NORTHWAY FINANCIAL INC
Form 10-Q
August 13, 2001

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, 2001
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 report)

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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date. At August 1, 2001, there were 1,514,780 shares of common stock outstanding, par value $1.00 per share.

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PART I. FINANCIAL INFORMATION PAGE

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements.

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

(Dollars in thousands, except per share data)	Three Months Ended June 30, 2001	2000	Six Ende 20
Interest and dividend income:			
Loans	$8,002	$8,206	$16,

Interest on debt securities:			
Taxable	462	740	1,
Tax exempt	125	62	
Dividends	89	111	
Federal funds sold	94	5	
Interest bearing deposits	1	3	
Total interest and dividend income	8,773	9,127	17,
Interest expense:			
Deposits	3,005	2,584	6,
Borrowed funds	706	1,420	1,
Total interest expense	3,711	4,004	7,
Net interest and dividend income	5,062	5,123	10,
Provision for loan losses	225	255	
Net interest and dividend income after provision for loan losses	4,837	4,868	9,
Noninterest income:			
Service charges on deposit accounts and fees	311	245	
Securities gains, net	63	156	
Other	411	259	
Total noninterest income	785	660	1,
Noninterest expense:			
Salaries and employee benefits	2,239	2,186	4,
Office occupancy and equipment	714	641	1,
Amortization of deposit assumption premium	175	102	
Other	1,145	1,152	2,
Total noninterest expense	4,273	4,081	8,
Income before income tax expense	1,349	1,447	2,
Income tax expense	413	435	
Net income	$ 936	$1,012	$ 1,
Comprehensive net income	$ 904	$ 966	$ 2,
Per share data:			
Earnings per common share	$ 0.62	$ 0.64	$ 1
Cash dividends declared	$ 0.17	$ 0.15	$ 0
Weighted average number of common shares	1,520,525	1,598,618	1,530,

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

NORTHWAY FINANCIAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)	Jun. 30, 2001	Dec. 31, 2000
	(Unaudited)	
Assets		
Cash and due from banks and interest bearing deposits	14,822	$ 15,401
Federal funds sold	11,930	-
Investment securities available-for-sale	46,417	55,712

Investment securities held-to-maturity	-	2,752
Loans held-for-sale	2,650	229
Loans, net before allowance for loan losses	393,121	393,258
Allowance for loan losses	(4,486)	(4,354)
Loans, net	388,635	388,904
Other real estate owned	55	25
Accrued interest receivable	2,443	2,842
Deferred income tax asset, net	1,851	1,901
Premises and equipment, net	11,284	11,000
Deposit assumption premium	4,748	5,098
Other assets	1,966	1,280
Total assets	$486,801	$485,144
Liabilities and stockholders' equity		
Liabilities:		
Interest bearing deposits	$325,992	$335,027
Noninterest bearing deposits	56,537	56,745
Securities sold under agreements to repurchase	10,328	9,390
Short-term Federal Home Loan Bank advances	4,528	2,950
Long-term Federal Home Loan Bank advances	45,000	35,528
Other liabilities	2,413	3,942
Total liabilities	444,798	443,582
Stockholders' equity:		
Preferred stock, $1 par value; 1,000,000 shares authorized; none issued	-	-
Common stock, $1 par value; 9,000,000 shares authorized; 1,731,969 shares issued June 30, 2001 and December 31, 2000; and 1,515,740 outstanding June 30, 2001 and 1,559,369 outstanding December 31, 2000	1,732	1,732
Additional paid-in-capital	2,101	2,101
Retained earnings	44,527	43,110
Treasury stock, at cost (216,229 and 172,600 shares, respectively)	(5,760)	(4,708)
Accumulated other comprehensive income (loss), net of tax	(597)	(673)
Total stockholders' equity	42,003	41,562
Total liabilities and stockholders' equity	$486,801	$485,144

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

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

(Dollars in thousands)	For the Six Months Ended June 30, 2001	2000
Cash flows from operating activities:		
Net income	$ 1,938	$ 2,016
Adjustments to reconcile net income to net cash provided by operating activities:		

