FIRST NATIONAL LINCOLN CORP /ME/
Form 10-Q
May 10, 2007
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2007

Commission File Number 0-26589

FIRST NATIONAL LINCOLN CORPORATION

(Exact name of Registrant as specified in its charter)

MAINE 01-0404322

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

MAIN STREET, DAMARISCOTTA, MAINE 04543

(Address of principal executive offices) (Zip code)

(207) 563-3195

Registrant s telephone number, including area code

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

Yes x No[_]

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

Large accelerated filer [_] Accelerated filer x Non-accelerated filer [_]

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

Yes [_] No x

Indicate the number of shares outstanding of each of the registrant s classes of common stock as of May 9, 2007

Common Stock: 9,784,070 shares

Table of Contents

Part I. Financial Information

Selected Financial Data (Unaudited)

First National Lincoln Corporation and Subsidiary

Dollars in thousands, except for per share amounts	**For the three months ended March 31 2007**	2006
Summary of Operations		
Interest Income	**$16,948**	$14,812
Interest Expense	**9,383**	7,064
Net Interest Income	**7,565**	7,748
Provision for Loan Losses	**300**	250
Non-Interest Income	**2,148**	2,073
Non-Interest Expense	**5,250**	5,434
Net Income	**3,003**	2,978
Per Common Share Data		
Basic Earnings per Share	**$0.31**	$0.30
Diluted Earnings per Share	**0.31**	0.30
Cash Dividends Declared	**0.165**	0.145
Book Value	**11.12**	10.62
Market Value	**15.92**	17.59
Financial Ratios		
Return on Average Equity (1)	**11.25%**	11.56%
Return on Average Tangible Equity (1)	**15.12%**	15.74%
Return on Average Assets (1)	**1.10%**	1.15%
Average Equity to Average Assets	**9.77%**	9.92%
Average Tangible Equity to Average Assets	**7.27%**	7.29%
Net Interest Margin Tax-Equivalent (1)	**3.16%**	3.46%
Dividend Payout Ratio	**53.23%**	48.33%
Allowance for Loan Losses/Total Loans	**0.77%**	0.77%
Non-Performing Loans to Total Loans	**0.26%**	0.51%
Non-Performing Assets to Total Assets	**0.20%**	0.38%
Efficiency Ratio (2)	**51.16%**	52.60%
At Period End		
Total Assets	**$1,108,621**	$1,060,373
Total Loans	**846,190**	791,315
Total Investment Securities	**178,390**	187,930
Total Deposits	**824,761**	750,714
Total Shareholders Equity	**108,800**	104,579

[1]Annualized using a 365-day basis

[2]The Company uses the following formula in calculating its efficiency ratio:

Non-Interest Expense - Loss on Securities Sales

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

Item 1 Financial Statements

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

First National Lincoln Corporation

We have reviewed the accompanying interim consolidated financial information of First National Lincoln Corporation and Subsidiary as of March 31, 2007 and 2006 and for the three-month periods then ended. These financial statements are the responsibility of the Company s management.

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

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

/s/ Berry, Dunn, McNeil & Parker

Portland, Maine

May 9, 2007

Page 2

Consolidated Balance Sheets (Unaudited)

First National Lincoln Corporation and Subsidiary

In thousands of dollars	**March 31, 2007**	December 31, 2006	March 31, 2006
Assets			
Cash and due from banks	**$ 21,103**	$ 24,188	$ 21,052
Overnight funds sold	**-**	-	-
Securities available for sale	**43,924**	44,815	54,369
Securities to be held to maturity (fair value $133,474 at March 31, 2007, $134,649 at December 31, 2006, and $131,610 at March 31, 2006)	**134,466**	135,734	133,561
Loans held for sale (fair value approximates cost)	**584**	460	-
Loans	**846,190**	838,145	791,315
Less: allowance for loan losses	**6,495**	6,364	6,131
Net loans	**839,695**	831,781	785,184
Accrued interest receivable	**7,202**	6,140	6,096
Premises and equipment	**15,670**	15,845	16,516
Other real estate owned	**1,144**	1,144	498
Goodwill	**27,684**	27,684	27,684
Other assets	**17,149**	17,078	15,413
Total Assets	**$1,108,621**	$1,104,869	$1,060,373
Liabilities			
Demand deposits	**$ 53,128**	$ 62,157	$ 58,526
NOW deposits	**96,685**	99,612	100,432
Money market deposits	**140,465**	137,163	118,670
Savings deposits	**93,472**	98,131	103,267
Certificates of deposit	**182,890**	164,770	154,068
Certificates $100,000 and over	**258,121**	243,402	215,751
Total deposits	**824,761**	805,235	750,714
Borrowed funds	**162,512**	179,862	194,172
Other liabilities	**12,548**	12,445	10,908
Total Liabilities	**999,821**	997,542	955,794
Shareholders Equity			
Common stock	**98**	98	100
Additional paid-in capital	**45,693**	45,587	47,430
Retained earnings	**62,685**	61,298	56,505
Net unrealized gains on securities available-for-sale	**672**	696	544
Net unrealized loss on postretirement benefit costs	**(348)**	(352)	-
Total Shareholders Equity	**108,800**	107,327	104,579
Total Liabilities & Shareholders Equity	**$1,108,621**	$1,104,869	$1,060,373
Common Stock			
Number of shares authorized	**18,000,000**	18,000,000	18,000,000
Number of shares issued and outstanding	**9,783,515**	9,770,792	9,849,166
Book value per share	**$11.12**	$10.98	$10.62

See Report of Independent Registered Public Accounting Firm.

