NORTHWAY FINANCIAL INC
Form 10-Q
November 07, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

(Mark One)
[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended September 30, 2005

OR

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ______________ to ______________

Commission File Number 000-23129

NORTHWAY FINANCIAL, INC
(Exact name of registrant as specified in its charter)

New Hampshire	04-3368579
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
9 Main Street Berlin, New Hampshire	03570
(Address of principal executive offices)	(Zip Code)

(603) 752-1171
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last year)

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 twelve (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 ninety (90) days. YES [X] NO [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES [ ] NO [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date. At October 24, 2005, there were 1,497,174 shares of common stock outstanding, par value $1.00 per share.

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NORTHWAY FINANCIAL, INC.

PART I. FINANCIAL INFORMATION PAGE

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements.

NORTHWAY FINANCIAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	Sep. 30, 2005

	(Unaudited)
Assets:	
Cash and due from banks and interest bearing deposits	$ 15,419
Federal funds sold	15,660
Securities available-for-sale	101,571
Federal Home Loan Bank stock	5,541
Federal Reserve Bank stock	365
Loans held-for-sale	243
Loans, net before allowance for loan losses	461,481
Less: allowance for loan losses	5,210
Loans, net	456,271
Premises and equipment, net	13,149
Other real estate owned	25
Core deposit intangible	2,234
Goodwill	10,152
Other assets	10,645
Total assets	$ 631,275
Liabilities and stockholders' equity:	
Liabilities	
Interest bearing deposits	$ 383,124
Noninterest bearing deposits	79,205
Short-term borrowings	7,405
Long-term debt	105,620
Other liabilities	5,954
Total liabilities	581,308
Stockholders' equity	
Preferred stock, $1.00 par value; 1,000,000 shares authorized; none issued	--
Common stock, $1.00 par value; 9,000,000 shares authorized; 1,731,969 issued at September 30, 2005 and December 31, 2004 and 1,497,174 outstanding at September 30, 2005 and 1,503,574 outstanding at December 31, 2004	1,732
Surplus	2,064
Retained earnings	54,290
Treasury stock, at cost (234,795 shares at September 30, 2005 and 228,395 shares at December 31, 2004)	(6,330)
Accumulated other comprehensive loss, net of tax	(1,789)
Total stockholders' equity	49,967
Total liabilities and stockholders' equity	$ 631,275

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

NORTHWAY FINANCIAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(Dollars in thousands, except per share data)	Three Months Ended Sep. 30, 2005	2004	Nine Months Ended Sep. 30 2005	20

Interest and dividend income:				
Loans	$ 6,954	$ 6,655	$ 20,287	$ 19
Interest on debt securities:				
Taxable	947	809	2,946	2
Tax-exempt	58	32	126	
Dividends	85	65	236	
Federal funds sold	132	33	155	
Interest bearing deposits	1	1	2	
Total interest and dividend income	8,177	7,595	23,752	22
Interest expense:				
Deposits	1,094	793	2,758	2
Borrowed funds	1,248	1,074	3,548	3
Total interest expense	2,342	1,867	6,306	5
Net interest and dividend income	5,835	5,728	17,446	16
Provision for loan losses	--	120	75	
Net interest and dividend income after provision for loan losses	5,835	5,608	17,371	16
Noninterest income:				
Service charges and fees on deposit accounts	634	591	1,799	1
Securities gains, net	41	20	210	
Gain on sales of loans, net	112	319	214	
Other	550	513	1,396	1
Total noninterest income	1,337	1,443	3,619	4
Noninterest expense:				
Salaries and employee benefits	2,884	3,009	8,663	9
Office occupancy and equipment	1,131	908	3,060	2
Amortization of core deposit intangible	238	238	715	
Other	1,693	1,412	4,872	4
Total noninterest expense	5,946	5,567	17,310	16
Income before income tax expense	1,226	1,484	3,680	3
Income tax expense	349	507	1,076	1
Net income	$ 877	$ 977	$ 2,604	$ 2
Comprehensive net income	$ 180	$ 2,037	$ 1,506	$ 1
Per share data:				
Basic earnings per common share	$ 0.58	$ 0.65	$ 1.73	$
Earnings per common share assuming dilution	$ 0.58	$ 0.64	$ 1.72	$
Cash dividends declared	$ 0.18	$ 0.17	$ 0.53	$
Weighted average number of common shares, basic	1,503,904	1,499,574	1,504,997	1,499
Weighted average number of common shares, diluted	1,512,501	1,509,419	1,514,195	1,511

