is effective for fiscal years beginning after

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

1. Summary of Significant Accounting Policies (cont.)

December 15, 2020 and will be applied prospectively. Management does not expect the ASU will have a material effect on the Company's consolidated financial statements.

In March 2017, FASB issued ASU No. 2017-08, *Premium Amortization on Purchased Callable Debt Securities*. This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. Today, entities generally amortize the premium over the contractual life of the security. The new guidance does not change the accounting for purchased callable debt securities held at a discount; the discount continues to be amortized to maturity. The ASU is effective for fiscal years beginning after December 15, 2018; early adoption is permitted. The guidance calls for a modified retrospective transition approach under which a cumulative-effect adjustment will be made to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. Management does not expect the ASU will have a material effect on the Company's consolidated financial statements.

In May 2017, FASB issued ASU No. 2017-09, *Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting*. The ASU was issued to provide clarity and reduce both 1) diversity in practice and 2) cost and complexity when applying the guidance in Topic 718, Compensation-Stock Compensation, to a change to the terms or conditions of a shared-based payment award. The ASU includes guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. The ASU is effective for the annual period, and interim periods within the annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period. The ASU should be applied prospectively to an award modified on or after the adoption date. The ASU will not have a material effect on the Company's consolidated financial statements.

In August 2017, FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815)*. The amendments in this ASU improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition, this ASU makes certain targeted improvements to simplify the application of the hedge accounting guidance in current GAAP. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018. Early application is permitted in any interim period after issuance of the ASU. Management does not expect the ASU will have a material effect on the Company's consolidated financial statements.

In February 2018, FASB issued AU No. 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. This ASU was issued to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The ASU is effective for fiscal years beginning after December 15, 2018, with early adoption permitted for financial statements which have not yet been issued. The Company adopted the ASU for the December 31, 2017 consolidated financial statements and made the required disclosures regarding stranded tax effects.

2. Cash and Due from Banks

The Bank is required to maintain certain reserves of vault cash or deposits with the Federal Reserve Bank. The amount of this reserve requirement, included in cash and due from banks, was approximately $313,000 and $211,000 as of December 31, 2017 and 2016, respectively.

3. Securities

Securities have been classified in the consolidated balance sheets according to management's intent. The amortized cost and fair value of securities, with gross unrealized gains and losses, follow:

2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale				
U.S. Treasury securities	$ 1,977,000	$ -	$ (6,000)	$ 1,971,000
State and municipal	9,898,000	140,000	(28,000)	10,010,000
Corporate bonds	2,012,000	-	(46,000)	1,966,000
Mortgage-backed and CMO's	73,470,000	224,000	(1,236,000)	72,458,000
Total debt securities	87,357,000	364,000	(1,316,000)	86,405,000
Marketable equity securities	500,000	-	(33,000)	467,000
Total securities available-for-sale	$ 87,857,000	$ 364,000	$ (1,349,000)	$ 86,872,000
Securities Held-to-Maturity				
Mortgage-backed and CMO's	$ 9,000	$ -	$ -	$ 9,000
Total securities held-to-maturity	$ 9,000	$ -	$ -	$ 9,000

2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale				
U.S. Treasury securities	$ 1,966,000	$ 15,000	$ -	$ 1,981,000
State and municipal	9,593,000	46,000	(161,000)	9,478,000
Corporate bonds	1,000,000	-	(79,000)	921,000
Mortgage-backed and CMO's	75,509,000	371,000	(1,438,000)	74,442,000
Total debt securities	88,068,000	432,000	(1,678,000)	86,822,000
Marketable equity securities	500,000	-	(51,000)	449,000
Total securities available-for-sale	$ 88,568,000	$ 432,000	$ (1,729,000)	$ 87,271,000
Securities Held-to-Maturity				
Mortgage-backed and CMO's	$ 12,000	$ -	$ -	$ 12,000
Total securities held-to-maturity	$ 12,000	$ -	$ -	$ 12,000

The following summarizes the Company's gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31, 2017:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate bonds	$ -	$ -	$ 454,000	$ (46,000)	$ 454,000	$ (46,000)
Mortgage-backed and CMO's	26,810,000	(235,000)	38,840,000	(1,001,000)	65,650,000	(1,236,000)
U.S. Treasury securities	1,971,000	(6,000)	-	-	1,971,000	(6,000)
State and municipal	2,113,000	(18,000)	956,000	(10,000)	3,069,000	(28,000)
Marketable equity securities	-	-	467,000	(33,000)	467,000	(33,000)
Total temporarily impaired securities	$ 30,894,000	$ (259,000)	$ 40,717,000	$(1,090,000)	$ 71,611,000	$ (1,349,000)

At December 31, 2017, unrealized losses within the marketable equity securities category relate to one individual security which had a continuous loss for more than one year. Unrealized losses within the mortgage backed and CMO's category relate to sixty-eight individual securities of which forty-three had continuous losses for more than one year. Unrealized losses within the state and municipal bonds category relate to seven individual securities of which two had continuous losses for more than one year. Unrealized losses within the corporate bond category relate to one bond which had a continuous loss position for more than one year. The primary cause for unrealized losses within the debt securities is the impact movements in interest rates have had in comparison to the underlying yields on these securities.

The following summarizes the Company's gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31, 2016:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate bonds	$ -	$ -	$ 421,000	$ (79,000)	$ 421,000	$ (79,000)
State and municipal	6,638,000	(161,000)	-	-	6,638,000	(161,000)
Mortgage-backed and CMO's	51,666,000	(1,103,000)	8,289,000	(335,000)	59,955,000	(1,438,000)
Marketable equity securities	-	-	449,000	(51,000)	449,000	(51,000)
Total temporarily impaired securities	$ 58,304,000	$(1,264,000)	$ 9,159,000	$ (465,000)	$ 67,463,000	$(1,729,000)

3. Securities (cont.)

At December 31, 2016, unrealized losses within the marketable equity securities category relate to one individual security which had a continuous loss for more than one year. Unrealized losses within the mortgage-backed and collateralized mortgage obligations (CMO's) category relate to fifty-seven individual securities of which eleven had continuous losses for more than one year. Unrealized losses within the state and municipal bonds category relate to fourteen individual securities of which none had continuous losses for more than one year. Unrealized losses within the corporate bond category relate to one bond which had a continuous loss position for more than one year. The primary cause for unrealized losses within the debt securities is the impact movements in interest rates have had in comparison to the underlying yields on these securities.