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

Consolidated Statements of Income (Unaudited)

First National Lincoln Corporation and Subsidiary

	For the three months ended March 31,	
In thousands of dollars	**2007**	2006
Interest income		
Interest and fees on loans	**$14,462**	$12,507
Interest on deposits with other banks	**-**	-
Interest and dividends on investments	**2,486**	2,305
Total interest income	**16,948**	14,812
Interest expense		
Interest on deposits	**7,229**	5,119
Interest on borrowed funds	**2,154**	1,945
Total interest expense	**9,383**	7,064
Net interest income	**7,565**	7,748
Provision for loan losses	**300**	250
Net interest income after provision for loan losses	**7,265**	7,498
Non-interest income		
Investment management and fiduciary income	**503**	496
Service charges on deposit accounts	**659**	622
Net securities gains	**-**	-
Mortgage origination and servicing income	**100**	84
Other operating income	**886**	871
Total non-interest income	**2,148**	2,073
Non-interest expense		
Salaries and employee benefits	**2,712**	2,662
Occupancy expense	**379**	374
Furniture and equipment expense	**474**	505
Amortization of identified intangibles	**71**	71
Other operating expense	**1,614**	1,822
Total non-interest expense	**5,250**	5,434
Income before income taxes	**4,163**	4,137
Applicable income taxes	**1,160**	1,159
NET INCOME	**$3,003**	$2,978
Earnings per common share:		
Basic earnings per share	**$0.31**	$0.30
Diluted earnings per share	**$0.31**	$0.30
Cash dividends declared per share	**$0.165**	$0.145
Weighted average number of shares outstanding	**9,780,352**	9,857,326
Incremental Shares	**40,945**	84,829

See Report of Independent Registered Public Accounting Firm.

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Page 4

Consolidated Statements of Changes in Shareholders Equity (Unaudited)

First National Lincoln Corporation and Subsidiary

In thousands of dollars except number of shares	Number of common shares	Common stock	Additional paid-in capital	Retained earnings	Net unrealized gains on securities available for sale	Net unrealized loss on post-retirement benefit costs	Total share-holders equity
Balance at December 31, 2005	**9,832,777**	**$ 99**	**$47,718**	**$54,901**	**$734**	**$ -**	**$103,452**
Net income	-	-	-	2,978	-	-	2,978
Net unrealized loss on securities available for sale, net of tax benefit of $102	-	-	-	-	(190)	-	(190)
Comprehensive income	-	-	-	2,978	(190)	-	2,788
Cash dividends declared	-	-	-	(1,429)	-	-	(1,429)
Payment to repurchase common stock	(32,887)	-	(578)	-	-	-	(578)
Proceeds from sale of common stock	49,276	1	290	-	-	-	291
Tax benefit of disqualifying disposition of incentive stock option shares	-	-	-	55	-	-	55
Balance at March 31, 2006	**9,849,166**	**$100**	**$47,430**	**$56,505**	**$544**	**$ -**	**$104,579**
Balance at December 31, 2006	**9,770,792**	**$ 98**	**$45,587**	**$61,298**	**$696**	**$(352)**	**$107,327**
Net income	-	-	-	3,003	-	-	3,003
Net unrealized loss on securities available for sale, net of tax benefit of $13	-	-	-	-	(24)	-	(24)
Net change in unrecognized transition obligation for postretirement benefits, net of tax of $3	-	-	-	-	-	4	4
Comprehensive income	-	-	-	3,003	(24)	4	2,983
Cash dividends declared	-	-	-	(1,616)	-	-	(1,616)
Equity compensation expense	-	-	15	-	-	-	15
Payment to repurchase common stock	(6,668)	-	(111)	-	-	-	(111)
Proceeds from sale of common stock	19,391	-	202	-	-	-	202
Balance at March 31, 2007	**9,783,515**	**$ 98**	**$45,693**	**$62,685**	**$672**	**$(348)**	**$108,800**

See Report of Independent Registered Public Accounting Firm.

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

Consolidated Statements of Cash Flows (Unaudited)

First National Lincoln Corporation and Subsidiary

	For three months ended March 31,	
In thousands of dollars	**2007**	2006
Cash flows from operating activities		
Net income	**$ 3,003**	$ 2,978
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	**307**	344
Provision for loan losses	**300**	250
Loans originated for resale	**(5,663)**	(4,198)
Proceeds from sales and transfers of loans	**5,539**	4,198
Equity compensation expense	**15**	-
Net increase (decrease) in other assets and accrued interest	**(1,194)**	18
Net increase in other liabilities	**68**	1,354
Net accretion of discounts on investments	**(355)**	(21)
Net acquisition amortization	**57**	67
Provision for losses on other real estate owned	**17**	-
Net cash provided by operating activities	**2,094**	4,990
Cash flows from investing activities		
Proceeds from maturities, payments and calls of securities available for sale	**1,226**	97
Proceeds from maturities, payments and calls of securities to be held to maturity	**51,777**	2,817
Proceeds from sales of other real estate owned	**518**	-
Purchases of securities available for sale	**(343)**	-
Purchases of securities to be held to maturity	**(50,183)**	(7,134)
Net increase in loans	**(8,768)**	(19,727)
Capital expenditures	**(132)**	(148)
Net cash used in investing activities	**(5,905)**	(24,095)
Cash flows from financing activities		
Net decrease in demand deposits, savings, money market and club accounts	**(13,313)**	(27,583)
Net increase in certificates of deposit	**32,868**	64,378
Advances on long-term borrowings	**10,000**	-
Repayment on long-term borrowings	**(5,000)**	-
Net decrease in short-term borrowings	**(22,356)**	(21,011)
Payments to repurchase common stock	**(111)**	(578)
Proceeds from sale of common stock	**202**	291
Tax benefit from disqualifying disposition of stock options		55
Dividends paid	**(1,564)**	(1,377)
Net cash provided by financing activities	**726**	14,175
Net decrease in cash and cash equivalents	**(3,085)**	(4,930)
Cash and cash equivalents at beginning of year	**24,188**	25,982
Cash and cash equivalents at end of period	**$ 21,103**	$ 21,052
Interest paid	**$ 9,001**	$ 6,292
Income taxes paid	**$ 273**	$ 8
Non-cash transactions		
Change in unrealized gain on available for sale securities, net of tax	**$ (24)**	$ (190)
Net transfer from loans to other real estate owned	**$ 535**	$ -

See Report of Independent Registered Public Accounting Firm.