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

NORTHWAY FINANCIAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

For the

(Dollars in thousands)	Ended 2005
Cash flows from operating activities:	
Net income	$ 2,604
Adjustments to reconcile net income to net cash provided by operating activities:	
Provision for loan losses	75
Depreciation and amortization	1,806
Securities gains, net	(210
Loss on sale, disposal and write-down of premises and equipment	2
Amortization of premiums and accretion of discounts on securities, net	38
Decrease in unearned income, net	(204
Amortization of discount on loans acquired	107
Loss on sales of other real estate owned and other personal property, net	--
Decrease (increase) in loans held-for-sale	68
Net change in other assets and other liabilities	835
Net cash provided by operating activities	5,121
Cash flows from investing activities:	
Proceeds from sales of securities available-for-sale	4,690
Proceeds from maturities of securities available-for-sale	9,284
Purchases of securities available-for-sale	(14,390
Purchases of Federal Home Loan Bank stock	(26
Loan originations and principal collections, net	12,509
Recoveries of previously charged-off loans	236
Proceeds from sales of and payments received on other real estate owned	10
Proceeds from sales of and payments received on other personal property	359
Additions to premises and equipment	(541
Net cash provided by (used in) investing activities	12,131
Cash flows from financing activities:	
Net (decrease) increase in deposits	(13,030
Advances from FHLB	13,000
Repayment of FHLB Advances	(6,000
Net (decrease) increase in short-term borrowings	(3,863
Exercise of stock options, net of tax benefit	111
Purchase of treasury stock	(362
Cash dividends paid	(798
Net cash (used in) provided by financing activities	(10,942
Net increase (decrease) in cash and cash equivalents	6,310
Cash and cash equivalents at beginning of period	24,769
Cash and cash equivalents at end of period	$ 31,079
Supplemental disclosure of cash flows:	
Interest paid	$ 6,034
Taxes paid	$ 934
Loans transferred to other real estate owned	$ 35
Loans transferred to other personal property	$ 473
Amount due to broker for pending securities purchases	$ 1,666

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

NORTHWAY FINANCIAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2005
(Unaudited)

1. Basis of Presentation

The unaudited condensed consolidated financial statements of Northway Financial, Inc. and its wholly-owned subsidiaries, The Berlin City Bank and The Pemigewasset National Bank of Plymouth, New Hampshire (collectively, "the Company") included herein have been prepared by the Company in accordance with the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted in accordance with such rules and regulations. The Company, however, believes that the disclosures are adequate to make the information presented not misleading. The amounts shown reflect, in the opinion of management, all adjustments necessary for a fair presentation of the financial statements for the periods reported.

The results of operations for the three month and nine month periods ended September 30, 2005 and 2004 are not necessarily indicative of the results of operations to be expected for the full year or any other interim periods. The interim financial statements are meant to be read in conjunction with the Company's audited financial statements presented in its Annual Report on Form 10-K for the fiscal year ended December 31, 2004.

In preparing financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the balance sheet and revenues and expenses for the reported periods. Actual results could differ from these estimates. The Company believes that the most critical accounting policies, which are those that are most important to the portrayal of the Company's financial condition and result of operations and require management's most difficult, subjective and complex judgments, relate to the determination of the allowance for loan losses, the impairment analysis of goodwill and core deposit intangibles, determination of the expense and liability related to the Company's pension plan, and determination of mortgage servicing rights.

The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

2 Stock-Based Compensation

As of September 30, 2005, the Company has a stock-based employee compensation plan which is described more fully in its Annual Report on Form 10-K for the fiscal year ended December 31, 2004. The Company accounts for this plan under the recognition and measurement principles of the Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under this plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 (revised 2004) ("SFAS 123R"), Share Based Payment, to stock-based employee compensation.