Management evaluates investments for other-than-temporary impairment (OTTI) based on the type of investment and the period of time the investment has been in an unrealized loss position. At December 31, 2017 and 2016, management has determined that the current unrealized losses on these securities are consistent with changes in the overall bond and equity markets caused by an increase in market yields and spread levels and the securities are not other-than-temporarily impaired. The exception to this is a mortgage-backed security at Banc of America Funding Corporation (BAFC). Management performed an internal analysis on the market value of its investment at BAFC as of December 31, 2017 and 2016, and recognized OTTI write-downs of this security of $5,000 and $4,000 for the years ended December 31, 2017 and 2016, respectively.

At December 31, 2017 and 2016, securities with a fair value of $33,261,000 and $28,604,000, respectively, were pledged to secure certain borrowings and municipal deposits and repurchase agreements as required or permitted by law.

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2017 follow:

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within 1 year	$ 55,000	$ 56,000	$ -	$ -
Over 1 year through 5 years	25,451,000	25,172,000	3,000	3,000
Over 5 years through 10 years	22,726,000	22,537,000	6,000	6,000
Over 10 years	39,125,000	38,640,000	-	-
	$ 87,357,000	$ 86,405,000	$ 9,000	$ 9,000

Mortgage-backed securities and CMO's are allocated among the above maturity groupings based on their final maturity dates.

The Bank's investment in Federal Home Loan Bank (FHLB) stock was evaluated for impairment and the Bank did not identify any events or changes in circumstances that may have had a significant adverse effect on the carrying value of that investment.

4. Loans

A summary of the loan balances are as follows:

	2017	2016
Mortgage loans on real estate		
Residential 1-4 family	$ 141,429,000	$ 140,407,000
Commercial	331,373,000	296,737,000
	472,802,000	437,144,000
Commercial loans	164,431,000	161,017,000
Municipal loans	10,184,000	6,986,000
Consumer installment loans	13,155,000	17,146,000
Business credit cards	387,000	310,000
Subtotal	660,959,000	622,603,000
Less: Allowance for loan losses	6,048,000	6,032,000
Add: Net deferred loan costs	677,000	676,000
Loans, net	$ 655,588,000	$ 617,247,000

The following tables present the allowance for loan losses and select loan information for the years ended December 31, 2017 and 2016:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	2017 Total
Allowance for loan losses						
Beginning balance	$ 2,064,000	$ 3,511,000	$ 211,000	$ 95,000	$151,000	$ 6,032,000
Provision for (reduction of) loan losses	657,000	449,000	145,000	(26,000)	-	1,225,0000
Loans charged off	(276,000)	(1,003,000)	(158,000)	(28,000)	-	(1,465,000)
Recoveries of loans previously charged off	57,000	143,000	23,000	33,000	-	256,000
Ending balance	$ 2,502,000	$ 3,100,000	$ 221,000	$ 74,000	$151,000	$ 6,048,000
Individually evaluated for impairment	$ 430,000	$ 218,000	$ 22,000	$ 10,000	$ -	$ 680,000
Collectively evaluated for impairment	$ 2,072,000	$ 2,882,000	$ 199,000	$ 64,000	$151,000	$ 5,368,000
Loans						
Ending balance	$175,002,000	$331,373,000	$141,429,000	$13,155,000		$660,959,000
Individually evaluated for impairment	$ 2,635,000	$ 3,018,000	$ 882,000	$ 105,000		$ 6,640,000
Collectively evaluated for impairment	$172,367,000	$328,355,000	$140,547,000	$13,050,000		$654,319,000

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	2016 Total
Allowance for loan losses						
Beginning balance	$ 1,924,000	$ 2,737,000	$ 278,000	$ 62,000	$329,000	$ 5,330,000
Provision for (reduction of) loan losses	556,000	818,000	34,000	86,000	(178,000)	1,316,000
Loans charged off	(481,000)	(254,000)	(120,000)	(59,000)	-	(914,000)
Recoveries of loans previously charged off	65,000	210,000	19,000	6,000	-	300,000
Ending balance	$ 2,064,000	$ 3,511,000	$ 211,000	$ 95,000	$151,000	$ 6,032,000
Individually evaluated for impairment	$ 42,000	$ 332,000	$ 30,000	$ -	$ -	$ 404,000
Collectively evaluated for impairment	$ 2,022,000	$ 3,179,000	$ 181,000	$ 95,000	$151,000	$ 5,628,000
Loans						
Ending balance	$168,313,000	$296,737,000	$140,407,000	$17,146,000		$622,603,000
Individually evaluated for impairment	$ 2,278,000	$ 5,632,000	$ 1,003,000	$ 69,000		$ 8,982,000
Collectively evaluated for impairment	$166,035,000	$291,105,000	$139,404,000	$17,077,000		$613,621,000

Management's judgment of the likelihood of a loss is demonstrated by the internal risk rating assigned to each loan in both the Commercial and Consumer portfolios.

Commercial: Commercial and Commercial Real Estate

The commercial portfolio is closely monitored for quality and the likelihood of loss. Based on the current information surrounding the facts and circumstances of the loan, an internal credit rating is assigned. Credit ratings 1-5 are deemed to be a performing loan with no significant likelihood of loss. The ratings are further measured with a 6 – special mention, 7 – substandard, 8 – doubtful, and 9 – loss. Each of these ratings is supported by the facts and circumstances surrounding the loan that would cause a higher probability of some loss and thus as the rating progresses down the scale a higher reserve for loan loss is allocated to the particular group mentioned.

Loans rated 1: Loans in this category include municipalities or other government establishments primarily engaged in providing general support for government or administration of education programs.

Loans rated 2: Loans in this category include borrowers of unquestioned credit standing and a consistently strong financial condition as evidenced by earnings, liquidity, leverage, and cash flow. Additionally, loans secured by cash collateral or properly margined marketable securities are considered rated 2.

Loans rated 3: These loans include borrowers that have most of the characteristics of a loan rated 2, but either the financial condition, management, or industry is not quite as strong.

4. Loans (cont.)

Loans rated 4: These loans include borrowers that have a reasonable financial condition. While loans in this category are definitely sound, they do carry a higher risk. The borrower is generally profitable with occasional moderate losses.

Loans rated 5: These loans are considered "watch list." These loans are those commercial loans that, while credit-worthy, exhibit some characteristics which require special attention by the loan officer. This is the lowest permissible rating for a new loan. Loans rated 5 must be closely monitored as any deterioration may be cause for prompt re-rating to 6 or lower. Principal areas of concern may be management problems, industry stress, financial deterioration, operating losses, inadequate cash flow, highly cyclical industries, or any other area that would negatively affect the borrower's ability to repay the obligation in full on a timely basis.

Loans rated 6: Loans in this category are considered "special mention." These loans are considered protected but may have potential weaknesses, which may weaken the asset or inadequately protect the Bank's credit position at some future date.