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

Notes to Consolidated Financial Statements

First National Lincoln Corporation and Subsidiary

Note 1 Basis of Presentation

First National Lincoln Corporation (the Company) is a financial holding company that owns all of the common stock of The First, N.A. (the Bank). The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of Management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions and balances are eliminated in consolidation. The income reported for the 2007 period is not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the consolidated financial statements and notes included in the Company s annual report on Form 10-K for the year ended December 31, 2006.

Note 2 Common Stock

On July 21, 2006, the Company announced that its Board of Directors had authorized a new program for the repurchase of up to 250,000 shares of the Company s common stock or approximately 2.5% of the outstanding shares. The Company expects such repurchases to be effected from time to time, in the open market, in private transactions or otherwise, during a period of up to 24 months. The amount and timing of shares to be purchased will be subject to market conditions and will be based on several factors, including the price of the Company s stock and the level of stock issuances under the Company s employee stock plans. No assurance can be given as to the specific timing of the share repurchases or as to whether and to what extent the share repurchase will be consummated. As of March 31, 2007, the Company had repurchased 113,704 shares under the new repurchase plan at an average price of $17.02 and at a total cost of $1.9 million.

Note 3 Stock Options

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

The Company applies the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), Share-Based Payment , to stock-based employee compensation for fiscal years beginning on or after January 1, 2006. As a result, $15,000 in compensation cost is included in the Company s financial statements for the current year. The unrecognized compensation cost to be amortized over a weighted average remaining vesting period of 2.9 years is $156,000, which is comprised of $17,000 for 16,500 options granted in 2002 and $139,000 for 42,000 options granted in 2005.

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

The following table summarizes the status of the Company s non-vested options as of March 31, 2007.

Page 7

	Number of Shares	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2006	58,500	$3.95
Granted in 2007	-	-
Vested in 2007	-	-
Forfeited in 2007	-	-
Non-vested at March 31, 2007	58,500	$3.95

During 2007, 9,000 options were exercised, with proceeds paid to the Company of $31,000. The excess of the fair value of the stock issued upon option exercise over the exercise price was $120,000. A summary of the status of the Company s Stock Option Plan as of March 31, 2007 and changes during the three months then ended, is presented below.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2006	123,000	$10.53		
Granted in 2007	-	-		
Vested in 2007	-	-		
Exercised in 2007	(9,000)	3.42		
Forfeited in 2007	-	-		
Outstanding at March 31, 2007	114,000	$11.09	4.9	$695
Exercisable at March 31, 2007	55,500	$ 6.39	2.6	$574

Note 4 Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (EPS) for the three months ended March 31, 2007 and 2006:

In thousands, except number of shares and per share data	Income (Numerator)	Shares (Denominator)	Per-Share Amount
For the three months ended March 31, 2007			
Net income as reported	$3,003		
Basic EPS: Income available to common shareholders	$3,003	9,780,352	$0.31
Effect of dilutive securities: incentive stock options		40,945	
Diluted EPS: Income available to common shareholders plus assumed conversions	$3,003	9,821,297	$0.31
For the three months ended March 31, 2006			
Net income as reported	$2,978		
Basic EPS: Income available to common shareholders	$2,978	9,857,326	$0.30
Effect of dilutive securities: incentive stock options		84,829	
Diluted EPS: Income available to common shareholders plus assumed conversions	$2,978	9,942,155	$0.30

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

Note 5 Postretirement Benefit Plans

In December 2006, the Company implemented SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R). This Statement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in the funded status in the year in which the changes occur through comprehensive income of a business entity. The Bank sponsors postretirement benefit plans which provide certain life insurance and health insurance benefits for certain retired employees and health insurance for retired directors. None of these plans are pre-funded. The following table sets forth the accumulated postretirement benefit obligation and funded status:

	At March 31,	
In thousands of dollars	**2007**	2006
Change in benefit obligation		
Benefit obligation at beginning of year	**$ 2,005**	$1,705
Service cost	**3**	3
Interest cost	**31**	30
Benefits paid	**(38)**	(32)
Benefit obligation at end of period	**2,001**	1,706
Funded status		
Benefit obligation at end of period	**(2,001)**	(1,706)
Unamortized prior service cost	**-**	(11)
Unamortized net actuarial loss	**-**	56
Unrecognized transition obligation	**-**	201
Accrued benefit cost	**$(2,001)**	$(1,460)

The following table sets forth the net periodic pension cost:

	For three months ended March 31,	
In thousands of dollars	**2007**	2006
Components of net periodic benefit cost		
Service cost	**$ 3**	$ 3
Interest cost	**31**	30
Amortization of unrecognized transition obligation	**7**	7
Amortization of prior service credit	**(1)**	(1)
Amortization of accumulated losses	**1**	2
Net periodic benefit cost	**$41**	$41

Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive loss are as follows:

	At March 31,	
In thousands of dollars	**2007**	2006
Unamortized prior service credit	**$ 7**	$ -
Unamortized net actuarial loss	**(370)**	-
Unrecognized transition obligation	**(172)**	-
	(535)	-
Deferred tax benefit at 35%	**(187)**	-
Net unrecognized postretirement benefits included in accumulated other comprehensive income	**$ (348)**	$ -

Page 9

A weighted average discount rate of 7.0% was used in determining both the accumulated benefit obligation and the net periodic benefit cost. The measurement date for benefit obligations was as of year-end for prior years presented. The Company s expected benefit payments for the second quarter of 2007 are $38,000 and the expected benefit payments for all of 2007 are $153,000. There is no expected contribution for 2007. Plan expense for 2007 is estimated to be $168,000.