Provision for loan losses	450	500
Depreciation and amortization	869	697
Deferred income taxes	-	(149)
Write down of real estate acquired by foreclosure	3	-
Gains on sales of investment securities available-for-sale, net	(95)	(276)
Amortization of premiums & accretion of discounts on securities, net	11	25
Increase (decrease) in unearned income, net	1	(130)
(Gains) losses on sales of real estate acquired by foreclosure	(9)	16
Net increase in loans held for sale	(1,699)	(211)
Net change in other assets and other liabilities	(1,626)	(81)
Net cash (used) provided by operating activities	(157)	2,407
Cash flows from investing activities:		
Proceeds from sales of investment securities available-for-sale	4,118	1,351
Proceeds from maturities of investment securities held-to-maturity	-	1,363
Proceeds from maturities of investment securities available-for-sale	28,880	2,569
Purchase of investment securities available-for-sale	(20,965)	(2,709)
Purchase of investment securities held-to-maturity	-	(855)
Net increase in loans	(1,205)	(24,563)
Proceeds from sales of real estate acquired by foreclosure	15	75
Proceeds from sales of and payments received on other personal property	296	250
Additions to premises and equipment	(803)	(291)
Net cash provided (used) by investing activities	10,336	(22,810)
Cash flows from financing activities:		
Net increase (decrease) in deposits	(9,243)	9,385
Advances from Federal Home Loan Bank	14,000	19,000
Repayment of Federal Home Loan Bank advances	-	(23,000)
Net (decrease) increase in short-term Federal Home Loan Bank advances	(2,950)	16,800
Net increase in securities sold under agreements to repurchase	938	986
Purchases of treasury stock	(1,052)	(608)
Cash dividends paid	(521)	(482)
Net cash provided by financing activities	1,172	22,081
Net increase in cash and cash equivalents	11,351	1,678
Cash and cash equivalents at beginning of period	15,401	16,087
Cash and cash equivalents at end of period	$26,752	$17,765

Continued....

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

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

(Dollars in thousands)	For the Six Months Ended June 30, 2001	2000
Cash paid during the period for:		
Interest	$9,081	$7,528
Income taxes	$ 983	$ 756
Supplemental disclosures of non-cash activities:		
Loans transferred to real estate owned	$ 33	$ --
Loans transferred to other personal property	$ 270	$ 315
Loans transferred to held-for-sale	$ 722	$ --
Available-for-sale securities transferred to other assets	$ 225	$ --
Carrying amount of held-to-maturity securities transferred to available-for-sale	$2,738	$ --
Long-term Federal Home Loan Bank advances transferred to short-term Federal Home Loan Bank advances	$4,528	$ --

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

NORTHWAY FINANCIAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2001
(Unaudited)

1. Basis of Presentation.

The unaudited condensed consolidated financial statements of Northway Financial, Inc. and its two wholly owned bank subsidiaries (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 generally accepted accounting principles 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 and six month periods ended June 30, 2001 and 2000 are not necessarily indicative of the results of operations to be expected for the full year or any other interim periods.

The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles in the United States of America.

2. Impact of New Accounting Standard.

In June 1998, the FASB issued Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, effective for fiscal years beginning after June 15, 2000. This Statement establishes accounting and reporting standards for derivative instruments and hedging activities, including certain derivative instruments embedded in other contracts, and requires that an entity recognize all derivatives as assets or liabilities in the balance sheet and measure them at fair value. If certain conditions are met, an entity may elect to designate a derivative as follows: (1) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (2) a hedge of the exposure to variable cash flows of a forecasted transaction, or (3) a hedge of the foreign currency exposure of an unrecognized firm commitment, an available-for-sale security, a foreign currency denominated forecasted transaction, or a net investment in a foreign operation. The Statement generally provides for matching the timing of the recognition of the gain or loss on derivatives designated as hedging instruments with the recognition of the changes in the fair value of the item being hedged. Depending on the type of hedge, such recognition will be either net income or other comprehensive income. For a derivative not designated as a hedging instrument, changes in fair value will be recognized in net income in the period of change. Management adopted this pronouncement on January 1, 2001. Statement No. 133 allows for a one-time change in the classification of securities in the investment portfolio. In conjunction with the adoption of Statement No. 133, the Company transferred all securities held-to-maturity to the available-for-sale category at their market value of $2,731,000 as of January 1, 2001. In connection with the transfer, the Company recorded in comprehensive income an unrealized holding loss of approximately $13,000, net of tax effect. Under Statement No. 133, this transfer will not call into question the Company's intent to hold other debt securities to maturity in the future. The adoption of this Statement has had no other material impact on the consolidated financial statements.

The FASB has issued Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This Statement replaces Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, and rescinds Statement No. 127, Deferral of the Effective Date of Certain Provisions of FASB Statement No. 125. Statement No. 140 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. This Statement provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings. This Statement is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001; however, the disclosure provisions are effective for fiscal years ending after December 15, 2000. The adoption of this Statement has had no material impact on the consolidated financial statements.

The FASB has issued Statement No. 141, Business Combinations. This Statement improves the consistency of the accounting and reporting of business combinations by requiring that all business combinations be accounted for under a single method - the purchase method. Use of the pooling-of-interests method is no longer permitted. Statement No. 141 requires that the purchase method be used for business combinations initiated after June 30, 2001. Management is currently evaluating the impact of adopting this Statement on the consolidated financial statements, but to date has not determined the impact.