Loans rated 7: Loans in this category are considered "substandard." These loans might be inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Assets so classified often have well-defined weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Loans rated 8: Loans in this category are considered "doubtful." Loans classified as doubtful have all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses may make collection or liquidation in full highly questionable and improbable on the basis of currently existing facts, conditions, and values. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage of strengthening of the asset, its rating as 9 is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plans.

Loans rated 9: Loans in this category are considered "loss" or uncollectible. For these loans it is not practical or desirable to defer writing off the basically worthless loan even though partial recovery may be effected in the future.

Consumer: Residential 1-4 Family,
Consumer – Installment and Consumer – Indirect Installment

These loans are broken out as either a pass or substandard. A loan is typically marked as substandard when it becomes 90 days past due or under certain circumstances such as bankruptcy or excessive tax liens. Higher reserves are allocated to substandard consumer loans as there would be a higher probability of loss.

The following tables summarize credit risk indicators by portfolio as of December 31, 2017 and 2016:

Commercial Credit Risk Exposure
Credit Risk Profile by Internally Assigned Grade

2017	Commercial	Commercial Real Estate
Pass	$ 164,817,000	$ 317,755,000
Special mention	4,009,000	10,628,000
Substandard	6,176,000	2,990,000
Doubtful	-	-
Loss	-	-
2017 Total	$ 175,002,000	$ 331,373,000
2016		
Pass	$ 158,700,000	$ 279,892,000
Special mention	4,808,000	7,491,000
Substandard	4,805,000	9,354,000
Doubtful	-	-
Loss	-	-
2016 Total	$ 168,313,000	$ 296,737,000

Consumer Credit Exposure
Credit Risk Profile by Internally Assigned Grade

2017	Residential Real Estate	Consumer-Installment	Consumer-Indirect Installment
Pass	$ 140,454,000	$ 4,981,000	$ 8,138,000
Substandard	975,000	29,000	7,000
2017 Total	$ 141,429,000	$ 5,010,000	$ 8,145,000
2016			
Pass	$ 139,121,000	$ 4,179,000	$ 12,932,000
Substandard	1,286,000	35,000	-
2016 Total	$ 140,407,000	$ 4,214,000	$ 12,932,000

The following presents an aging analysis of past due loans as of December 31, 2017 and 2016:

2017	30-59 Days Past Due	60-90 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Loans on Nonaccrual	Recorded Investment Loans > 90 Days & Accruing
Commercial	$ 1,795,000	$ 86,000	$ 2,297,000	$ 4,178,000	$ 170,824,000	$ 175,002,000	$ 2,556,000	$ -
Commercial real estate	555,000	182,000	415,000	1,152,000	330,221,000	331,373,000	1,119,000	356,000
Residential real estate	715,000	206,000	61,000	982,000	140,447,000	141,429,000	1,109,000	54,000
Consumer – installment	14,000	-	-	14,000	4,996,000	5,010,000	29,000	-
Consumer – indirect installment	153,000	62,000	1,000	216,000	7,929,000	8,145,000	44,000	1,000
2017 Total	$ 3,232,000	$ 536,000	$ 2,774,000	$ 6,542,000	$ 654,417,000	$ 660,959,000	$ 4,857,000	$ 411,000
2016								
Commercial	$ 1,556,000	$ 49,000	$ 113,000	$ 1,718,000	$ 166,595,000	$ 168,313,000	$ 2,244,000	$ -
Commercial real estate	943,000	6,716,000	-	7,659,000	289,078,000	296,737,000	7,609,000	-
Residential real estate	976,000	19,000	5,000	1,000,000	139,407,000	140,407,000	1,037,000	5,000
Consumer – installment	-	-	-	-	4,214,000	4,214,000	35,000	-
Consumer – indirect installment	214,000	24,000	-	238,000	12,694,000	12,932,000	-	-
2016 Total	$ 3,689,000	$ 6,808,000	$ 118,000	$10,615,000	$ 611,988,000	$ 622,603,000	$ 10,925,000	$ 5,000

4. Loans (cont.)

The Bank takes a conservative approach in credit risk management and remains focused on community lending and reinvesting, working closely with borrowers experiencing credit problems to assist in loan repayment or term modifications. Troubled debt restructured loans (TDRs) consist of loans where the Bank, for economic or legal reasons related to the borrower's financial difficulties, granted a concession to the borrower that it would not otherwise consider. TDRs involve term modifications or a reduction of either interest or principal that the Bank would not normally make for other borrowers with similar risk characteristics. Once such an obligation has been restructured, it will continue to remain in restructured status until paid in full. Current balances of loan modifications qualifying as TDRs during the years ended December 31, 2017 and 2016 were $303,000 and $2,868,000, respectively. Loans restructured due to credit difficulties that are now performing were $2,573,000 and $2,980,000 at December 31, 2017 and 2016, respectively.

At December 31, 2017 and 2016, the allowance related to TDRs was $243,000 and $364,000, respectively. The specific reserve component was determined by using the fair value of the underlying collateral, which was obtained through independent appraisals and internal evaluations, or by discounting the total expected future cash flows from the borrower. There were no commitments to lend additional funds to borrowers with loans classified as TDRs at December 31, 2017 and 2016.

In 2017, there were no loans that did not perform according to the TDR terms and were subsequently charged off or transferred to OREO. In 2016, four commercial loans and one residential real estate loan did not perform according to the TDR terms and were subsequently charged off or transferred to OREO in the combined amount of $220,000.

The following is a summary of TDRs (accruing and non-accruing) by portfolio segment modified during the years ended December 31, 2017 and 2016:

2017	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Current Balance
Commercial	4	$ 137,000	$ 137,000	$ 137,000
Commercial real estate	2	242,000	170,000	166,000
2017 Total	6	$ 379,000	$ 307,000	$ 303,000
2016				
Commercial	18	$ 1,897,000	$ 1,425,000	$ 1,764,000
Commercial real estate	3	1,079,000	1,079,000	1,069,000
Consumer	1	40,000	40,000	35,000
2016 Total	22	$ 3,016,000	$ 2,544,000	$ 2,868,000

The following is a summary of TDRs (accruing and non-accruing) by portfolio segment as of December 31, 2017 and 2016:

2017	Number of Contracts	Current Balance	Related Allowance
Commercial	24	$ 802,000	$ 3,000
Commercial real estate	32	2,867,000	218,000
Residential real estate	4	648,000	22,000
Consumer	1	29,000	-
2017 Total	61	$ 4,346,000	$ 243,000
2016			
Commercial	29	$ 2,006,000	$ 2,000
Commercial real estate	33	4,731,000	332,000
Residential real estate	5	694,000	30,000
Consumer	1	35,000	-
2016 Total	68	$ 7,466,000	$ 364,000