Note 6 Goodwill and Other Intangible Assets

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

Note 7 Loan Servicing

The Company implemented SFAS No. 156, Accounting for Servicing of Financial Assets, in the first quarter of 2007. An amendment to SFAS No. 140, SFAS No. 156 requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. Servicing assets and servicing liabilities will subsequently be reported using the amortization method or the fair value measurement method.

In evaluating the reasonableness of the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. The model utilizes a variety of assumptions, the most significant of which are loan prepayment assumptions and the discount rate used to discount future cash flows. Prepayment assumptions, which are impacted by loan rates and terms, are calculated using a three-month moving average of weekly prepayment data published by the Public Securities Association and modeled against the serviced loan portfolio by the third party valuation specialist. The discount rate is the quarterly average ten-year U.S. Treasury rate plus 5.0%. Other assumptions include delinquency rates, foreclosure rates, servicing cost inflation, and annual unit loan cost. All assumptions are adjusted periodically to reflect current circumstances. Amortization of the mortgage servicing rights, as well as write-offs of capitalized rights due to prepayments of the related mortgage loans, are recorded as a charge against mortgage servicing fee income.

For the three months ended March 31, 2007, mortgage servicing rights of $178,000 were capitalized and amortization for the period totaled $111,000. At March 31, 2007 and 2006, the Bank serviced loans for others totaling $163.7 million and $163.0 million, respectively. Mortgage servicing rights are included in other assets and are detailed in the following table:

	At March 31	
In thousands of dollars	**2007**	2006
Mortgage servicing rights	**$ 3,494**	$ 2,893
Accumulated amortization	**(2,550)**	(1,845)
Impairment reserve	**(9)**	(8)
	$ 935	$ 1,040

Note 8 Derivative Financial Instruments

The Bank uses an interest rate protection agreement (cap) as a cash flow hedge to eliminate the cash flow exposure of interest rate movements on money-market deposits. The premium paid for the cap is amortized over its life. Any cash payments received are recorded as an adjustment to net interest income. The Bank documents its risk management strategy and hedge effectiveness at the inception of and during the term of the hedge. The cap is designated and qualifies as a cash flow hedge, and thus is recorded at fair value. SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , provides that a cash flow hedge is effective to the extent the variability in its cash flows offsets the variability in the cash flows of the hedged item, in this case the increase in cost of money market deposits.

Management has determined that the hedge relationship is 100 percent effective. The fair value of the derivative, $72,000 at March 31, 2007, is recorded on the balance sheet. This approximates the amortized cost of the cap, and as a result, no unrealized gain or loss, net of applicable income taxes, is recorded in other comprehensive income in the statement of changes in shareholders equity for the period ended March 31, 2007.

Note 9 Income Taxes

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109 (FIN 48). This statement clarifies 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. FIN 48 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. Effective January 1, 2007, the Company has adopted the provisions of FIN 48 and there was no material effect on the financial statements. As a result, there was no cumulative effect related to adopting FIN 48. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2004 through 2006.

Note 10 Reclassifications

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

Note 11 Impact of Recently Issued Accounting Standards

In September 2006, FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and early application is encouraged. This Statement does not require any new fair value measurements and the Company does not expect application of this Statement to change current practice.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities , which permits companies to choose to measure many financial instruments and certain other items at fair value. The objective of the new pronouncement is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for the Company in 2008. The Company has not yet made a determination if it will elect to apply the options available in SFAS No. 159.

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

First National Lincoln Corporation and Subsidiary

Critical Accounting Policies

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

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

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

Executive Summary

The current challenges faced by the banking industry were summed up very well by Don Johnson and Jeff Kaplan in the March issue of the NASDAQ Regional Banking Monitor, in which they noted that investors should not expect much improvement from the flat earnings reported (by banks) during the fourth quarter of 2006. While the first quarter is generally weaker than the fourth quarter ... the anticipated weakness also reflects the challenges facing the industry. First quarter earnings growth is expected to be hurt by the deterioration of asset quality in the form of higher nonperforming assets, net charge-offs and loan loss provisions as well as a moderation of loan growth, (and) stiff competition on loan and deposit pricing.

The Company s first-quarter results were better than those Kaplan and Johnson predicted for the banking industry. Net income and earnings per share were higher than the first quarter of 2006 as well as above those posted for the previous quarter. Net income for the three months ended March 31, 2007, was $3,003,000, an increase of 0.8% from net income of $2,978,000 for the comparable period of 2006 and up $33,000 or 1.1% from the previous quarter. Fully diluted earnings per share for the three months ended March 31, 2007 were $0.31, a 3.3% increase from the $0.30 reported for the first quarter of 2006. Although the Company had modest growth in earning assets this quarter, it experienced margin compression due to the flat-to-inverted yield curve, with liability costs increasing more rapidly than yield on assets. The net interest margin on a tax-equivalent basis declined to 3.16% for the first three months of 2007 from 3.46% for the same period in 2006, which, in turn, has resulted in a modest decline in net interest income.

Asset quality remains strong, with first quarter net chargeoffs of $169,000 significantly lower than the $243,000 average quarterly net chargeoffs during the past two years. Past-due and problem loans remain low and improved, with non-performing loans to total loans at 0.26% as of March 31, 2007, compared to 0.51% a year ago.

Net Interest Income

Total interest income of $16.9 million for the three months ended March 31, 2007 is a 14.4% increase from total interest income of $14.8 million for the comparable period of 2006. Rising interest rates resulted in higher asset yields in 2007 compared to 2006. Total interest expense of $9.4 million for the first three months of 2007 is a 32.8% increase from total interest expense of $7.1 million for the first three months of 2006. This was a direct result of the rising interest rate climate and increased volume of higher cost sources of funding. Net interest income decreased 2.4% to $7.6 million for the three months ended March 31, 2007, from $7.7 million reported for the same period in 2006.

