NORTHWAY FINANCIAL INC
Form 10-Q
August 09, 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 June 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)

No Change
(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 July 22, 2005, there were 1,505,574 shares of common stock outstanding, par value $1.00 per share.

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NORTHWAY FINANCIAL, INC.

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements.

NORTHWAY FINANCIAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	June 30, 2005 (Unaudited
Assets:	
Cash and due from banks and interest bearing deposits	$ 18,509
Federal funds sold	7,055
Securities available-for-sale	101,559
Federal Home Loan Bank stock	5,541
Federal Reserve Bank stock	365
Loans held-for-sale	400
Loans, net before allowance for loan losses	464,811
Less: allowance for loan losses	5,278
Loans, net	459,533
Premises and equipment, net	13,475
Core deposit intangible	2,472
Goodwill	10,152
Other assets	10,164
Total assets	$629,225
Liabilities and stockholders' equity:	
Liabilities	
Interest bearing deposits	$383,696
Noninterest bearing deposits	78,341
Short-term borrowings	7,187
Long-term debt	105,620
Other liabilities	4,026
Total liabilities	578,870
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 June 30, 2005 and December 31, 2004 and 1,505,574 outstanding at June 30, 2005 and 1,503,574 outstanding at December 31, 2004	1,732
Surplus	2,064
Retained earnings	53,684
Treasury stock, at cost (226,395 shares at June 30, 2005 and 228,395 shares at December 31, 2004)	(6,033
Accumulated other comprehensive loss, net of tax	(1,092
Total stockholders' equity	50,355
Total liabilities and stockholders' equity	$629,225

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 June 30, 2005	2004	Si End 2005
Interest and dividend income:			
Loans	$6,628	$ 6,641	$13,3
Interest on debt securities:			
Taxable	990	825	1,9
Tax-exempt	38	34	
Dividends	78	58	1
Federal funds sold	7	13	
Interest bearing deposits	1	-	
Total interest and dividend income	7,742	7,571	15,5
Interest expense:			
Deposits	853	743	1,6
Borrowed funds	1,215	1,130	2,3
Total interest expense	2,068	1,873	3,9
Net interest and dividend income	5,674	5,698	11,6
Provision for loan losses	-	120	
Net interest and dividend income after provision for loan losses	5,674	5,578	11,5
Noninterest income:			
Service charges and fees on deposit accounts	625	607	1,1
Securities gains, net	98	261	1
Gain on sales of loans, net	53	44	1
Other	519	352	8
Total noninterest income	1,295	1,264	2,2
Noninterest expense:			
Salaries and employee benefits	2,896	3,087	5,7
Office occupancy and equipment	957	888	1,9
Amortization of core deposit intangible	239	239	4
Other	1,660	1,488	3,1
Total noninterest expense	5,752	5,702	11,3
Income before income tax expense	1,217	1,140	2,4
Income tax expense	313	392	7
Net income	$ 904	$ 748	$ 1,7
Comprehensive net income (loss)	$1,436	$(1,023)	$ 1,3

Per share data:			
Basic earnings per common share	$ 0.60	$ 0.50$	1.
Earnings per common share assuming dilution	$ 0.60	$ 0.49$	1.
Cash dividends declared	$ 0.18	$ 0.17	$ 0.
Weighted average number of common shares	1,507,069	1,499,574	1,505,5