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

The following table presents a summary of information pertaining to impaired loans by loan category as of December 31, 2017 and 2016:

2017	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With no related allowance recorded:				
Commercial	$ 1,150,000	$ 1,150,000	$ -	$ 19,000
Commercial real estate	1,622,000	1,622,000	-	80,000
Residential real estate	709,000	709,000	-	3,000
Consumer	90,000	90,000	-	3,000
With an allowance recorded:				
Commercial	$ 1,485,000	$ 1,485,000	$ 430,000	$ 68,000
Commercial real estate	1,396,000	1,396,000	218,000	66,000
Residential real estate	173,000	173,000	22,000	1,000
Consumer	15,000	15,000	10,000	2,000
2017 Total:				
Commercial	$ 2,635,000	$ 2,635,000	$ 430,000	$ 87,000
Commercial real estate	3,018,000	3,018,000	218,000	146,000
Residential real estate	882,000	882,000	22,000	4,000
Consumer	105,000	105,000	10,000	5,000

2016	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With no related allowance recorded:				
Commercial	$ 1,970,000	$ 1,970,000	$ -	$ 35,000
Commercial real estate	2,243,000	2,243,000	-	34,000
Residential real estate	822,000	822,000	-	5,000
Consumer	69,000	69,000	-	3,000
With an allowance recorded:				
Commercial	$ 308,000	$ 308,000	$ 42,000	$ 19,000
Commercial real estate	3,389,000	3,389,000	332,000	170,000
Residential real estate	181,000	181,000	30,000	11,000
Consumer	-	-	-	-
2016 Total:				
Commercial	$ 2,278,000	$ 2,278,000	$ 42,000	$ 54,000
Commercial real estate	5,632,000	5,632,000	332,000	204,000
Residential real estate	1,003,000	1,003,000	30,000	16,000
Consumer	69,000	69,000	-	3,000

The following is a summary of information pertaining to impaired loans:

	2017	2016
Impaired loans without a valuation allowance	$ 3,571,000	$ 5,104,000
Impaired loans with a valuation allowance	3,069,000	3,878,000
Total impaired loans	$ 6,640,000	$ 8,982,000
Valuation allowance related to impaired loans	$ 680,000	$ 404,000
Average investment in impaired loans	$ 9,311,000	$ 8,677,000

December 31, 2017 and 2016, there were five and six mortgage loans, respectively, collateralized by residential real estate in the process of foreclosure with a total balance of $227,000 and $331,000, respectively.

5. Bank Premises and Equipment

A summary of the cost and accumulated depreciation of bank premises and equipment follows:

	2017	2016
Land	$ 2,740,000	$ 2,755,000
Buildings	11,530,000	11,901,000
Equipment	12,837,000	12,477,000
Leasehold improvements	1,112,000	1,112,000
Construction in progress	-	170,000
	28,219,000	28,415,000
Accumulated depreciation	(17,170,000)	(16,253,000)
	$ 11,049,000	$ 12,162,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

6. Investments in Limited Partnerships

Through June 2016, the Company held investments in limited partnerships with related New Market Tax Credits (NMTC). These investments were carried at cost and amortized on the effective yield method. Amortization of the investments in the limited partnerships for the year ended December 31, 2016 totaled $69,000, and is recognized as a component of income tax expense in the consolidated statements of income.

7. Deposits

At December 31, 2017, the scheduled maturities of time deposits are as follows:

2018	$ 130,542,000
2019	39,338,000
2020	8,709,000
2021	5,717,000
2022 and thereafter	9,210,000
	$ 193,516,000

8. Advances from Federal Home Loan Bank

Pursuant to collateral agreements with the FHLB, advances are collateralized by all stock in the FHLB, qualifying first mortgages and securities available-for-sale.

Fixed-rate advances of $55,167,000 and $20,178,000 at December 31, 2017 and 2016, respectively, mature through August 2023. At December 31, 2017 and 2016, the interest rates on fixed rate advances ranged from 0.00 to 2.19 percent. At December 31, 2017 and 2016, the weighted-average interest rates on fixed-rate advances were 1.59 percent and 0.69 percent, respectively.

The floating rate advance of $10,700,000 at December 31, 2017 matures in January 2018. At December 31, 2017, the interest rate on the floating rate advance was 1.59 percent. The floating rate advance of $1,000,000 at December 31, 2016 matured in January 2017. At December 31, 2016, the interest rate on the floating rate advance was 0.80 percent.

At December 31, 2017 and 2016, the Company also had $1,000,000 available under a long-term line of credit with the FHLB.

The contractual maturities of advances at December 31, 2017 are as follows:

2018	$ 38,700,000
2019	8,000,000
2020	15,000,000
2021	4,000,000
2023	167,000

9. Other Borrowed Funds

Other borrowed funds of $118,000 and $889,000 at December 31, 2017 and 2016, respectively, consist of securities sold under agreements to repurchase.

Securities sold under agreements to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date, except for the term repurchase agreements. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities. At December 31, 2017 and 2016, securities with a fair value of $118,000 and $889,000, respectively, were pledged to secure other borrowed funds.

Information concerning securities sold under agreements to repurchase for the years ended December 31, 2017 and 2016 is summarized as follows:

	2017	2016
Average balance during the year	$ 270,000	$ 647,000
Average interest rate during the year	0.10%	0.10%
Maximum month-end balance during the year	$ 769,000	$ 889,000

At December 31, 2017, the Company also had $8,500,000 available under lines of credit with other banks which were in addition to the line of credit disclosed in Note 8. There were no advances outstanding at December 31, 2017.

10. Capital Trust Securities

On October 14, 2003, the Company sponsored the creation of Katahdin Capital Trust II (the "Trust II"), a statutory business trust created under the laws of Delaware. The Company is the owner of all of the common securities of the Trust II. On October 16, 2003, the Trust II issued $3,000,000 of London Interbank Offered Rate (LIBOR) floating rate plus 3.05% margin Capital Securities (the "Capital Securities II," and with the common securities, the "Trust Securities II"), the proceeds from which were used by the Trust II, along with the Company's $93,000 capital contribution for the Common Securities II, to acquire $3,093,000 aggregate principal amount of the Company's LIBOR floating rate plus 3.05% Junior Subordinated Deferrable Interest Debentures due October 16, 2033 (the "Debentures"), which constitute the sole assets of the Trust II. The Company has, through the Declaration of Trust which established the Trust II, the Common Securities II and Capital Securities II Guarantee Agreements, the Debentures and a related Indenture, taken together, fully, irrevocably and unconditionally guaranteed all of the Trust II's obligations under the Trust Securities II.