The Company s net interest margin on a tax-equivalent basis decreased from 3.46% in the first three months of 2006 to 3.16% for the three months ended March 31, 2007. This is due to the current flat yield curve and liability costs increasing at a faster rate than the yield on assets. These results are consistent with the Company s expectations for changes in its net interest income in the current rate environment.

Tax-exempt interest income amounted to $947,000 and $879,000 for the three months ended March 31, 2007 and 2006, respectively. Tax equivalency is calculated using a 35.0% effective tax rate. The following table presents the effect of tax-exempt income on the calculation of the net interest margin, using a 35.0% tax rate in 2007 and 2006:

	For the three months ended March 31,	
	2007	2006
Net interest income as presented	**$ 7,565**	$ 7,748
Effect of tax-exempt income	**510**	474
Net interest income, tax equivalent	**$ 8,075**	$ 8,222

The following table presents the amount of interest earned or paid, as well as the average yield or rate on an annualized basis, for each major category of assets or liabilities for the three months ended March 31, 2007 and 2006. Tax-exempt income is calculated on a tax-equivalent basis, using a 35.0% tax rate in 2007 and 2006.

Three months ended March 31,	**2007**		2006	
Dollars in thousands	**Amount of interest**	**Average yield/rate**	Amount of interest	Average yield/rate
Interest-earning assets				
Investments	**$ 2,855**	**5.98%**	$ 2,659	5.84%
Loans held for sale	**4**	**7.95%**	8	5.96%
Loans	**14,599**	**7.03%**	12,619	6.56%
Total interest-earning assets	**17,458**	**6.84%**	15,286	6.42%
Interest-bearing liabilities				
Deposits	**7,229**	**3.91%**	5,119	3.04%
Other borrowings	**2,154**	**4.81%**	1,945	4.10%
Total interest-bearing liabilities	**9,383**	**4.08%**	7,064	3.27%
Net interest income	**$ 8,075**		$ 8,222	
Interest rate spread		**2.75%**		3.15%
Net interest margin		**3.16%**		3.46%

The following table presents changes in interest income and expense attributable to changes in interest rates and volume for interest-earning assets and interest-bearing liabilities for the three months ended March 31, 2007 compared to 2006. Tax-exempt income is calculated on a tax-equivalent basis, using a 35.0% tax rate in both years.

Three months ended March 31, 2007 compared to 2006

Dollars in thousands	Volume	Rate	Rate/Volume[1]	Total
Interest on earning assets				
Interest-bearing deposits	$ -	$ -	$ -	$ -
Investment securities	129	64	3	196
Loans held for sale	-	2	1	3
Loans	999	903	71	1,973
Total interest income	1,128	969	75	2,172
Interest expense				
Deposits	497	1,470	143	2,110
Other borrowings[2]	(108)	336	(19)	209
Total interest expense	389	1,806	124	2,319
Change in net interest income	$ 739	$ (837)	$ (49)	$ (147)

[1] Represents the change attributable to a combination of change in rate and change in volume.

[2] Includes federal funds purchased.

Provision for Loan Losses

A $300,000 provision to the allowance for loan losses was made during the first three months of 2007, compared to a $250,000 provision made for the same period of 2006. This additional provision is not indicative of a significant decline in loan quality   it was to maintain the allowance for loan losses at an adequate level given continued growth in our loan portfolio and our level of chargeoffs.

Non-Interest Income

Non-interest income was $2,148,000 for the three months ended March 31, 2007, an increase of 3.6% from $2,073,000 reported for the first three months of 2006. This rise in non-interest income was primarily due to increases in mortgage origination and servicing income as well as increased levels of revenue on deposit accounts.

Non-Interest Expense

Non-interest expense of $5,250,000 for the three months ended March 31, 2007, is a decrease of 3.4% compared to non-interest expense of $5,434,000 for the same period in 2006. This decline was attributable to minimal increases in employee costs as well as lower other operating expense. Due to the challenges produced by the interest rate environment established by the FOMC, the Company aggressively sought to control operating expense in the first quarter of 2007.

Income Taxes

Income taxes on operating earnings were $4,163,000 for the three months ended March 31, 2007, up from $4,137,000 in the same period a year ago. This is in line with the Company   s level of income before taxes.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109 (FIN 48). This statement clarifies 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. FIN 48 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. Effective January 1, 2007, the Company has adopted the provisions of FIN 48 and there was no material effect on the financial statements. As a result, there was no cumulative effect related to adopting FIN 48. However, certain amounts have been reclassified in the statement of financial position in order to comply with the requirements of the statement. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ending December 31, 2004 through 2006.

Investments

The Company s investment portfolio decreased by $2.2 million or 1.2% to $178.4 million between December 31, 2006, and March 31, 2007. At March 31, 2007, the Company s available-for-sale portfolio had an unrealized gain, net of taxes, of $0.7 million. Between March 31, 2006, and March 31, 2007, the Company s investment portfolio decreased by $9.5 million or 5.1%.

Loans

Loans grew by $8.0 million or 1.0% during the first three months of 2007. The growth in commercial loans was $8.0 million or 2.4% while municipal loans decreased $0.1 million or 0.5%. The residential mortgage portfolio increased by $2.4 million or 0.7%, and home equity lines of credit decreased $1.8 million or 2.5% year-to-date. Between March 31, 2006 and March 31, 2007 the loan portfolio increased $54.9 million or 6.9%, as a result of modest customer demand.

Allowance for Loan Losses

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

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

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

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

Consumer loans, which include residential mortgages, home equity loans/lines, and direct/indirect loans, are generally evaluated as a group based on product type and on the basis of delinquency data and other credit data available due to the large number of such loans and the relatively small size of individual credits. Allocations for these loan categories are principally determined by applying loss factors that represent

Management s estimate of inherent losses. In each category, inherent losses are estimated based upon Management s assessment of historical loss data, portfolio characteristics, economic trends, overall market conditions and past experience. In addition, certain loans in these categories may be individually risk-rated if considered necessary by Management.

