

A MESSAGE FROM THE PRESIDENT

It is with great sadness that I report the passing of Director Arthur L. Shur, of Island Falls, who had served on the Board since 1983, including over 20 years as Vice Chairman. During his time on the Board we have grown a great deal, from three branches in Patten Island Falls and Oakfield to sixteen throughout Maine and to nearly \$800 million in assets today. Arthur was an important component of that growth and he displayed a great commitment, understanding of community banking, and belief in Katahdin Trust Company for nearly 35 years. He will be sorely missed. We extend our heartfelt sympathy to Arthur's family. The Board will consider options for a director to serve out Arthur's term.

Bottom line results continue to be solid, but less than we desire due to factors which I will describe below. Net Income before preferred stock dividends in the 2nd quarter totaled \$1,155,000 which is lower than the same period last year by \$120,000. Year to date, Net Income before preferred stock dividends totaled \$1,981,000, below 2016 by \$202,000.

Net Interest Income totaled \$12,413,000 in the first six months, down by \$160,000 from the first six months of 2016. Last year, the Bank recovered interest income on a relationship that had been on non-accrual for an extended period of time. The recovery recorded in the 2nd quarter of 2016 totaled \$504,000. After adjusting for this, the run rate growth in net interest income year over year was \$344,000, a 2.9% increase. The Bank continues to have strong asset growth which has outpaced margin compression over the last year caused by continued pricing competition for loans and an increasing Fed Funds Target rate set by the Federal Reserve with no corresponding increases in longer term marketplace yields.

Non-Interest Income rose 10% over the first six months of last year to \$2,240,000 due to continuing success in fee income generation in several categories.

Non-Interest Expense through six months totaled \$11,129,000, increasing \$492,000 or 4.6%. We've had good success implementing efficiencies that will prove positive within Non Interest Expense as we continue to grow; however there are factors offsetting these results so far this year. First, Salary and Employee Benefit expense are tracking less than last year by \$33,000 while occupancy and furniture and fixtures expenses are also under last year by \$31,000. Offsetting this is the one-time branch closure expenses announced in the 1st quarter of \$285,000. Further, a change in the way the FDIC began calculating insurance premiums last year has caused a substantial increase in FDIC Insurance assessment this year totaling an increase of \$107,000 for the first six months. The main reason for the assessment increase is a premium charged on brokered deposit levels above 10% of total assets. We've taken steps to reduce the brokered deposits levels which will begin to reduce this particular part of the assessment. Lastly, we have seen a substantial increase year over year in debit card fraud activity for which the Bank is responsible by law for

covering the losses. This is an industry-wide problem. Losses in this category have increased by \$76,000 over the last year. We're taking steps to alleviate these losses with extra fraud protection controls. Together, these three increases totaled \$468,000 and represent over 95% of the total increase in non-interest expense for the first six months.

Turning to the balance sheet, the investment portfolio has grown to \$93,933,000, increasing by \$12,981,000 over last year at this time. The Bank has had great success growing assets, mainly on the commercial loan side of the portfolio this past year. Total Loans reached \$665,407,000 growing \$63,216,000, representing portfolio growth of 10.5%. This growth has helped outpace margin compression and has been significantly funded by increases in local deposits. Total Deposits reached \$649,444,000, or \$37,306,000 over last year. The increase is entirely related to local deposit growth throughout our markets. The remainder of funding came in the form of Federal Home Loan Bank Borrowings which increased by \$37,029,000.

Non-Performing Assets to Total Assets stood at 1.63% as compared to 1.53% last year. This is a significant improvement from the 1st quarter 2017 number of 2.01%. Driving this is a \$2.7 million reduction in non-performing assets over this quarter as several credits have come to successful resolutions. Nearly 40% of our current total non-performing assets are tied to a single relationship which we're working through. This relationship will likely take some time to resolve. Due to both growth and asset quality factors, we've added \$370,000 to the Provision for Loan Loss in the 2nd quarter. The Year to Date Provision for Loan Loss stands at \$590,000 as compared to \$730,000 last year.

Tangible Book Value per share continues to grow totaling \$15.04 at quarter end, an increase of \$0.72 cents per share or 5.0%. The company paid out a dividend of \$0.10 per share to common shareholders in the 2nd quarter, representing an annualized dividend yield of 2.9% when considering the stock price of \$13.75 at the time of this writing.

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

Sincerely,



Jon J. Prescott
President & CEO

DIRECTORS

- Steven L. Richardson**, Chairman
Richard J. York, Vice Chairman
Jon J. Prescott
Robert E. Anderson
- Peter F. Briggs**
Kimberley A. Niles
Paul R. Powers

SENIOR MANAGEMENT

- Jon J. Prescott**, President & CEO
Peter P. St. John, Executive Vice President, Commercial Services
Bonnie C. Foster, Senior Vice President, Retail Services
William P. Lucy, Senior Vice President, Commercial Services
Matthew M. Nightingale, Senior Vice President, Treasurer & CFO