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		Three Month Ended Sep. 3 2005	2004
Net income	As reported	$ 877	$ 977
Deduct: Total stock-based employee compensation expense determined under fair value based methods awards, net of related tax effects		--	--
	Pro forma	$ 877	$ 977
Earnings per common share	As reported	$ 0.58	$ 0.65
	Pro forma	$ 0.58	$ 0.65
Earnings per common share (assuming dilution)	As reported	$ 0.58	$ 0.64
	Pro forma	$ 0.58	$ 0.64

3. Impact of New Accounting Standards.

In January 2003, the Financial Accounting Standards Board ("the FASB") issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), in an effort to expand upon and strengthen existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. In December 2003, the FASB revised Interpretation No. 46, also referred to as Interpretation 46 (R) ("FIN 46(R)"). The objective of this interpretation is not to restrict the use of variable interest entities but to improve financial reporting by companies involved with variable interest entities. Until now, one company generally has included another entity in its consolidated financial statements only if it controlled the entity through voting interests. This interpretation changes that approach, by requiring a variable interest entity to be consolidated by a company only if that company is subject to a majority of the risk of loss from the variable interest entity's activities, or entitled to receive a majority of the entity's residual returns, or both. The Company is required to apply FIN 46(R) to all entities subject to it no later than the end of the first fiscal year or interim period ending after March 15, 2004. However, prior to the required application of FIN 46(R) the Company shall apply FIN 46 or FIN 46(R) to those entities that are considered to be special-purpose entities as of the end of the first reporting period ending after December 15, 2003. The adoption of this interpretation did not have a material effect on the Company's consolidated financial statements.

In December 2003, the American Institute of Certified Public Accountants ("AICPA") issued Statement of Position 03-3 ("SOP 03-3") "Accounting for Certain Loans or Debt Securities Acquired in a Transfer." SOP 03-3 requires loans acquired through a transfer, such as a business combination, where there are differences in expected cash flows and contractual cash flows due in part to credit quality be recognized at their fair value. The excess of contractual cash flows over expected cash flows is not to be recognized as an adjustment of yield, loss accrual, or valuation allowance. Valuation allowances cannot be created nor "carried over" in the initial accounting for loans acquired in a transfer on loans subject to SFAS 114, "Accounting by Creditors for Impairment of a Loan." This SOP is effective for loans acquired in fiscal years beginning after December 15, 2004, with early adoption encouraged. The Company does not believe the adoption of SOP 03-3 will have a material impact on the Company's financial position or results of operations.

In December 2004, the FASB issued SFAS No. 123R. SFAS No 123R revises FASB Statement No. 123, "Accounting for Stock Based Compensation" and supersedes APB

Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS 123R requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. It establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair-value based measurement method in accounting for share-based payment transactions with employees except for equity instruments held by employee share ownership plans. SFAS 123R was effective for the Company as of the beginning of the first interim or annual reporting period that began after June 15, 2005. However, since the issuance of SFAS 123R, the SEC has delayed the effective date. The new effective date for the Company is January 1, 2006. The Company does not believe the adoption of this Statement will have a material impact on the Company's financial position or results of operations.

4. Pension Benefits.

The following summarizes the net periodic benefit cost for the three months and nine months ended September 30:

	(Dollars in Thousands)			
	Three Months Ended Sep. 30,		Nine Months Ended Sep. 30,	
	2005	2004	2005	2004
Service cost	$ 135	$ 120	$ 403	$ 356
Interest cost	86	75	258	227
Expected return on plan assets	(91)	(72)	(273)	(216)
Amortization of prior service cost	(21)	(21)	(63)	(63)
Recognized net actuarial loss	34	33	102	106
Net periodic benefit cost	$ 143	$ 135	$ 427	$ 410

The Company previously disclosed in its consolidated financial statements for the year ended December 31, 2004 that it expected pension plan contributions to be $745,000 in 2005. During the first quarter 2005, the Company contributed $295,000 to the pension plan and anticipates contributing an additional $450,000 on or about December 31, 2005.