The other method used to allocate the allowance for loan losses entails the assignment of reserve amounts to individual loans on the basis of loan impairment. Certain loans are evaluated individually and are judged to be impaired when Management believes it is probable that the Company will not collect all of the contractual interest and principal payments as scheduled in the loan agreement. Under this method, loans are selected for evaluation based on internal risk ratings or non-accrual status. A specific reserve is allocated to an individual loan when that loan has been deemed impaired and when the amount of a probable loss is estimable on the basis of its collateral value, the present value of anticipated future cash flows, or its net realizable value. At March 31, 2007, impaired loans with specific reserves totaled $1.3 million (all of these loans were on non-accrual status) and the amount of such reserves were $0.5 million.

All of these analyses are reviewed and discussed by the Directors Loan Committee, and recommendations from these processes provide Management and the Board of Directors with independent information on loan portfolio condition. As a result of these analyses, the Company has concluded that the level of the allowance for loan losses was adequate as March 31, 2007. As of that date, the balance of $6,495,000 was 0.77% of total loans, compared to 0.76% at December 31, 2006 and 0.77% at March 31, 2006. Loans considered to be impaired according to SFAS 114/118 totaled $2.5 million at March 31, 2007 compared to $3.5 million at December 31, 2006. The portion of the allowance for loan losses allocated to impaired loans at March 31, 2007, was $0.5 million compared to $0.2 million at December 31, 2006.

In Management s opinion, the level of the Company s allowance for loan losses is adequate. Although the allowance is lower as a percentage of loans than many peers, the Bank s loan portfolio has a higher percentage of residential mortgage loans than peers, which typically reflects a much lower level of credit risk. The Company s actual historical experience supports this by the overall credit quality of the portfolio and historically low level of chargeoffs.

Non-Performing Assets

At March 31, 2007, loans on non-accrual status totaled $2.2 million, which compares to non-accrual loans of $3.5 million as of December 31, 2006. In addition to loans on non-accrual status March 31, 2007, loans past due 90 days or more and accruing (calculated on a constant 30-day month basis) totaled $0.8 million which compares to $0.7 million as of December 31, 2006. The Company continues to accrue interest on these loans because it believes collection of the interest is reasonably assured.

Goodwill

On January 14, 2005, the Company completed the acquisition of FNB Bankshares (FNB) of Bar Harbor, Maine, and its subsidiary, The First National Bank of Bar Harbor, which was merged into the Bank. The total value of the transaction was $48.0 million, and all of the voting equity interest of FNB was acquired in the transaction. As of December 31, 2006, in accordance with SFAS No. 142, the Company completed its annual review of goodwill and determined there has been no impairment.

Deposits

During the first three months of 2007, total deposits increased by $19.5 million or 2.4% over December 31, 2006. Core deposits (demand, NOW, savings and money market accounts) decreased by $13.3 million or 3.4% in the first three months of 2007, and during the same period, certificates of deposit increased $32.8 million or 8.0%. Between March 31, 2006, and March 31, 2007, deposits grew by 9.9%, or $74.0 million. Certificates of deposit grew by $71.2 million, while money market accounts also grew by $21.8 million. Demand deposits decreased by $5.4 million, while NOW accounts also decreased by $3.7 million, and savings decreased by $9.8 million. The majority of the growth in certificates of deposit, both year-to-date and year-over-year, was primarily from wholesale and brokered sources. The Company saw a decline in core deposits year-over-year due to transfers to higher-yielding certificates of deposit due to higher interest rates.

Borrowed Funds

The Company s funding includes borrowings from the Federal Home Loan Bank of Boston, the Federal Reserve System, and repurchase agreements, enabling it to grow its balance sheet and its revenues. They may also be used to carry out interest rate risk management stategies, and are increased to replace or supplement other sources of funding, including core deposits and certificates of deposit. During the three months ended March 31, 2007, borrowed funds decreased $17.4 million or 9.6% from December 31, 2006, as a result of the deposit growth previously noted. Between March 31, 2006 and March 31, 2007, borrowed funds also decreased by $31.7 million or 16.3%.

Shareholders Equity

Shareholders equity as of March 31, 2007 was $108.8 million, compared to $107.3 million as of December 31, 2006. The Company s earnings in the first three months of 2007, net of dividends paid, added to shareholders equity. The net unrealized loss on available-for-sale securities, presented in accordance with SFAS 115, remained relatively the same at $0.7 million for quarter ended March 31, 2007.

In 2007, a cash dividend of 16.5 cents per share was declared in the first quarter compared to 14.5 cents in the first quarter of 2006. The dividend payout ratio was 53.23% in the first quarter of 2007 compared to 48.33% in the first quarter of 2006. In determining future dividend payout levels, the Board of Directors carefully analyzes capital requirements and earnings retention, as set forth in the Company s Dividend Policy. The ability of the Company to pay cash dividends to its shareholders depends on receipt of dividends from its subsidiary, the Bank. The subsidiary may pay dividends to its parent out of so much of its net profits as the Bank s directors deem appropriate, subject to the limitation that the total of all dividends declared by the Bank in any calendar year may not exceed the total of its net profits of that year combined with its retained net profits of the preceding two years. The amount available for dividends in 2007 is this year s net income plus retained earnings of $10.2 million from 2006 and 2005.

Regulatory leverage capital ratios for the Company were 7.46% and 7.22% at March 31, 2007 and December 31, 2006, respectively. The Company had a tier one risk-based capital ratio of 10.47% and tier two risk-based capital ratio of 11.34% at March 31, 2007, compared to 10.40% and 11.26%, respectively, at December 31, 2006. These are comfortably above the standards to be rated well-capitalized by regulatory authorities qualifying the Company for lower deposit-insurance premiums.