On December 20, 2005, the Company sponsored the creation of Katahdin Capital Trust III (the "Trust III"), a statutory business trust created under the laws of Delaware. The Company is the owner of all of the common securities of the Trust III. On December 22, 2005, the Trust III issued $4,000,000 of LIBOR floating rate plus 1.50% margin Capital Securities (the "Capital Securities III," and with the common securities, the "Trust Securities III"), the proceeds from which were used by the Trust III, along with the Company's $124,000 capital contribution for the Common Securities III, to acquire $4,124,000 aggregate principal amount of the Company's LIBOR floating rate plus 1.50% Junior Subordinated Deferrable Interest Debentures due January 7, 2036 (the "Debentures"), which constitute the sole assets of the Trust III. The Company has, through the Declaration of Trust which established the Trust III, the Common Securities III and Capital Securities III Guarantee Agreements, the Debentures and a related Indenture, taken together, fully, irrevocably and unconditionally guaranteed all of the Trust III's obligations under the Trust Securities III.

11. Income Taxes

Allocation of federal and state income taxes between current and deferred portions is as follows:

	2017	2016
Current tax provision		
Federal	$ 2,504,000	$ 1,230,000
State	113,000	120,000
	2,617,000	1,350,000
Deferred federal tax provision	154,000	514,000
	$ 2,771,000	$ 1,864,000

The income tax provision differs from the expense that would result from applying federal statutory rates to income before income taxes, as follows:

	2017	2016
Computed tax expense	$ 2,384,000	$ 2,230,000
Increase (reduction) in income taxes resulting from:		
Tax exempt interest	(166,000)	(121,000)
State taxes, net of federal benefit	113,000	79,000
Income from life insurance	(113,000)	(105,000)
Preferred stock dividends	(5,000)	(5,000)
Tax credits, net of investment amortization	-	(66,000)
Change in federal tax rate	271,000	-
Other	287,000	(148,000)
	$ 2,771,000	$ 1,864,000

Deferred tax assets and liabilities are recognized at the expected future tax rate. On December 22, 2017, the Federal tax rate decreased from 34% to 21% effective January 1, 2018. Accordingly, deferred tax assets and liabilities were revalued at December 31, 2017 to reflect the 21% tax rate.

Items which give rise to deferred income tax assets and liabilities are as follows:

11. Income Taxes (cont.)

	2017	2016
Deferred tax assets		
Other-than-temporary impairment of investment securities	$ 46,000	$ 73,000
Allowance for loan losses	1,270,000	2,051,000
Employee benefit plans	511,000	799,000
Net unrealized loss on derivative instruments	-	164,000
Net unrealized loss on securities available-for-sale	207,000	441,000
Other	51,000	96,000
	2,085,000	3,624,000
Deferred tax liabilities		
Depreciation	418,000	808,000
Amortization of goodwill	1,038,000	1,629,000
Amortization of interest rate cap premium	79,000	192,000
Prepaid expenses	96,000	124,000
Net unrealized gain on derivative instruments	5,000	-
Other	13,000	1,000
	1,649,000	2,754,000
Net deferred tax asset	$ 436,000	$ 870,000

No valuation allowance is deemed necessary for the deferred income tax asset. The net deferred income tax asset is included in other assets in the consolidated balance sheets.

12. Earnings Per Share

The following sets forth the computation of basic and diluted earnings per common share for 2017 and 2016:

	2017	2016
Net income available to common shareholders, as reported	$ 3,478,000	$ 3,939,000
Weighted-average common shares outstanding	3,373,220	3,399,826
Effect of unvested restricted stock grants	-	-
Diluted weighted-average common shares	3,373,220	3,399,826
Basic earnings per common share	$ 1.03	$ 1.16
Diluted earnings per common share	$ 1.03	$ 1.16

13. Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and commercial letters-of-credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

At December 31, 2017 and 2016, the contractual amounts of the Company's financial instruments were as follows:

	Contract Amount	
	2017	2016
Lending-related instruments:		
Home equity lines-of-credit	$ 21,173,000	$ 19,580,000
Other lines-of-credit	58,632,000	57,484,000
Credit card arrangements	2,488,000	2,265,000
Letters-of-credit	3,365,000	2,505,000
Derivative financial instruments:		
Notional amounts of interest rate swaps	120,572,000	96,240,000
Notional amounts of interest rate caps	25,000,000	28,000,000

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for lines-of-credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements.

Unfunded commitments under commercial lines-of-credit, revolving credit lines, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines-of-credit are uncollateralized, usually do not contain a specified maturity date, and may not be drawn upon to the total extent to which the Company is committed.

Commercial letters-of-credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters-of-credit are primarily issued to support public and private borrowing arrangements. Substantially all letters-of-credit issued have expiration dates within one year. The credit risk involved in issuing letters-of-credit is essentially the same as that involved in extending loan facilities to customers. The Company generally holds collateral supporting those commitments if deemed necessary.

To reduce credit risk related to the use of credit-related financial instruments, the Company might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Company's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant and equipment, and real estate.

14. Significant Group Concentrations of Credit Risk

A large portion of the Company's loan portfolio consists of single family residential loans and commercial real estate loans in Maine. The local economy depends heavily on Maine industries including the agricultural and forest industries, which are subject to annual variations. Accordingly, the collectability of a substantial portion of the Company's loan portfolio is dependent on the health of Maine's economy.

The Company's policy for requiring collateral is to obtain security in excess of the amount borrowed. The amount of collateral obtained is based on management's credit evaluation of the borrower. The Company requires appraisals of real property held as collateral. For consumer loans, the Company will accept security which has a title certificate. Collateral held for commercial loans may include accounts receivable, inventory, property and equipment, and income-producing properties. The contract or notional amounts of these instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

The contractual amount of credit-related financial instruments such as commitments to extend credit and letters-of-credit represents the amount of potential accounting loss should the contract be fully drawn upon, the customer default, and the value of any existing collateral become worthless.

15. Legal Contingencies

Various legal claims arise from time-to-time in the normal course of business which, in the opinion of management, will have no material effect on the Company's consolidated financial statements.

16. Minimum Regulatory Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Effective January 1, 2015, the Bank implemented the Basel III regulatory framework. These new rules and framework revised minimum capital requirements and adjusted prompt corrective action thresholds. Under the Basel III regulatory framework, the quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital and common equity Tier 1 (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Effective in 2015, the Company is considered a Small Bank Holding Company and therefore not subject to the Basel III capital rules. Regulatory capital requirements limit a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% above its minimum risk-based capital requirements. The capital conservation buffer requirement is being phased in from January 1, 2016 through January 1, 2019, when the full capital conservation buffer requirement

16. Minimum Regulatory Capital Requirements (cont.)

will be effective. As of December 31, 2017, the Bank had a capital conservation buffer of 4.65% of risk-weighted assets, which was in excess of the phased-in regulatory requirement of 1.25%. As of December 31, 2016, the Bank had a capital conservation buffer of 5.02% of risk-weighted assets, which was in excess of the phased-in regulatory requirement of 0.625%. Management believes, as of December 31, 2017 and 2016, that the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2017, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios as of December 31, 2017 and 2016 are also presented in the table.