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

The following discussion and analysis and the related condensed consolidated financial statements relate to the Company.

Forward-Looking Statements

Certain statements in this Form 10-Q are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements can be identified by the use of the words "expect," "believe," "estimate," "will" and other expressions which predict or indicate future trends and which do not relate to historical matters. Forward-looking statements may include, but are not limited to, expectations regarding the impact on net income of merging the two banks, withdrawing from the indirect automobile lending line of business, projections of revenue, income or loss, expectations for impact of new products on noninterest income and expense, and plans related to products or services of the Company. Such forward-looking statements are subject to known and unknown risks, uncertainties and contingencies, many of which are beyond the control of the Company. The Company's actual results could differ materially from those projected in the forward-looking statements as the result of, among other factors, changes in interest rates, changes in the securities or financial markets, a deterioration in general economic conditions on a national basis or in the local markets in which the Company operates, including changes in local business conditions resulting in rising unemployment and other circumstances which adversely affect borrowers' ability to service and repay our loans, changes in loan defaults and charge-off rates, reduction in deposit levels necessitating increased borrowing to fund loans and investments, the passing of adverse government regulation, changes in assumptions used in making such forward-looking statements, as well as those factors set forth in the Company's Annual Report on Form 10-K for the year ending December 31, 2004, and in the Company's other filings with the Securities & Exchange Commission. These forward-looking statements were based on information, plans and estimates at the date of this Form 10-Q, and the Company does not promise to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.

Bank Consolidation

On October 1, 2005, the Company completed the consolidation of its two subsidiary banks, The Berlin City Bank and The Pemigewasset National Bank of Plymouth, New Hampshire, and a name change to Northway Bank. Both banks had been affiliated since the creation of Northway Financial, Inc. in 1997. They had been sharing technological resources, support functions, products and services, and administrative support. This consolidation will allow Northway Bank to provide a higher level of service to our customer base through our 20 banking offices spread throughout northern and central New Hampshire. We will continue to provide our customers with uninterrupted high quality service. The merger, which was an internal corporate reorganization, was designed to strengthen the Company's marketing initiatives under a unified name and logo and is also expected to result in cost savings through, for example, elimination of duplicative governmental filings and certain back-office expenses.

Financial Condition

The Company's total assets at September 30, 2005 were $631,275,000 compared to $638,418,000 at December 31, 2004, a decrease of $7,143,000. Net loans, including loans held-for-sale, decreased $13,299,000 to $456,514,000. This was due primarily to a decrease in indirect consumer loans, the result of our decision to exit this line of business effective during the third quarter of 2004. The decrease in indirect consumer loans was partially offset by increases in residential mortgage loans, commercial real estate, commercial and direct consumer loans.

Deposits decreased $13,030,000 to $462,329,000 from $475,359,000 at December 31, 2004 due to a decrease in all deposit categories except time deposits. Short-term borrowings decreased $3,863,000 due to a decrease in securities sold under agreements to repurchase. Long-term Federal Home Loan Bank advances increased $7,000,000 to $85,000,000 from $78,000,000 at December 31, 2004 due to four new advances during the year totaling $13,000,000 and ranging in term from one to three years with an average interest rate of 3.05%, which was partially offset by the maturity of $6,000,000 in advances. Total stockholders' equity increased $457,000 to $49,967,000 at September 30, 2005 from $49,510,000 at December 31, 2004 due primarily to net income of $2,604,000 which was partially offset by the recording of an additional comprehensive loss associated with securities available-for-sale of $1,098,000, treasury stock purchases of $362,000 and dividends paid of $798,000.

The Company maintains an allowance for loan losses to absorb charge-offs of loans in the existing portfolio. The allowance is increased when a loan loss provision is recorded as an expense. When a loan, or portion thereof, is considered uncollectible, it is charged against this allowance. Recoveries of amounts previously charged-off are added to the allowance when collected.