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

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

	F
(Dollars in thousands)	
Cash flows from operating activities:	
Net income	$ 1
Adjustments to reconcile net income to net cash provided by operating activities:	
Provision for loan losses	
Depreciation and amortization	1
Gains on sales of securities available-for-sale, net	
Loss on sale, disposal and write-down of premises and equipment	
Amortization of premiums and accretion of discounts on securities, net	
Decrease in unearned income, net	
Amortization of discount on loans acquired	
Loss on sales of other real estate owned and other personal property, net	
Increase in loans held-for-sale	
Net change in other assets and other liabilities	
Net cash provided by operating activities	3
Cash flows from investing activities:	
Proceeds from sales of securities available-for-sale	4
Proceeds from maturities of securities available-for-sale	6
Purchases of securities available-for-sale	(11
Purchases of Federal Home Loan Bank stock	
Loan originations and principal collections, net	9
Recoveries of previously charged-off loans	
Proceeds from sales of and payments received on other real estate owned	
Proceeds from sales of and payments received on other personal property	
Additions to premises and equipment	
Net cash provided by (used by) investing activities	8
Cash flows from financing activities:	
Net (decrease) increase in deposits	(13
Advances from FHLB	13
Repayment of FHLB Advances	(6
Net increase in overnight FHLB Advances	
Net decrease in securities sold under agreements to repurchase	(4
Exercise of stock options, net of tax benefit	
Purchase of treasury stock	
Cash dividends paid	
Net cash (used in) provided by financing activities	(10

Net increase (decrease) in cash and cash equivalents	
Cash and cash equivalents at beginning of period	24
Cash and cash equivalents at end of period	$ 25
Supplemental disclosure of cash flows:	
Interest paid	$ 3
Taxes paid	$
Loans transferred to other real estate owned	$
Loans transferred to other personal property	$

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

NORTHWAY FINANCIAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 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 six month periods ended June 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 June 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.

		($000 Omitt Three Month Ended June 3 2005	 2004
Net income	As reported	$ 904	$
Deduct: Total stock-based employee compensation expense determined under fair value based methods awards, net of related tax effects		-	
	Pro forma	$ 904	$
Earnings per common share	As reported	$0.60	$
	Pro forma	$0.60	$
Earnings per common share (assuming dilution)	As reported	$0.60	$
	Pro forma	$0.60	$

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 FASB issued SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits - an amendment of SFAS No. 87, SFAS No. 88 and SFAS No. 106" ("SFAS No. 132 (revised 2003)"). SFAS No. 132 (revised 2003) revises employers' disclosures about pension plans and other postretirement benefit plans. It does not change the measurement or recognition of those plans required by SFAS No. 87, "Employers' Accounting for Pensions," SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits," and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." This Statement retains the disclosure requirements contained in SFAS No. 132, "Employers' Disclosures About Pensions and Other Postretirement Benefits," which it replaces. SFAS No. 132 (revised 2003) requires additional disclosures to those in the original SFAS No. 132 about assets, obligations, cash flows and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. SFAS No. 132 (revised 2003) is effective for financial statements with fiscal years ending after December 15, 2003 and interim periods beginning after December 15, 2003. Adoption of SFAS No. 132 (revised 2003) did not have a material impact 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 six months ended June 30:

	Three Months Ended June 30, 2005	2004	S 2005
Service cost	$134	$118	$268
Interest cost	86	76	172
Expected return on plan assets	(91)	(72)	(182)
Amortization of prior service cost	(21)	(21)	(42)
Recognized net actuarial loss	34	32	68
Amortization of transition asset	-		-
Special recognition of prior service costs	-	-	-
Net periodic benefit cost	$142	$133	$284

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 May 31, 2005, the Company announced 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 have been affiliated since the creation of Northway Financial, Inc. in 1997. They have 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 is an internal corporate reorganization, is designed to strengthen the Registrant's and its subsidiaries' 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. The consolidation has been approved by the Federal Deposit Insurance Corporation and is expected to be consummated on or about October 1, 2005, subject to final approval by the New Hampahire Banking Department.

Financial Condition

The Company's total assets at June 30, 2005 were $629,225,000 compared to $638,418,000 at December 31, 2004, a decrease of $9,193,000. Net loans, including loans held-for-sale, decreased $9,880,000 to $459,933,000. 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 $13,322,000 to $462,037,000 from $475,359,000 at December 31, 2004 due to a decrease in all deposit categories except time deposits. Short-term borrowings decreased $4,081,000 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, totaling $13,000,000, during the year 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 $845,000 to $50,355,000 at June 30, 2005 from $49,510,000 at December 31, 2004 due primarily to net income of $1,727,000 which was partially offset by the recording of an additional comprehensive loss associated with securities available-for-sale of $401,000 as well as dividends paid of $527,000.