As of December 31, 2017	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk-Weighted Assets Bank	$ 76,457,000	12.7%	$ 48,371,000	8.0%	$ 60,464,000	10.0%
Tier 1 Capital to Risk-Weighted Assets Bank	70,376,000	11.6	36,278,000	6.0	48,371,000	8.0
Common Equity Tier 1 Capital to Risk-Weighted Assets Bank	70,376,000	11.6	27,209,000	4.5	39,301,000	6.5
Tier 1 Capital to Average Assets Bank	70,376,000	8.9	31,669,000	4.0	39,586,000	5.0
As of December 31, 2016						
Total Capital to Risk-Weighted Assets Bank	$ 74,235,000	13.0%	$ 45,627,000	8.0%	$ 57,033,000	10.0%
Tier 1 Capital to Risk-Weighted Assets Bank	68,169,000	12.0	34,220,000	6.0	45,627,000	8.0
Common Equity Tier 1 Capital to Risk-Weighted Assets Bank	68,169,000	12.0	25,665,000	4.5	37,072,000	6.5
Tier 1 Capital to Average Assets Bank	68,169,000	9.2	29,791,000	4.0	37,239,000	5.0

17. Employee Benefit Plans

The Company has a safe harbor 401(k) plan whereby substantially all employees participate in the plan. Employees may contribute a portion of their compensation subject to certain limits based on federal tax laws. The Company makes safe harbor matching contributions equal to 100% of the first 3% of an employee's compensation plus 50% of the next 2% of an employee's compensation in addition to a discretionary contribution. For the years ended December 31, 2017 and 2016, expense attributable to the plan amounted to $330,000 and $348,000, respectively.

The Company has established a nonqualified supplemental executive retirement plan for the benefit of key employees. The amount of each benefit is guaranteed contingent upon employee vesting schedules. The present value of these benefits, being expensed over the employment service period, amounted to $309,000 and $281,000 for 2017 and 2016, respectively. Life insurance policies were acquired for the purpose of serving as the primary funding source. The cash value of these policies was $11,751,000 and $11,421,000 at December 31, 2017 and 2016, respectively, and is included in other assets.

For 2017 and 2016, in addition to a retainer fee of $13,000 for regular directors, $15,000 for the vice-chairman, and $16,000 for the chairman, outside directors of the Bank received $675, for each Board meeting attended, and for each subcommittee meeting attended.

Certain directors are eligible to participate in the Bank's health insurance plan. Directors are reimbursed for mileage expense or other similar expenses.

18. Restricted Stock Plan

The Company established a restricted stock plan during 2010 with 100,000 shares currently authorized by the Board of Directors for the compensation committee of the Board to administer. The compensation committee did not grant restricted stock during 2017 or 2016. A total of 11,897 shares have been issued under the restricted stock plan since inception, all of which are vested.

19. Other Noninterest Expenses

The components of other noninterest expenses which are in excess of 1% of total revenues (total interest and dividend income and noninterest income) and not shown separately in the consolidated statements of income are as follows for the years ended December 31:

	2017	2016
Printing, postage and supplies	$ 476,000	$ 506,000
Professional fees	439,000	383,000

20. Related Party Transactions

In the ordinary course of business, the Company has granted loans to principal officers and directors and their affiliates amounting to $17,678,000 and $14,568,000 at December 31, 2017 and 2016, respectively. Deposits from related parties held by the Company at December 31, 2017 and 2016 amounted to $6,444,000 and $6,138,000, respectively.

21. Employee Stock Ownership Plan

All Bank employees meeting certain age and service requirements are eligible to participate in the ESOP.

The Bank's ESOP purchased shares of Katahdin Bankshares Corp. common stock that include outstanding debt as follows:

Date	Shares	Net Price Per Share	Original Debt	Principal Balance Dec. 31, 2017
October 2016	25,000	$ 11.25	$ 287,000	$ 186,000

The October 2016 loan is from Katahdin Bankshares Corp. and is repayable annually with an interest rate of 2.55% for the term of 4 years.

Date	Shares	Net Price Per Share	Original Debt	Principal Balance Dec. 31, 2017
September 2017	27,000	$ 13.99	$ 371,000	$ 371,000

The September 2017 loan is from Katahdin Bankshares Corp. and is repayable annually with an interest rate of 3.30% for a term of 6 years and 3 months. The loan is interest only through 2020.

The loans are secured by the shares purchased by the ESOP. Participants' benefits become fully vested after five years of service. The Bank's contributions are the primary source of funds for the ESOP's repayment of the loans. Principal and interest payments for the years ended December 31, 2017 and 2016 totaled $97,000 and $15,000, respectively. ESOP expense was $87,000 and $16,000 for the years ended December 31, 2017 and 2016, respectively.

As of December 31, 2017, the remaining principal balance of the loans are scheduled to be paid as follows:

2018	$ 89,000
2019	92,000
2020	93,000
2021	92,000
2022	95,000
2023	96,000
	$ 557,000

21. Employee Stock Ownership Plan (cont.)

Shares held by the ESOP include the following at December 31:

	2017	2016
Allocated	9,431	1,306
Unallocated	43,069	24,194
	52,500	25,500

The fair value of the unallocated shares as of December 31, 2017 and 2016 was approximately $683,000 and $314,000, respectively.

22. Fair Value

GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. GAAP also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon model-based techniques incorporating various assumptions including interest rates, prepayment speeds, and credit losses. Assets and liabilities valued using model-based techniques are classified as either Level 2 or Level 3, depending on the lowest level classification of an input that is considered significant to the overall valuation. A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Securities available-for-sale: Fair values for securities available-for-sale are determined by obtaining quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities. The fair values of securities available-for-sale are classified as Level 2, except for the fair value of marketable equity securities which are classified as Level 1 using quoted market prices.