The FASB has issued Statement No. 142, Goodwill and Other Intangible Assets. Statement 142 requires that goodwill no longer be amortized to earnings, but instead be reviewed for impairment. The amortization of goodwill ceases upon adoption of the statement, which for most companies, will be January 1, 2002. Management is currently evaluating the impact of adopting this Statement on the consolidated financial statements, but to date has not determined the impact.

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

The following discussion and analysis and related consolidated financial statements include Northway Financial, Inc. and its wholly-owned subsidiaries, The Berlin City Bank and Pemigewasset National Bank (collectively, the "Company").

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 may include, but are not limited to, projections of revenue, income or loss, plans for future operations and acquisitions, and plans related to products or services of the Company and its subsidiaries. Such forward-looking statements are subject to known and unknown risks, uncertainties and contingencies, many of which are beyond the control of the Company. To the extent any such risks, uncertainties and contingencies are realized, the Company's actual results, performance or achievements could differ materially from anticipated results, performance or achievements. Factors that might affect such forward-looking statements include, among other things, overall economic and business conditions, interest rate fluctuations, the demand for the Company's products and services, competitive factors in the industries in which the Company competes, changes in government regulations, and the timing, impact and other uncertainties of future acquisitions.

In addition to the factors described above, the following are some additional factors that could cause our financial performance to differ from any forward-looking statement contained herein; a) the change in interest rates over the past year and expected changes in interest rates during the remainder of the year 2001; b) a change in product mix attributable to changing interest rates, customer preferences or competition; c) a significant portion of the Company's loan customers are in the hospitality business and therefore could be affected by weather conditions and/or high gasoline prices; and d) the effectiveness of advertising, marketing and promotional programs.

The words "believe," "expect," "anticipate," "intend," "estimate," "project," and other expressions which are predictions of or indicate future events and trends and which do not relate to historical matters identify forward-looking statements. Reliance should not be placed on forward-looking statements because they involve known or unknown risks, uncertainties or other factors, which may cause the actual results, performance or achievements of the Company to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. The Company undertakes no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Although the Company has attempted to list comprehensively the factors which might affect forward-looking statements, the Company wishes to caution investors that other factors may in the future prove to be important in affecting the Company's results of operations. New factors emerge from time to time and it is not possible for management to anticipate all of such factors, nor can it assess the impact of each such factor, or combination of factors, which may cause actual results to differ materially from forward-looking statements.

Financial Condition

The Company's total assets at June 30, 2001 were $486.8 million compared to $485.1 million at December 31, 2000, a $1.7 million increase. Net loans, including loans held for sale, increased $2.2 million to $391.3 million and investment securities decreased $12.0 million to $46.4 million. Cash and cash equivalents increased $11.4 million to $26.8 million as a result of the increase in federal funds sold balances. Total deposits decreased $9.2 million, while Federal Home Loan Bank advances increased $11.1 million and repurchase agreements increased $0.9 million. Total stockholders' equity increased $0.4 million from $41.6 million at December 31, 2000 to $42.0 million at June 30, 2001. The increase in stockholders' equity was a result of net income of $1.9 million partially offset by dividends of $0.5 million and treasury stock purchases totaling $1.1 million.

The Company maintains an allowance for loan losses to absorb future chargeoffs of loans in the existing portfolio. The allowance is increased when a loan loss provision is recorded in the income statement. 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. At June 30, 2001 the allowance for loan losses was $4.5 million, or 1.13% of total loans, as compared to $4.4 million, or 1.11% of total loans at December 31, 2000. The adequacy of the allowance for loan losses was based on an evaluation by each bank's management and Board of Directors of current and anticipated economic conditions, changes in the diversification, size and risk within the loan portfolio, and other factors. An analysis of the allowance for loan losses for the three and six month periods ended June 30, 2001 and 2000 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2001	2000	2001	2000
Balance at beginning of period	$4,460	$4,115	$4,354	$4,887
Charge-offs	(218)	(173)	(379)	(1,360)
Recoveries	19	23	61	193
Net charge-offs	(199)	(150)	(318)	(1,167)
Provision for loan losses	225	255	450	500
Balance at end of period	$4,486	$4,220	$4,486	$4,220

Nonperforming loans totaled $1.1 million as of June 30, 2001, compared to $1.0 million at December 31, 2000. The ratio of nonperforming loans to total loans was 0.28% as of June 30, 2001 compared to 0.24% at December 31, 2000 and the ratio of nonperforming assets to total assets was 0.25% as of June 30, 2001 compared to 0.22% at December 31, 2000.

Results of Operations

The Company reported net income of $0.9 million, or $0.62 per share, for the three months ended June 30, 2001, versus $1.0 million, or $0.64 per share, for the three months ended June 30, 2000. The decrease in net income is primarily a result of an increase in noninterest expense. Net income for the six months ended June 30, 2001 was $1.9 million, or $1.27 per share, as compared to $2.0 million, or $1.26 per share, for the six months ended June 30, 2000, such increase per share resulting from the Company's ongoing stock repurchase program.