Allowance for loan losses are estimated at the individual banks based on estimates of losses related to customer loan balances. In establishing the appropriate provisions for customer loan balances, the Company makes assumptions with respect to their future collectibility. The Company's assumptions are based on an individual assessment of the customer's credit quality as well as subjective factors and trends, including the credit rating of the loans. Generally, these individual credit assessments occur prior to the inception of the credit exposure and at regular reviews during the life of the exposure and consider (a) the customer's ability to meet and sustain their financial commitments; (b) a customer's current and projected financial condition; (c) the positive or negative effects of the current and projected industry outlook; and (d) the economy in general. Once the Company considers all of these factors, a determination is made as to the probability of default. An appropriate provision is made, which takes into account the severity of the likely loss on the outstanding loan balances based on the Company's experience in collecting these amounts. The Company's level of allowance for loan losses fluctuates depending upon all of the factors mentioned above.

At September 30, 2005 the allowance for loan losses was $5,210,000, or 1.13% of total loans, compared to $5,204,000, or 1.10% of total loans at December 31, 2004. The composition of the allowance for loan losses for the three month and nine month periods ended September 30, 2005 and 2004 is as follows:

	Three Months Ended Sep. 30,		Nine Months Ended Sep.30,	
(Dollars in thousands)	2005	2004	2005	2004
Balance at beginning of period	$5,278	$5,053	$5,204	$5,036
Charge-offs	(119)	(147)	(305)	(503)
Recoveries	51	181	236	284
Net (charge-offs) recoveries	(68)	34	(69)	(219)
Provision for loan losses	--	120	75	390
Balance at end of period	$5,210	$5,207	$5,210	$5,207

Nonperforming loans totaled $3,050,000 as of September 30, 2005, compared to $2,867,000 at December 31, 2004. The ratio of nonperforming loans to loans net of unearned income was 0.66% as of September 30, 2005, compared to 0.60% at December 31, 2004. Nonperforming assets, which include nonperforming loans, other real estate owned and other chattels owned, totaled $3,271,000 as of September 30, 2005, compared to $2,949,000 at December 31, 2004. The ratio of nonperforming assets to total assets was 0.52% as of September 30, 2005, compared to 0.46% at December 31, 2004.

Results of Operations

The Company reported net income of $877,000, or $0.58 per common share (basic), for the three months ended September 30, 2005, compared to $977,000, or $0.65 per common share (basic), for the three months ended September 30, 2004, a decrease of $100,000, or 10%. Net income for the nine months ended September 30, 2005 was $2,604,000, or $1.73 per common share (basic), compared to $2,454,000, or $1.64 per common share (basic), for the nine months ended September 30, 2004, an increase of $150,000, or 6%.

Net interest and dividend income for the third quarter increased $107,000 to $5,835,000 compared to $5,728,000 for the third quarter of 2004. Net interest and dividend income for the nine months ended September 30, 2005 increased

$476,000, or 2.8%, to $17,446,000 compared to $16,970,000 for the same period last year. The quarter-to-date and the year-to-date increase was the result of an increase of 11 basis points in the net interest margin. The improvement in the margin is primarily the result of redeploying amortization from the indirect automobile line of business into higher yielding residential mortgage loans and commercial loans.

There was no provision for loan losses for the third quarter of 2005, compared to $120,000 for the third quarter of last year. For the nine months ended September 30, 2005, the provision for loan losses was $75,000, a decrease of $315,000 from the $390,000 reported for the same period last year. The provision for loan losses is based upon a review of the adequacy of the allowance for loan losses, which is conducted on a quarterly basis. This review includes consideration of, among other factors, the Company's loan loss experience and takes into account the Company's decision to terminate indirect auto lending. This review is based upon many factors including the risk characteristics of the portfolio, trends in loan delinquencies, and an assessment of existing economic conditions. In addition, various regulatory agencies, as part of their examination process, review the banks' allowances for loan losses and such review may result in changes to the allowance based on judgments different from those of management.