Derivatives: Derivatives are reported at fair value utilizing Level 2 inputs obtained from third parties to value interest rate caps and swaps.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

		Fair Value Measurements at December 31, 2017 and 2016, Using		
December 31, 2017	Total	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Securities available-for-sale				
U.S. Treasury securities	$ 1,971,000	$ -	$ 1,971,000	$ -
State and municipal	10,010,000	-	10,010,000	-
Corporate bonds	1,966,000	-	1,966,000	-
Mortgage-backed and CMO's	72,458,000	-	72,458,000	-
Total debt securities	86,405,000	-	86,405,000	-
Marketable equity securities	467,000	467,000	-	-
Total securities available-for-sale	86,872,000	467,000	86,405,000	-
Derivative instruments	2,314,000	-	2,314,000	-
Total assets	$ 89,186,000	$ 467,000	$88,719,000	$ -
Liabilities				
Derivative instruments	$ 1,355,000	$ -	$ 1,355,000	$ -

December 31, 2016	Total	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Securities available-for-sale				
U.S. Treasury securities	$ 1,981,000	$ -	$ 1,981,000	$ -
State and municipal	9,478,000	-	9,478,000	-
Corporate bonds	921,000	-	921,000	-
Mortgage-backed and CMO's	74,442,000	-	74,442,000	-
Total debt securities	86,822,000	-	86,822,000	-
Marketable equity securities	449,000	449,000	-	-
Total securities available-for-sale	87,271,000	449,000	86,822,000	-
Derivative instruments	2,533,000	-	2,533,000	-
Total assets	$ 89,804,000	$ 449,000	$89,355,000	$ -
Liabilities				
Derivative instruments	$ 1,463,000	$ -	$ 1,463,000	$ -

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

Impaired loans: A loan is considered to be impaired when it is probable that all of the principal and interest due under the original underwriting terms of the loan may not be collected. Impairment is measured based on the fair value of the underlying collateral or the present value of future cash flows. The Company measures impairment on all nonaccrual loans for which it has established specific reserves as part of the specific allocated allowance component of the allowance for loan losses. The fair values of impaired loans are classified as Level 2.

Other real estate and property owned: Real estate acquired through foreclosure is recorded at fair value. The fair value of other real estate and property owned is based on property appraisals and an analysis of similar properties currently available. The fair values of other real estate and property owned are classified as Level 2.

Assets and liabilities measured at fair value on a nonrecurring basis are summarized below:

		Fair Value Measurements at December 31, 2017 and 2016, Using		
December 31, 2017	Total	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Impaired loans (market approach)	$ 2,389,000	$ -	$ 2,389,000	$ -
Other real estate and property owned (market approach)	384,000	-	384,000	-
December 31, 2016				
Assets				
Impaired loans (market approach)	$ 3,474,000	$ -	$ 3,474,000	$ -
Other real estate and property owned (market approach)	454,000	-	454,000	-

Certain impaired loans were written down to their value of $2,389,000 and $3,474,000 at December 31, 2017 and 2016, respectively, resulting in an impairment charge through the allowance for loan losses.

GAAP requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, if the fair values can be reasonably determined. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques using observable inputs when available. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Certain financial instruments and all nonfinancial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

22. Fair Value (cont.)

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Cash and due from banks and interest bearing deposits in banks: The carrying amount reported in the balance sheet for cash and cash equivalents approximates fair value.

Securities: Fair values for securities, excluding FHLB stock, are determined by obtaining quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities. The carrying value of FHLB stock approximates fair value based on the redemption provisions of the FHLB.

Loans receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The fair value of impaired loans is primarily based upon appraisals of the collateral by third-party appraisers and brokers' opinions by third-party brokers. The appraisals and opinions are based upon comparable prices for similar assets in active markets for residential real estate loans, and less active markets for commercial loans.

Deposit liabilities: The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts, and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities on time deposits.

Advances from Federal Home Loan Bank: The fair values of these borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Other borrowed funds: The fair values of these borrowed funds are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Junior subordinated debentures: The carrying values of these instruments approximate fair value.

Accrued interest: The carrying amounts of accrued interest approximate fair value.

Off-balance-sheet instruments: The Company's off-balance-sheet instruments consist of loan commitments. Fair values for loan commitments have not been presented as the future revenue derived from such financial instruments is not significant.

The estimated fair values, and related carrying amounts, of the Company's financial instruments are as follows:

	Fair Value Measurement at December 31, 2017				
	Carrying Amount	Fair Value	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets					
Cash and due from banks	$ 7,895,000	$ 7,895,000	$ 7,895,000	$ -	$ -
Interest bearing deposits in banks	6,089,000	6,089,000	6,089,000	-	-
Securities available-for-sale	86,872,000	86,872,000	467,000	86,405,000	-
Securities held-to-maturity	9,000	9,000	-	9,000	-
FHLB stock	3,564,000	3,564,000	-	3,564,000	-
Loans receivable, net:					
Commercial	172,639,000	172,254,000	-	1,055,000	171,199,000
Commercial real estate	328,537,000	319,463,000	-	1,178,000	318,285,000
Residential real estate	141,321,000	139,245,000	-	151,000	139,094,000
Consumer	13,091,000	13,175,000	-	5,000	13,170,000
Loan receivable, net	655,588,000	644,137,000	-	2,389,000	641,748,000
Accrued interest receivable	1,685,000	1,685,000	-	1,685,000	-
Derivative instruments	2,314,000	2,314,000	-	2,314,000	-
Financial liabilities					
Deposits	647,752,000	630,522,000	-	630,522,000	-
Advances from FHLB	65,867,000	65,590,000	-	65,590,000	-
Other borrowed funds	118,000	118,000	-	118,000	-
Accrued interest payable	254,000	254,000	-	254,000	-
Junior subordinated debentures	7,217,000	7,217,000	-	7,217,000	-
Derivative instruments	1,355,000	1,355,000	-	1,355,000	-

	Fair Value Measurement at December 31, 2016				
Financial assets					
Cash and due from banks	$ 6,450,000	$ 6,450,000	$ 6,450,000	$ -	$ -
Interest bearing deposits in banks	4,873,000	4,873,000	4,873,000	-	-
Securities available-for-sale	87,271,000	87,271,000	449,000	86,822,000	-
Securities held-to-maturity	12,000	12,000	-	12,000	-
FHLB stock	1,682,000	1,682,000	-	1,682,000	-
Loans receivable, net:					
Commercial	166,391,000	166,999,000	-	266,000	166,733,000
Commercial real estate	293,476,000	288,426,000	-	3,057,000	285,369,000
Residential real estate	140,314,000	139,340,000	-	151,000	139,189,000
Consumer	17,066,000	17,262,000	-	-	17,262,000
Loan receivable, net	617,247,000	612,027,000	-	3,474,000	608,553,000
Accrued interest receivable	1,618,000	1,618,000	-	1,618,000	-
Derivative instruments	2,533,000	2,533,000	-	2,533,000	-
Financial liabilities					
Deposits	652,969,000	638,800,000	-	638,800,000	-
Advances from FHLB	21,178,000	21,182,000	-	21,182,000	-
Other borrowed funds	889,000	889,000	-	889,000	-
Accrued interest payable	183,000	183,000	-	183,000	-
Junior subordinated debentures	7,217,000	7,217,000	-	7,217,000	-
Derivative instruments	1,463,000	1,463,000	-	1,463,000	-

23. Preferred Stock

The Company has authorized the issuance of up to 20,000 shares of preferred stock at any one time.