On July 21, 2006, the Company announced that its Board of Directors had authorized a new program for the repurchase of up to 250,000 shares of the Company s common stock or approximately 2.5% of the outstanding shares. The Company expects such repurchases to be effected from time to time, in the open market, in private transactions or otherwise, during a period of up to 24 months. The amount and timing of shares to be purchased will be subject to market conditions and will be based on several factors, including the price of the Company s stock and the level of stock issuances under the Company s employee stock plans. No assurance can be given as to the specific timing of the share repurchases or as to whether and to what extent the share repurchase will be consummated. As of March 31, 2007, the Company had repurchased 113,704 shares under the new repurchase plan at an average price of $17.02 and at a total cost of $1.9 million.

Average Daily Balance Sheets

The following table shows the Company s average daily balance sheets for the three month periods ended March 31, 2007 and 2006.

	For the Three months ended March 31,	
In thousands of dollars	**2007**	2006
Assets		
Cash and due from banks	**$ 20,001**	$ 20,401
Interest-bearing deposits	**-**	-
Investments		
U.S. Treasury securities & government agency securities	**92,576**	87,597
Obligations of states and political subdivisions	**58,535**	56,048
Other securities	**42,366**	40,881
Total investments	**193,477**	184,526
Loans held for sale	**202**	133
Loans		
Commercial	**337,433**	317,830
Consumer	**54,930**	40,323
State and municipal	**23,667**	20,509
Real estate	**425,934**	401,569
Total loans	**841,964**	780,231
Allowance for loan losses	**(6,382)**	(6,168)
Net loans	**835,582**	774,063
Premises and equipment	**15,795**	16,629
Goodwill	**27,684**	27,684
Other assets	**14,523**	29,712
Total assets	**$1,107,264**	$1,053,148
Liabilities and shareholders equity		
Deposits		
Demand	**$ 56,974**	$ 58,668
NOW	**96,220**	101,578
Money market	**141,189**	127,002
Savings	**95,313**	106,711
Certificates of deposit	**186,595**	143,978
Certificates of deposit over $100,000	**230,751**	204,419
Total deposits	**807,042**	742,356
Borrowed funds	**181,678**	192,375
Other liabilities	**10,328**	13,983
Total liabilities	**999,048**	948,714
Common stock	**98**	100
Additional paid-in capital	**45,637**	47,686
Retained earnings	**61,785**	55,915
Unrealized gain/loss on available-for-sale securities	**696**	733
Total shareholders equity	**108,216**	104,434
Total liabilities and shareholders equity	**$ 1,107,264**	$1,053,148

Off-Balance Sheet Financial Instruments

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

Sale of Loans

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

Contractual Obligations

The following table sets forth the contractual obligations of the Company as of March 31, 2007:

In thousands of dollars	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
Borrowed funds	**$ 162,512**	$ 105,315	$ 42,000	$ 15,000	$ 197
Operating leases	**474**	179	191	80	24
Certificates of deposit	**441,011**	359,256	76,309	5,446	-
Total	**$ 603,997**	$ 464,750	$ 118,500	$ 20,526	$ 221
Unused line, collateralized by residential real estate	$ 78,083	78,083	-	-	-
Other unused commitments	$ 50,126	50,126	-	-	-
Standby letters of credit	$ 1,466	1,466	-	-	-
Commitments to extend credit	$ 20,869	20,869	-	-	-
Total loan commitments and unused lines of credit	**$ 137,505**	$ 137,505	$ -	$ -	$ -

Liquidity Management

As of March 31, 2007 the Bank had primary sources of liquidity of $247.1 million. It is Management s opinion this is adequate. In its Asset/Liability policy, the Bank has guidelines for liquidity. The Company is not aware of any recommendations by the regulatory authorities which, if they were to be implemented, would have a material effect on the Company s liquidity, capital resources or results of operations.

Forward-Looking Statements

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

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

Item 3 Quantitative and Qualitative Disclosures About Market Risk

Market-Risk Management

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

Asset/Liability Management

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

Static gap analysis measures the amount of repricing risk embedded in the balance sheet at a point in time. It does so by comparing the differences in the repricing characteristics of assets and liabilities. A gap is defined as the difference between the principal amount of assets and liabilities that reprice within a specified time period. The Bank s cumulative one-year gap, March 31, 2007, was -13.73% of total assets. Core deposits with non-contractual maturities are presented based upon historical patterns of balance attrition and pricing behavior, which are reviewed at least annually.

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

A summary of the Bank s static gap, as of March 31, 2007 is presented in the following table:

	0-90 Days	**90-365 Days**	**1-5 Years**	**5+ Years**
Investment securities at amortized cost	$23,139	$20,860	$79,698	$53,279
Loans held for sale	2	9	52	521
Loans	303,296	114,846	336,104	91,912
Other interest-earning assets	-	8,569	-	-
Non-rate-sensitive assets	87	233	1,089	46,489
Total assets	**326,524**	**144,517**	**416,943**	**192,201**
Interest-bearing deposits	291,634	215,552	81,789	182,527
Borrowed funds	75,278	30,027	57,074	133
Non-rate-sensitive liabilities and equity	1,650	5,249	31,687	107,585
Total liabilities and equity	**368,562**	**250,828**	**170,550**	**290,245**
Period gap	**$(42,038)**	**$(106,311)**	**$246,393**	**$(98,044)**
Percent of total assets	-3.89%	-9.84%	22.81%	-9.08%
Cumulative gap (current)	(42,038)	(148,349)	98,044	-
Percent of total assets	-3.89%	-13.73%	9.08%	0.00%

The earnings simulation model forecasts capture the impact of changing interest rates on one-year and two-year net interest income. The modeling process calculates changes in interest income received and interest expense paid on all interest-earning assets and interest-bearing liabilities reflected on the Company s balance sheet. None of the assets used in the simulation are held for trading purposes. The modeling is done for a variety of scenarios that incorporate changes in the absolute level of interest rates as well as basis risk, as represented by changes in the shape of the yield curve and changes in interest rate relationships. Management evaluates the effects on income of alternative interest rate scenarios against earnings in a stable interest rate environment. This analysis is also most useful in determining the short-run earnings exposures to changes in customer behavior involving loan payments and deposit additions and withdrawals.