LOCATIONS

BRANCH OFFICES

- Ashland ATM**
17 Main Street
435-6461
- Fort Fairfield ATM**
290 Main Street
472-3161
- Oakfield ATM**
200 Oakfield Smyrna Rd
757-8288
- Bangor ATM**
609 Broadway
942-3146
- Fort Kent ATM**
79 West Main Street
834-2348
- Patten ATM**
11 Main Street
528-2211
- Bangor ATM**
52 Springer Drive
947-9674
- Hampden ATM**
57 Western Avenue
862-2211
- Presque Isle ATM**
6 North Street
764-8000
- Caribou ATM**
105 Bennett Drive
498-4200
- Houlton ATM**
65 North Street
532-4277
- Scarborough**
144 US Route One
510-7017
- Eagle Lake**
3440 Aroostook Road
444-5543
- Island Falls ATM**
1007 Crystal Road
463-2228
- Van Buren ATM**
29 Main Street, Ste.105
868-2728
- Mars Hill ATM**
28 Main Street
429-8400

REMOTE ATM LOCATION

Limestone ATM ONLY
35 Main Street, Limestone

COMMERCIAL LOAN OFFICE

Maine Financial Group 885-5900
144 US Route One, Scarborough



KatahdinTrust.com



PHOTO BY PAUL CUP



2017 SECOND QUARTER



KATAHDIN BANKSHARES CORP.

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)

CONSOLIDATED STATEMENT OF CONDITION

(UNAUDITED)

	June 30,	
	2017	2016
ASSETS		
Cash & Due from Banks	\$ 11,621	\$ 11,806
Investments	93,933	80,952
Total Loans	665,407	602,191
Reserve for Loan Loss	(6,409)	(5,597)
Fixed Assets	11,364	12,658
Other Assets	23,840	19,891
Total Assets	\$ 799,756	\$ 721,901

LIABILITIES

Deposits	\$ 649,444	\$ 612,138
Repurchase Agreements	140	611
Borrowings	70,177	33,148
Other Liabilities	13,660	11,823
Total Liabilities	\$ 733,421	\$ 657,720

SHAREHOLDERS' EQUITY

Preferred Stock, Series D	\$ 9,813	\$ 9,720
Common Shareholders' Equity	57,136	54,629
Net Unrealized Appreciation (Depreciation) on Securities Available-for-Sale, Net of Tax	(132)	885
Net Unrealized Appreciation (Depreciation) on Derivative Investments at Fair Value, Net of Tax	(209)	(1,053)
Unearned ESOP Shares	(273)	-
Total Shareholders' Equity	\$ 66,335	\$ 64,181
Total Liabilities & Shareholders' Equity	\$ 799,756	\$ 721,901

Letters of Credit	\$ 2,949	\$ 3,090
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CONSOLIDATED STATEMENT OF INCOME

(UNAUDITED)

	For 3 Months Ended June 30,		For 6 Months Ended June 30,	
	2017	2016	2017	2016
Interest Income	\$ 7,587	\$ 7,651	\$ 14,889	\$ 14,697
Interest Expense	1,289	1,007	2,476	2,124
Net Interest Income	\$ 6,298	\$ 6,644	12,413	\$ 12,573
Less: Provision for Loan Losses	370	460	590	730
Net Interest Income After Provisions	\$ 5,928	\$ 6,184	\$ 11,823	\$ 11,843
Non-Interest Income	1,254	1,070	2,240	2,037
Non-Interest Expense ⁷	5,468	5,356	11,129	10,637
Net Operating Income	\$ 1,714	\$ 1,898	\$ 2,934	\$ 3,243
Less: Provision for Income Taxes	559	623	953	1,060
Net Income	\$ 1,155	\$ 1,275	\$ 1,981	\$ 2,183
Less: Dividends on Preferred Stock	219	219	438	438
Net Income Available to Common Shareholders	\$ 936	\$ 1,056	\$ 1,543	\$ 1,745

Earnings Per Common Share	\$ 0.28	\$ 0.31	\$ 0.46	\$ 0.51
Annualized Return on Average Assets	0.59%	0.71%	0.51%	0.62%
Annualized Return on Average Common Equity	6.67%	7.86%	5.59%	6.53%
Book Value Per Share at period end ¹			\$ 16.72	\$ 16.00
Tangible Book Value Per Share at period end ²			\$ 15.04	\$ 14.32
Weighted Average Common Shares Outstanding ³			3,380,173	3,404,367
Common Shares Outstanding period end			3,404,367	3,404,367
Adjusted Common Shares Outstanding period end ⁴			3,380,173	3,404,367
Allowance for Loan Losses to period end Loans			0.96%	0.93%
Non-Performing Loans to period end Loans ⁵			1.87%	1.74%
Non-Performing Assets to Total Assets ⁶			1.63%	1.53%

1) Common equity per common share. Book Value shall be calculated using Adjusted Common Shares Outstanding period end.

2) Tangible common equity per common share. Tangible Book Value shall be calculated using Adjusted Common Shares Outstanding period end.

3) Weighted Average Common Shares Outstanding less weighted average unallocated ESOP shares. Used for calculating Earnings per Common Share.

4) Adjusted Common Shares Outstanding are Common Shares Outstanding 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.

5) Non-performing loans consist of non-accrual loans and restructured loans, where applicable. Inclusive of any guaranteed portion of non-accrual loans.

6) Non-performing assets consist of non-accrual loans, restructured loans, and foreclosed assets, where applicable. Inclusive of any guaranteed portion of non-accrual loans.

7) Non Interest Expense for 6 months ended June 30, 2017 included real estate write-downs and other one-time branch consolidation costs totaling \$285,000.

SHAREHOLDER INFORMATION

SHAREHOLDER RELATIONS

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

Matthew M Nightingale
Senior 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 www.otcm Markets.com/stock/KTHN/quote.

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)
www.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.