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 June 30, 2005 the allowance for loan losses was $5,278,000, or 1.14% 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 six month periods ended June 30, 2005 and 2004 is as follows:

Three Months June 30, (Dollars in thousands)	2005	2004	Six Months Ended Ended June 30, 2005	2004
Balance at beginning of period	$5,312	$5,057	$5,204	$5,036
Charge-offs	(95)	(162)	(186)	(356)
Recoveries	61	38	185	103
Net charge-offs	(34)	(124)	(1)	(253)
Provision for loan losses	-	120	75	270
Balance at end of period	$5,278	$5,053	$5,278	$5,053

Nonperforming loans totaled $3,163,000 as of June 30, 2005, compared to $2,867,000 at December 31, 2004. The ratio of nonperforming loans to loans net of unearned income was 0.68% as of June 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 $3,325,000 as of June 30, 2005, compared to $2,949,000 at December 31, 2004. The ratio of nonperforming assets to total assets was 0.53% as of June 30, 2005, compared to 0.46% at December 31, 2004.

Results of Operations

The Company reported net income of $904,000, or $0.60 per common share (basic), for the three months ended June 30, 2005, compared to $748,000, or $0.50 per common share (basic), for the three months ended June 30, 2004, an increase of $156,000, or 21%. Net income for the six months ended June 30, 2005 was $1,727,000, or $1.15 per common share (basic), compared to $1,477,000, or $0.99 per common share (basic), for the six months ended June 30, 2004, an increase of $250,000, or 17%.

Net interest and dividend income for the second quarter decreased $24,000 to $5,674,000 compared to $5,698,000 for the second quarter of 2004. Net interest and dividend income for the six months ended June 30, 2005 increased $369,000, or 3.3%, to $11,611,000 compared to $11,242,000 for the same period last year. The year-to-date increase was the result of an increase of 10 basis points in the net interest margin as well as a $6,507,000 increase in average earning assets. These improvements were due in part to the fact that during the second quarter of 2004, the Company deployed a leverage strategy which resulted in an increase in mortgage backed securities of $20,000,000, which was funded by intermediate term FHLB advances at an attractive spread. Further, amortization from the indirect automobile line of business was redeployed into higher yielding residential mortgage loans and commercial loans.

There was no provision for loan losses for the second quarter of 2005, compared to $120,000 for the second quarter of last year. For the six months ended June 30, 2005, the provision for loan losses was $75,000, a decrease of $195,000 from the $270,000 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 increased $31,000 to $1,295,000 in the second quarter of 2005 compared to $1,264,000 in the second quarter of 2004. Service charges and fees on deposit accounts increased $18,000. Net securities gains decreased $163,000 in the second quarter of 2005 compared to the second quarter of 2004. Gains on sales of loans increased $9,000. Other noninterest income increased $167,000 to $519,000 compared to $352,000 for the same period a year ago due primarily to the recording of a gain on the cash surrender value of life insurance of $83,000 compared to a loss of $49,000 for the same period last year. Further, the commission on alternative investment products increased $68,000 to $72,000 compared to $4,000 for the same period a year ago. Noninterest income for the six months ended June 30, 2005 decreased $278,000 to $2,282,000 compared to $2,560,000 for the same period last year. Service charges and fees on deposit accounts increased $113,000 due to increases in overdraft fee income principally the result of the Bounce ProtectionTM program. Net securities gains for the six months ended June 30, 2005 were $169,000, a decrease of $551,000 from the $720,000 reported for the same period a year ago. Gains on sales of loans increased $19,000 over one year ago. Other noninterest income increased $141,000 due primarily to the recording of commissions on alternative investment products.

