NORTHWAY FINANCIAL INC
Form 10-Q
November 09, 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 September 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 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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date. At October 30, 2001, there were 1,511,628 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 STATEMENTS OF INCOME
(Unaudited)

(Dollars in thousands, except per share data)	Three Months Ended September 30, 2001	2000
Interest and dividend income:		
Loans	$7,854	$8,531
Interest on debt securities		
Taxable	454	721
Tax exempt	122	63
Dividends	79	128
Federal funds sold	208	265

Interest bearing deposits	1	5
Total interest and dividend income	8,718	9,713
Interest expense:		
Deposits	2,655	3,032
Borrowed funds	784	1,268
Total interest expense	3,439	4,300
Net interest and dividend income	5,279	5,413
Provision for loan losses	225	255
Net interest and dividend income after provision for loan losses	5,054	5,158
Noninterest income:		
Service charges on deposit accounts and fees	270	266
Securities gains, net	33	138
Other	497	314
Total noninterest income	800	718
Noninterest expense:		
Salaries and employee benefits	2,299	2,353
Office occupancy and equipment	675	677
Amortization of deposit purchase premium	128	134
Other	1,183	1,143
Total noninterest expense	4,285	4,307
Income before income tax expense	1,569	1,569
Income tax expense	470	537
Net income	$1,099	$1,032
Comprehensive net income	$ 957	$1,360
Per share data:		
Earnings per common share	$ 0.72	$ 0.65
Cash dividends declared	$ 0.17	$ 0.15
Weighted average number of common shares	1,513,264	1,586,134

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

NORTHWAY FINANCIAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	Sept. 30, 2001	Dec. 31, 2000
	(Unaudited)	
Assets		
Cash and due from banks and interest bearing deposits	$ 14,581	$ 15,401
Federal funds sold	23,450	--
Investment securities available-for-sale	49,003	55,712
Investment securities held-to-maturity	--	2,752
Loans held for sale	1,280	229
Loans	395,390	393,258
Allowance for loan losses	(4,576)	(4,354)

Loans, net	390,814	388,904
Real estate acquired by foreclosure	32	25
Accrued interest receivable	2,513	2,842
Deferred income tax asset, net	1,944	1,901
Premises and equipment, net	11,396	11,000
Deposit assumption premium	4,620	5,098
Other assets	2,104	1,280
Total assets	$501,737	$485,144
Liabilities and Stockholders' Equity		
Liabilities:		
Interest bearing deposits	$336,792	$335,027
Non-interest bearing deposits	60,479	56,745
Repurchase agreements	10,914	9,390
Short-term Federal Home Loan Bank advances	3,028	2,950
Long-term Federal Home Loan Bank advances	45,000	35,528
Other liabilities	2,909	3,942
Total liabilities	459,122	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 and 1,511,628 outstanding September 30, 2001 and 1,559,369 outstanding December 31, 2000	1,732	1,732
Additional paid-in-capital	2,101	2,101
Retained earnings	45,376	43,110
Treasury stock, at cost (220,341 and 172,600 shares, respectively)	(5,855)	(4,708)
Accumulated other comprehensive (loss) income, net of tax	(739)	(673)
Total stockholders' equity	42,615	41,562
Total liabilities and stockholders' equity	$501,737	$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)	Fo En 20
Cash flows from operating activities:	
Net income	$ 3
Adjustments to reconcile net income to net cash provided by operating activities:	
Provision for loan losses	
Depreciation and amortization	1
Deferred income taxes	
Write-down of real estate acquired by foreclosure	

Gains on sales of investment securities available-for-sale, net	
Amortization of premium & accretion of discounts on securities, net	
Increase (decrease) in unearned income, net	
(Gain) loss on sales of other real estate owned and other personal property, net	
Net increase in loans held for sale	
Net change in other assets and other liabilities	(1
Net cash provided by operating activities	2
Cash flows from investing activities:	
Proceeds from sales of investment securities available-for-sale	4
Proceeds from maturities of investment securities held-to-maturity	
Proceeds from maturities of investment securities available-for-sale	33
Purchase of investment securities available-for-sale	(28
Purchase of investment securities held-to-maturity	
Net increase in loans	(3
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	(1
Net cash provided (used) by investing activities	5
Cash flows from financing activities:	
Deposits assumed in branch transaction, net of assumption premium	
Net increase in deposits	5
Advances from Federal Home Loan Bank	14
Repayment of Federal Home Loan Bank advances	(1
Net (decrease) increase in short-term Federal Home Loan Bank advances	(2
Net increase in securities sold under agreements to repurchase	1
Purchases of treasury stock	(1
Cash dividends paid	
Net cash provided by financing activities	14
Net increase in cash and cash equivalents	22
Cash and cash equivalents at beginning of period	15
Cash and cash equivalents at end of period	$38

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

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

(Dollars in thousands)	For the Nine Months Ended September 30, 2001	2000
Cash paid during the period for:		
Interest	$12,670	$11,424
Income taxes	$ 1,024	$ 1,064
Supplemental disclosures of non-cash activities:		
Loans transferred to real estate owned	$ 33	$ 48

Loans transferred to other personal property	$ 402	$ 500
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
September 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 nine month periods ended September 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 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, 2000.

In preparing financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the reported period. Actual results could differ from these estimates. Material estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses.

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

2 Impact of New Accounting Standards.

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. The adoption of this Statement has had no material impact on the consolidated financial statements.