The Bank s most recent simulation model projects net interest income would increase by approximately 6.47% of stable-rate net interest income if short-term rates affected by Federal Open Market Committee actions fall gradually by two percentage points over the next year, and decrease by approximately 6.86% if rates rise gradually by two percentage points. Both scenarios are well within ALCO s policy limit of a decrease in net interest income of no more than 10.0% given a 2.0% move in interest rates, up or down. Management believes this reflects a reasonable interest rate risk position. In year two, and assuming no additional movement in rates, the model forecasts that net interest income would be higher than that earned in a stable rate environment by 15.69% in a falling-rate scenario, and lower than that earned in a stable rate environment by 17.42% in a rising rate scenario, when compared to the year-one base scenario. A summary of the Bank s interest rate risk simulation modeling, as of March 31, 2007 is presented in the following table:

Changes in Net Interest Income	**2007**
Year 1	
Projected change if rates decrease by 2.0%	+6.47%
Projected change if rates increase by 2.0%	-6.86%
Year 2	
Projected change if rates decrease by 2.0%	+15.69%
Projected change if rates increase by 2.0%	-17.42%

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

The information for static gap and changes in net interest income presented in this section pertains to the Bank only and does not include goodwill and a small volume of assets and liabilities owned by the Company and included in its consolidated financial statements as of March 31, 2007. This sensitivity analysis does not represent a Company forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions including, among others, the nature and timing of interest rate levels, yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, and reinvestment/ replacement of asset and liability cash flows. While assumptions are developed based upon current economic and local market conditions, the Company cannot make any assurances as to the predictive nature of these assumptions, including how customer preferences or competitor influences might change.

Interest Rate Risk Management

A variety of financial instruments can be used to manage interest rate sensitivity. These may include investment securities, interest rate swaps, and interest rate caps and floors. Frequently called interest rate derivatives, interest rate swaps, caps and floors have characteristics similar to securities but possess the advantages of customization of the risk-reward profile of the instrument, minimization of balance sheet leverage and improvement of liquidity. As of March 31, 2007, the Company was using interest rate caps for interest rate risk management.

The Company engages an independent consultant to periodically review its interest rate risk position, as well as the effectiveness of simulation modeling and reasonableness of assumptions used. As of March 31, 2007, there were no significant differences between the views of the independent consultant and Management regarding the Company s interest rate risk exposure. Management expects interest rates will remain stable for the next two quarters and believes that the current level of interest rate risk is acceptable.

Item 4: Controls and Procedures

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as of March 31, 2007, the end of the quarter covered by this report, the Company carried out an evaluation under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures. In designing and evaluating the Company s disclosure controls and procedures, the Company and its management recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and the Company s management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective at the reasonable assurance level to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission s rules and forms. There was no change in the Company s internal control over financial reporting that occurred during the quarter ended March 31, 2007 that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting. The Company reviews its disclosure controls and procedures, which may include its internal controls over financial reporting on an ongoing basis, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that the Company s systems evolve with its business.

Part II Other Information

Item 1 Legal Proceedings

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

Item 1A Risk Factors

There have been no material changes to the Risk Factors previously disclosed in Item 1A of the Company s Annual Report on Form 10-K for the period ended December 31, 2006.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

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

Month	**Shares**	**Average Price**	**Proceeds**
January 2007	1,191	$16.61	$20,000
February 2007	1,381	16.54	22,000
March 2007	776	16.19	13,000
Total	3,348	$16.48	$55,000

b. None

c. On July 21, 2006, the Company announced that its Board of Directors had authorized a new program for the repurchase of up to 250,000 shares of the Company s common stock or approximately 2.5% of the outstanding shares. The Company expects such repurchases to be effected from time to time, in the open market, in private transactions or otherwise, during a period of up to 24 months. The amount and timing of shares to be purchased will be subject to market conditions and will be based on several factors, including the price of the Company s stock and the level of stock issuances under the Company s employee stock plans. No assurance can be given as to the specific timing of the share repurchases or as to whether and to what extent the share repurchase will be consummated. As of March 31, 2007, the Company had repurchased 113,704 shares under the new repurchase plan at an average price of $17.02 and at a total cost of $1,936,000. The following table details repurchases under this program during the three months ended March 31, 2007:

Month	**Total Number of**	**Average Price Paid Per Share**	**Total Number of Shares Purchased as Part of a Publicly Announced Plan or Progr**

	Shares Purchased		
January 2007	5,210	$16.49	5,210
February 2007	808	16.50	808
March 2007	650	16.31	650
Total	**6,668**	**$16.47**	**6,668**

Item 3 Default Upon Senior Securities

None.

Item 4 Submission of Matters to a Vote of Security Holders

None

Item 5 Other Information

A. None.

B. None.

Page 24

Item 6 Exhibits

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

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

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

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

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

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

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

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

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

Exhibit 10.4 Specimen Amendment to Employment Continuity Agreement entered into with Mr. Dalrymple, incorporated by reference to Exhibit 10.1 to the Company s Form 8-K filed under item 1.01 on September 27, 2005.

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

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

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

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

Signatures

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

FIRST NATIONAL LINCOLN CORPORATION

/s/ Daniel R. Daigneault

Daniel R. Daigneault

President & Chief Executive Officer

Date: May 10, 2007

/s/ F. Stephen Ward

F. Stephen Ward

Executive Vice President & Chief Financial Officer

Date: May 10, 2007