Noninterest income decreased $106,000 to $1,337,000 in the third quarter of 2005 compared to $1,443,000 in the third quarter of 2004. For the quarter ended September 30, 2005, service charges and fees on deposit accounts increased $43,000 compared to the third quarter of 2004. Net securities gains increased $21,000 in the third quarter of 2005 compared to the third quarter of 2004. Gains on sales of loans decreased $207,000 due primarily to the recognition of gains associated with the sale of a pool of commercial loans guaranteed by the Small Business Administration in 2004. In the third quarter, other noninterest income increased $37,000 to $550,000 compared to $513,000 for the same period a year ago. Noninterest income for the nine months ended September 30, 2005 decreased $384,000 to $3,619,000 compared to $4,003,000 for the same period last year. For the nine months ended September 30, 2005, service charges and fees on deposit accounts increased $156,000 due to increases in overdraft fee income principally the result of the Bounce ProtectionTM program. Net securities gains for the nine months ended September 30, 2005 were $210,000, a decrease of $530,000 from the $740,000 reported for the same period a year ago. Gains on sales of loans for the nine months ended September 30, 2005 decreased $188,000 over one year ago, again as a result of the recording of gains associated with the sale of a pool of commercial loans during 2004. Other noninterest income for the nine months ended September 30, 2005 increased $178,000 due primarily to the recording of commissions on alternative investment products.

Noninterest expense increased $379,000 to $5,946,000 for the quarter ended September 30, 2005, compared to the $5,567,000 recorded during the same period last year. Salaries and employee benefits decreased $125,000 to $2,884,000 for the third quarter of 2005 compared to $3,009,000 for the third quarter 2004. This decrease was due primarily to both a decrease in salaries expense and an increase in deferred loan origination costs related to SFAS No. 91, "Accounting for Nonrefundable Fees and Costs Associated with Origination and Acquiring Loans and Initial Direct Cost of Leases" ("SFAS 91"), which has the effect of reducing salary expense, which was partially offset by a higher level of health and dental insurance and profit sharing expense. Office occupancy and equipment expense increased $223,000 to $1,131,000 for the third quarter 2005 compared to $908,000 for the same period last year. This increase is due primarily to signage expense of $129,000 related to the merger as well as $91,000 in write-down of leasehold improvements associated with the decision to close two supermarket branches in December 2005. Other noninterest expense increased $281,000 to $1,693,000 for the third quarter of 2005 compared to $1,412,000 for the same period last year. The Company incurred one-time merger-related expenses of $346,000 during the third quarter of 2005 associated primarily with advertising, professional fees, legal fees, and stationery and office supplies. These expenses were partially offset by a decrease in both insurance expense and miscellaneous expense associated with consumer rebates on indirect installment loans.

For the nine months ended September 30, 2005 noninterest expense totaled $17,310,000, an increase of $433,000 over the same period last year. Included in noninterest expense for 2005 is approximately $150,000 of one-time expenses associated with moving the Company's proof and item processing and data processing to the Berlin facility. In addition, the Company incurred $542,000 during the nine months ended September 30, 2005 in one-time merger-related expenses associated primarily with advertising, professional fees, legal fees, signage and stationery and office supplies. Additional merger-related expenses relating to professional fees, advertising, legal fees, and stationery and office supplies of approximately $325,000 are expected to be incurred in the fourth quarter of 2005.

For the nine months ended September 30, 2005, salaries and employee benefits decreased $433,000 to $8,663,000 compared to $9,096,000 for the same period a year ago. The decrease was due primarily to three factors: i) a decrease in salaries expense and the related payroll taxes and benefits, ii) a decrease in the expense relating to the liability of deferred compensation on a Supplemental Employee Retirement Plan, and iii) an increase in deferred loan origination costs related to SFAS No. 91, which has the effect of reducing salary expense. Office occupancy and equipment expense increased $302,000 to $3,060,000 for the nine months ended September 30, 2005 compared to $2,758,000 for the same period last year. This expense includes $129,000 of merger related expenses associated with signage as well as $91,000 of one-time expenses associated with the write-down of leasehold improvements associated with the pending closure of two supermarket branches in December 2005. Other noninterest expense increased $564,000 over the prior year. This increase was primarily the result of the one-time expenses associated with moving proof and item processing and data processing as well as the one-time merger related expenses. Excluding these one-time expenses, other noninterest expense declined approximately $40,000 when compared to one year ago. This is due primarily to a decrease in insurance, shareholder reporting, and home equity closing costs, partially offset by increases in legal expense, repossession and other real estate owned expense, telecommunications and contributions.