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 believes that adopting this Statement will have no significant impact of on the consolidated financial statements.

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, economic and business conditions in the Company's market areas, 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 current economic downturn nation-wide and regionally, as well as a deterioration of local business conditions, including termination of operations of a major employer in the primary market area of the Berlin City Bank, b) the change in interest rates over the past year and expected changes in interest rates during the remainder of the year 2001; c) a change in product mix attributable to changing interest rates, customer preferences or competition; d) 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 e) 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 September 30, 2001 were $501.7 million compared to $485.1 million at December 31, 2000, a $16.6 million increase. Net loans, including loans held for sale, increased $3.0 million to $392.1 million and investment securities decreased $9.5 million to $49.0 million. Cash and cash equivalents increased $22.6 million to $38.0 million as a result of a decrease in investment securities and an increase in deposit and debt balances. Deposits increased $5.5 million, Federal Home Loan Bank advances increased $9.6 million and repurchase agreements increased $1.5 million. Total stockholders' equity increased $1.0 million from $41.6 million at December 31, 2000 to $42.6 million at September 30, 2001. The increase in stockholders' equity was a result of net income of $3.0 million partially offset by an increased accumulated comprehensive loss of $0.1 million, dividends of $0.8 million and treasury stock purchases totaling $1.1 million.

The Company maintains an allowance for loan losses to absorb future 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. At September 30, 2001 the allowance for loan losses was $4.6 million, or 1.16% of total loans, compared to $4.4 million, or 1.11% of total loans at December 31, 2000. The allowance for loan losses is 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 month and nine month periods ended September 30, 2001 and 2000 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands)	2001	2000	2001	2000
Balance at beginning of period	$4,486	$4,220	$4,354	$4,887
Charge-offs	(175)	(199)	(554)	(1,559)
Recoveries	40	22	101	215
Net Charge-offs	(135)	(177)	(453)	(1,344)
Provision for loan losses	225	255	675	755
Balance at end of period	$4,576	$4,298	$4,576	$4,298

Nonperforming loans totaled $1.1 million as of September 30, 2001, compared to $1.0 million at December 31, 2000. The ratio of nonperforming loans to total loans was 0.27% as of September 30, 2001 compared to 0.24% at December 31, 2000 and the ratio of nonperforming assets to total assets was 0.23% as of September 30, 2001 compared to 0.22% at December 31, 2000.

Results of Operations

The Company reported net income of $1.10 million, or $0.72 per common share, for the three months ended September 30, 2001, compared to $1.03 million, or $0.65 per common share, for the three months ended September 30, 2000. The increase in net income for the quarter is primarily attributable to higher noninterest income and lower tax expense. Net interest and dividend income for the three months ended September 30, 2001 decreased $0.13 million to $5.28 million compared to $5.41 million for the third quarter of the prior year.

Net income for the nine months ended September 30, 2001 was $3.04 million, or $1.99 per common share, compared to $3.05 million, or $1.91 per share, for the nine months ended September 30, 2000. The decrease in net income is primarily a result of decreases in net interest and dividend income and an increase in operating expenses partially offset by increased noninterest income and lower taxes. For the nine months ended September 30, 2000 net interest and dividend income decreased $0.38 million to $15.44 million compared to $15.82 million for the same period of the prior year. The increase in net income per share is a result of a reduction of shares of common stock outstanding in connection with the Company's share repurchase program.

Noninterest income increased $0.08 million to $0.80 million in the third quarter of 2001 compared to $0.72 million in the third quarter of 2000. For the nine months ended September 30, 2001 noninterest income increased $0.24 million to $2.18 million compared to $1.94 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 decreased $0.02 million to $4.29 million for the quarter ended September 30, 2001 compared to the $4.31 million recorded during the same period last year. For the nine months ended September 30, 2001 noninterest expense totaled $12.59 million, an increase of $0.15 million over $12.44 million recorded for the same period of the prior year. The results for the third quarter of 2000 included expenses associated with the West Ossipee branch acquisition which did not recur in 2001 while the increase on a year-to-date basis was principally attributable to the acquisition of an additional branch during the third quarter of the prior year.

Income Tax Expense

The Company recognized income tax expense of $1.32 million and $1.51 million for the nine months ended September 30, 2001 and 2000, respectively. The effective tax rates were 30.3% and 33.1% for those respective periods. The decrease in the effective tax rate is due to the favorable effect of the Company's State of New Hampshire tax credits related to economic development grants and a higher proportion of tax exempt investments.

Liquidity

Liquidity risk management refers to the Company's and its subsidiaries' 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 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. 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 sources of liquidity for the parent holding company are dividends from the subsidiary banks.

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

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 resulted in the acquisition of the BNH branch in Littleton, New Hampshire on October 26, 2001. Deposit levels at that branch totaled approximately $28.7 million at acquisition. In addition, BCB purchased certain loans associated with the branch totaling approximately $2.6 million.

Capital

The Company's Tier 1 and Total Risk Based Capital ratios were 10.06% and 11.25%, respectively, at September 30, 2001. The Company's Tier 1 leverage ratio at September 30, 2001 was 7.68%. As of September 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). As a result of the above mentioned branch acquisition Total Risk Based Capital at BCB is anticipated to fall below the "well capitalized" level for a period of time.

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 - None

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 September 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.

November 9, 2001 BY: \S\ William J. Woodward

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

November 9, 2001 BY: \S\ George L. Fredette

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