Noninterest expense increased $50,000 to $5,752,000 for the quarter ended June 30, 2005, compared to the $5,702,000 recorded during the same period last year. Salaries and employee benefits decreased $191,000 to $2,896,000 for the second quarter of 2005 compared to $3,087,000 for the second quarter 2004. This decrease was due primarily to both a decrease in the expense relating to the liability of deferred compensation on a Supplemental Employee Retirement Plan 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. Office occupancy and equipment expense increased $69,000 to $957,000 for the second quarter 2005 compared to $888,000 for the same period last year. Other noninterest expense increased $172,000 to $1,660,000 for the second quarter of 2005 compared to $1,488,000 for the same period last year due primarily to increases in legal expense, repossession expense and contributions.

For the six months ended June 30, 2005 noninterest expense totaled $11,364,000, an increase of $54,000 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. This move will streamline back room operations. For the six months ended June 30, 2005, salaries and employee benefits decreased $308,000 to $5,779,000 compared to $6,087,000 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 91, which has the effect of reducing salary expense. Office occupancy and equipment expense increased $79,000 to $1,929,000 for the six months ended June 30, 2005 compared to $1,850,000 for the same period last year. Other noninterest expense increased $283,000 over the prior year due in large part to the one-time expenses associated with moving proof and item processing and data processing. In addition, the Company recorded increases in legal expense, repossession and other real estate owned expense and contributions.

Comprehensive Income/(Loss)

The Company reported comprehensive net income of $1,436,000 for the quarter ended June 30, 2005, compared to a comprehensive net loss of $1,023,000 for the quarter ended June 30, 2004. For the six months ended June 30, 2005, comprehensive net income was $1,326,000 compared to a comprehensive net loss of $280,000 for the six months ended June 30, 2004. 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.

For the quarter ended June 30, 2005, the Company decreased its unrealized loss on available-for-sale securities by $532,000, net of tax. When added to the quarterly net income of $904,000 the result is a comprehensive net income of $1,436,000. For the quarter ended June 30, 2004, the Company increased its unrealized loss on available-for-sale securities by $1,771,000. When deducted from the quarterly net income of $748,000, the result is a comprehensive net loss of $1,023,000.

For the six months ended June 30, 2005, the Company increased its unrealized loss on available-for-sale securities by $401,000, net of tax. When deducted from net income year-to-date of $1,727,000 the result is a comprehensive net income of $1,326,000. For the six months ended June 30, 2004, the Company increased its unrealized loss on available-for-sale securities by $1,757,000. When deducted from year-to-date income of $1,477,000, the result is a comprehensive net loss of $280,000.

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. In accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", the negative adjustment to comprehensive income of $401,000 for the six months ended June 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 $727,000 and $745,000 for the six months ended June 30, 2005 and 2004, respectively. The effective tax rates were 29.6% and 33.5% 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 12.65% and 14.81%, respectively, at June 30, 2005. The Company's Tier 1 leverage ratio at June 30, 2005 was 9.04%. As of June 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

The Company's Annual Meeting of Stockholders was held on May 31, 2005. At the Annual Meeting, the stockholders elected Stephen G. Boucher, Barry J. Kelley and Randall G. Labnon to three-year terms as directors. Each of these directors' terms will expire at the 2008 annual meeting. The final vote for each of these elected directors is as follows:

	For	Withheld
Stephen G. Boucher	1,239,939	30,772
Barry J. Kelley	1,241,595	29,116
Randall G. Labnon	1,241,739	28,972

The directors continuing in office are Frederick C. Anderson, Brien L. Ward, Fletcher W. Adams, Arnold P. Hanson, Jr., John H. Noyes and William J. Woodward.

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.
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.

August 4, 2005 BY: /S/William J. Woodward

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

August 4, 2005 BY: /S/Richard P. Orsillo

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

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