Comprehensive Net Income

Comprehensive income includes net income plus or minus other items required to be reported directly in the equity section of the balance sheet without having been recognized in the determination of net income. These other components include the unrealized holding gains and losses on available-for-sale securities and any adjustments recognized in accordance with the Company's accounting for pensions as an additional liability not yet recognized as net periodic benefit costs.

The Company reported comprehensive net income of $180,000 for the quarter ended September 30, 2005, compared to comprehensive net income of $2,037,000 for the quarter ended September 30, 2004. For the nine months ended September 30, 2005, comprehensive net income was $1,506,000 compared to comprehensive net income of $1,757,000 for the nine months ended September 30, 2004.

For the quarter ended September 30, 2005, the Company increased its unrealized loss on available-for-sale securities by $697,000, net of tax. When deducted from the quarterly net income of $877,000 the result is a comprehensive net income of $180,000. For the quarter ended September 30, 2004, the Company decreased its unrealized loss on available-for-sale securities by $1,060,000. When added to the quarterly net income of $977,000, the result is a comprehensive net income of $2,037,000.

For the nine months ended September 30, 2005, the Company increased its unrealized loss on available-for-sale securities by $1,098,000, net of tax. When deducted from net income year-to-date of $2,604,000 the result is a comprehensive net income of $1,506,000. For the nine months ended September 30, 2004, the Company increased its unrealized loss on available-for-sale securities by $697,000. When deducted from year-to-date income of $2,454,000, the result is a comprehensive net income of $1,757,000.

The primary factor contributing to the unrealized gain or loss on available-for-sale securities is the interest rate environment at the time of the valuation and the impact of the downgrade of two bond holdings that continue to perform. In accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", the negative adjustment to comprehensive income of $1,098,000 for the nine months ended September 30, 2005 is not expected to impact net income as the Company has the ability and intent to hold available-for-sale securities until cost recovery occurs.

Income Tax Expense

The Company recognized income tax expense of $349,000 and $507,000 for the three months ended September 30, 2005 and 2004, respectively. The effective tax rates were 28.5% and 34.2% for those respective periods. The effective tax rate for 2005 is positively impacted by the fact that several contributions were made which provided tax credits to the Company due to the 75% state tax exemption.

The Company recognized income tax expense of $1,076,000 and $1,252,000 for the nine months ended September 30, 2005 and 2004, respectively. The effective tax rates were 29.2% and 33.8% for those respective periods. The effective tax rate for 2005 is positively impacted by the fact that several contributions in excess of $100,000 in the aggregate were made which provided tax credits to the Company due to the 75% state tax exemption.

Liquidity

Liquidity risk management refers to the Company's ability to raise funds in order to meet existing and anticipated financial obligations. These obligations to make payment include withdrawal of deposits on demand or at their contractual maturity, the repayment of borrowings as they mature, funding new and existing loan commitments as well as new business opportunities. Liquidity may be provided through amortization, maturity or sale of assets such as loans and securities available-for-sale, liability sources such as increased deposits, utilization of the Federal Home Loan Bank ("FHLB") credit facility, purchased or other borrowed funds, and access to the capital markets. Liquidity targets are subject to change based on economic and market conditions and are controlled and monitored by the Company's Asset/Liability Committee.

At the subsidiary bank level, liquidity is managed by measuring the net amount of marketable assets, after deducting pledged assets, plus lines of credit, primarily with the FHLB, that are available to fund liquidity requirements. Management then measures the adequacy of that aggregate amount relative to the aggregate amount of liabilities deemed to be sensitive or volatile. These include core deposits in excess of $100,000, term deposits with short maturities, and credit commitments outstanding.

Additionally, Northway Financial, Inc. requires cash for various operating needs, including dividends to shareholders, the stock repurchase program, capital injections to the subsidiary banks, and the payment of general corporate expenses. The primary sources of liquidity for Northway Financial, Inc. are dividends from its subsidiary banks and reimbursement for services performed on behalf of the banks.