On June 27, 2014, the Company issued 4,000 shares of Preferred Series D floating rate non-cumulative perpetual preferred stock at an issuance price of $2,500 per share. The net proceeds from the issuance totaled $9,603,000. The dividend will be set quarterly at a floating rate of 3 month LIBOR plus 4.25%, with a floor of 8.75%. Dividends on Preferred Series D are payable quarterly in arrears on January 15, April 15, July 15, and October 15 of each year.

Preferred Series D qualifies as Tier 1 capital on the Company's books for regulatory purposes and rank senior to the Company's common stock and senior or at an equal level in the Company's capital structure to any other shares of preferred stock the Company may issue in the future. The dividend rights have priority over all common stock dividends, and thus the dividends on the preferred stock need to be paid before the Company can pay dividends on the common stock.

The Company has the option to redeem the Preferred Series D shares, in whole or in part, from time to time, on or after the five year anniversary of the issuance, at a redemption price of $2,500 per share.

24. Interest Rate Swaps and Caps

The Company uses derivative instruments as partial hedges against large fluctuations in interest rates. At least quarterly, all financial instruments are reviewed as part of the asset/liability management process. The financial instruments are factored into the Company's overall interest rate risk position. The Company regularly reviews the credit quality of the counterparty from which the instruments have been purchased. The Company uses derivative financial instruments for risk management purposes and not for trading or speculative purposes. The Company controls the credit risk of these instruments through collateral, credit approvals, and monitoring procedures. The derivative instruments contain provisions that require the Company to post collateral with the counterparty for its contracts that are in a net loss position based on their fair value and the Company's credit

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

24. Interest Rate Swaps and Caps (cont.)

rating. At December 31, 2016, the Company had posted $100,000 of cash as collateral. As no contracts were in a net loss position at December 31, 2017, the Company did not have any cash posted as collateral at that date.

The following table presents the details of the interest rate swap agreements:

Party	Notional Amount	Effective Date	Maturity Date	Variable Index Received	Fixed Rate Paid	Fair Value as of Dec. 31, 2017	2016
Company	$ 4,000,000	April 7, 2010	April 7, 2017	3-Month USD LIBOR	3.48%	$ -	$(27,000)
Bank	15,000,000	July 1, 2016	June 30, 2020	1-Month USD LIBOR	0.855	430,000	381,000

As these instruments qualify as highly effective cash flow hedges, changes in fair value are recorded in other comprehensive income (loss), net of tax.

The following presents the details of interest rate protection agreements (caps):

Party	Notional Amount	Up Front Premiums Paid	Termination Date	Floating Rate Option	Strike Rate	Fair Value as of Dec. 31, 2017	2016
Company	$ 3,000,000	$ 270,000	April 7, 2017	3-Month USD LIBOR	3.48%	$ -	$ -
Bank	25,000,000	1,998,000	April 4, 2019	3-Month USD LIBOR	0.23	529,000	716,000

The caps were acquired to limit the Company's exposure to interest rates. The up-front premiums are being amortizing based on the expense amortization schedules established at the inception of the hedges, with the corresponding adjustment to the income statement. At inception, the hedging relationships were expected to be 100% effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedges. As these instruments qualify as highly effective cash flow hedges, the change in fair value is recorded in other comprehensive income (loss), net of tax.

The Bank enters into interest rate swap agreements executed with commercial banking customers to facilitate customers' risk management strategies. In addition to the swap agreement with the borrower, the Bank enters into a second "back-to-back" swap agreement with a third party; the general terms of the swap mirror those of the first swap agreement. In entering into this transaction, the Bank has offset its interest rate risk exposure to the swap agreement with the borrower. All interest rate swaps are valued at observable market prices for similar instruments or valued using observable market interest rates.

The following table presents summary information regarding the fair value of customer related interest rate swaps, which are included in other assets (liabilities) as of December 31:

	2017 Asset (Liability)	2016 Asset (Liability)
Swaps receive fixed	$ 1,355,000	$ 1,436,000
Swaps pay fixed	(1,355,000)	(1,436,000)
Net customer related swaps	$ -	$ -

The outstanding notional amounts of interest rate swaps entered into on behalf of customers at December 31 were as follows:

	2017	2016
Swaps receive fixed	$ 52,786,000	$ 38,620,000
Swaps pay fixed	(52,786,000)	(38,620,000)

25. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about the conditions that existed at the balance sheet date, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the balance sheet date, but arose after that date. Management has evaluated subsequent events occurring through February 14, 2018, the date the financial statements were available to be issued.

SHAREHOLDER INFORMATION

ANNUAL MEETING

The Annual Shareholders' Meeting will be held in the Katahdin Trust Company Room at The Center for Community Health Education at Houlton Regional Hospital, Houlton, Maine on Monday, May 7, 2018 at 10:30 a.m.

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:

Matthew M. Nightingale
Executive Vice President, Treasurer & CFO
PO Box 450 | Patten, ME 04765
(207) 521-3200
m.nightingale@katahdintrust.com

STOCK

Katahdin Bankshares Corp. stock is quoted on the OTC Markets quote board OTCQX under the symbol KTHN. Current stock information can be found at otcmarkets.com/stock/KTHN/quote.

BEST 50 OTCQX

TRANSFER AGENT

For shareholder inquiries regarding change of address or title, please contact:

Computershare Trust Company, N.A .
PO Box 30170 | College Station, TX 77842-3170
1-800-368-5948 (U.S. or Canada)
1-781-575-4223 (outside the U.S. or Canada)
computershare.com/investor

DIRECT STOCK PURCHASE AND DIVIDEND REINVESTMENT PLAN

Katahdin's transfer agent, Computershare Trust Company, N.A. ("Computershare"), sponsors and administers the Computershare Investment Plan (CIP) for Katahdin Bankshares Corp. Common Stock. This plan offers direct stock purchase and dividend reinvestment options and is available to current Katahdin Bankshares Corp. shareholders as well as new investors. For more information, you may contact Computershare.

BRANCH OFFICES

Ashland, Bangor, Caribou, Eagle Lake, Fort Fairfield, Fort Kent, Hampden, Houlton, Island Falls, Mars Hill, Oakfield, Patten, Presque Isle, Scarborough and Van Buren.

Learn more about Katahdin Trust on our website at KatahdinTrust.com and get the latest news and information by following us on Facebook, Twitter, LinkedIn, and Instagram.

Katahdin Bankshares Corp.

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