Net interest and dividend income for the second quarter of $5.1 million matched the $5.1 million of the second quarter of the prior year. For the six months ended June 30, 2001 net interest and dividend income decreased $0.2 million to $10.2 million as compared to $10.4 million for the same period of the prior year due to rapid declines in the prime rate.

Due to the low level of problem loans, the provision for loan losses decreased $30 thousand to $225 thousand for the three months ended June 30, 2001 compared to $255 thousand for the same quarter a year ago and decreased $50 thousand to $450 thousand for the six months ended June 30, 2001 compared to $500 thousand for the same period a year ago.

Noninterest income increased $125 thousand to $785 thousand in the second quarter of 2001 versus $660 thousand in the second quarter of 2000. For the six months ended June 30, 2001 noninterest income increased $160 thousand to $1.4 million as compared to $1.2 million for the same period of the prior year. In each case, the increase was primarily due to increased deposit service charges and other income which offset a decrease in securities gains.

Noninterest expense increased $0.2 million to $4.3 million for the quarter ended June 30, 2001 compared to the $4.1 million recorded during the same period last year. For the six months ended June 30, 2001 noninterest expense totaled $8.3 million, an increase of $0.2 million over the $8.1 million recorded for the same period of the prior year. The increase was principally attributable to the acquisition of an additional branch since the second quarter of the prior year.

Income Tax Expense

The Company recognized income tax expense of $851 thousand and $973 thousand for the six months ended June 30, 2001 and 2000, respectively. The effective tax rate was 30.5% and 32.6% for those respective periods. The decrease in the effective tax rate is due to the fact that the Company has obtained a number of State of New Hampshire tax credits related to economic development grants and is carrying a higher proportion of tax exempt investments.

Liquidity

Liquidity risk management refers to the Company's ability to raise funds in order to meet their existing and anticipated financial obligations. These obligations are the withdrawal of deposits on demand or at their contractual maturity, the repayment of borrowings as they mature, the ability to fund new and existing loan commitments and the ability to take advantage of 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 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, which 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 liabilities. These include core deposits in excess of $100,000, term deposits with short maturities, and credit commitments outstanding.

Additionally, the parent holding company 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 source of liquidity for the parent holding company is dividends from the subsidiary banks.

The Company's current level of liquidity and funds availability from outside sources are sufficient to meet the Company's needs. The Company, however, has been successful in its efforts to increase its lending capabilities and may need to identify additional sources of liquidity as the loan portfolio builds.

Capital

The Company's Tier 1 and Total Risk Based Capital ratios were 9.99% and 11.20%, respectively, at June 30, 2001. The Company's leverage ratio at June 30, 2001 was 7.86%.

As of June 30, 2001, the capital ratios of the Company and all its subsidiary banks exceeded the minimum capital ratio requirements of the "well capitalized" category under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA).

Branch Acquisition

On June 11, 2001, the Berlin City Bank (BCB) signed a purchase and sale agreement with the Bank of New Hampshire (BNH) which will result in the acquisition of the BNH branch in Littleton, New Hampshire. Deposit levels at that branch totaled approximately $32.7 million as of April 11, 2001. In addition, BCB will purchase certain loans associated with the branch totaling approximately $2.2 million. The purchase is scheduled to close on October 26, 2001.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Since December 31, 2000, there have been no material changes in the Company's quantitative and qualitative disclosures about market risk. A more full description of the quantitative and qualitative disclosures about market risk was provided by the Company on pages 8 through 18 of the Company's 2000 Annual Report to Stockholders filed as Exhibit 13 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings - None

Item 2. Changes in Securities - 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 15, 2001. At the Annual Meeting, the stockholders elected Fletcher W. Adams, Arnold P. Hanson, Jr., John H. Noyes and William J. Woodward to three year terms as directors expiring at the 2004 annual meeting. The final vote for each of these elected directors is as follows:

	For	Withheld

Fletcher W. Adams	1,177,706	14,229
Arnold P. Hanson, Jr.	1,177,290	14,645
John H. Noyes	1,177,706	14,229
William J. Woodward	1,176,938	14,997

Directors continuing in office are Peter H. Bornstein, Stephen G. Boucher, Charles H. Clifford, Jr., Barry J. Kelley, Bruce W. Keogh, Randall G. Labnon and John D. Morris.

Item 5. Other Information - None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits - None

(b) The Company did not file any Reports on Form 8-K during the quarter ended June 30, 2001.

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 13, 2001 BY: \S\ William J. Woodward

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

August 13, 2001 BY: \S\ George L. Fredette

George L. Fredette
Senior Vice President & CFO
(Principal Financial and Accounting Officer)