Management believes that the Company's current level of liquidity and funds available from outside sources is sufficient to meet the Company's needs.

Capital

The Company's Tier 1 and Total Risk Based Capital ratios were 12.86% and 15.05%, respectively, at September 30, 2005. The Company's Tier 1 leverage ratio at September 30, 2005 was 8.86%. As of September 30, 2005, the capital ratios of the Company and the subsidiary banks exceeded the minimum capital ratio requirements of the "well-capitalized" category under the Federal Deposit Insurance Corporation Improvement Act of 1991.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Since December 31, 2004, there have been no material changes in the Company's quantitative and qualitative disclosures about market risk. A fuller description of the quantitative and qualitative disclosures about market risk was provided by the Company on pages 24 and 25 of Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004, and is incorporated by reference as Exhibit 19 of this report.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Company's management conducted an evaluation with the participation of the Company's Chief Executive Officer and Chief Financial Officer, regarding the effectiveness of the Company's disclosure controls and procedures, as of the end of the last fiscal quarter. 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 a reasonable assurance of achieving the desired control objectives, and 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 they believe the Company's disclosure controls and procedures are reasonably effective 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. We intend to continue to review and document our disclosure controls and procedures, including our internal controls and procedures for financial reporting, and we may from time to time make changes to the disclosure controls and procedures to enhance their effectiveness and to ensure that our systems evolve with our business.

(b) Changes in internal controls.

There were no changes in the Company's internal controls over financial reporting identified in connection with the Company's evaluation of its disclosure controls and procedures that occurred during the Company's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings - None

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds - None

Item 3. Defaults Upon Senior Securities - None

Item 4. Submission of Matters to a Vote of Security Holders - None

Item 5. Other Information - None

Item 6. Exhibits

Exhibit Number	Description of Exhibit
2.1	Amended and Restated Bank Merger Agreement and Contract for Union. (incorporated by reference to Exhibit 2.1 to the Company's Quarterly Report of Form 10-Q for the quarter ended June 30, 2005).
3.1	Amended and Restated Articles of Incorporation of Northway Financial, Inc. (incorporated by reference to Exhibit 3.1 to Registration Statement No. 333-33033).
3.2	By-laws of Northway Financial, Inc (incorporated by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997).
4	Form of Certificate representing the Company Common Stock (reference is also made to Exhibits 3.1 and 3.2) (incorporated by reference to Exhibit 4 to Registration Statement No. 333-33033).
10.1	Employment Agreement for William J. Woodward (incorporated by reference to Exhibit 10.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997).
10.2	Employment Agreement for Fletcher W. Adams (incorporated by reference to Exhibit 10.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997).
10.3	Amendment to the Employment Agreement for William J. Woodward. (incorporated by reference to Exhibit 10.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 1998).
10.4	Amendment to the Employment Agreement for Fletcher W. Adams. (incorporated by reference to Exhibit 10.4 to the Company's Annual Report on Form 10-K for the year ended December 31, 1998).
10.5	Northway Financial, Inc. 1999 Stock Option and Grant Plan (incorporated by reference to Exhibit 4.1 to Registration Statement No. 333-83571 dated July 23,1999).
10.7	Form of Key Employee Agreement (incorporated by reference to Exhibit 10.8 to the Company's Annual Report on Form 10-K for the year ended 1999).
10.8	Supplemental Executive Retirement Plan. (incorporated by reference to Exhibit 10.8 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003).
11	Statement re computation of per Share Earnings
19	Company's quantitative and qualitative disclosure about market risk as discussed in the Company's Annual Report of Form 10-K for the fiscal year ended December 31, 2004.

31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to 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.

NORTHWAY FINANCIAL, INC.

November 4, 2005

BY:/S/William J. Woodward

William J. Woodward
President & CEO
(Principal Executive Officer)

November 4, 2005

BY:/S/Richard P. Orsillo

Richard P. Orsillo
Senior Vice President & CFO
(Principal Financial and Accounting Officer)

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