NORTHWAY FINANCIAL INC
Form 10-Q
November 10, 2004

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

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

For the quarterly period ended September 30, 2004

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date. At October 22, 2004, there were 1,499,574 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)	Sep. 30, 2004	De
	(Unaudited)	
Assets:		
Cash and due from banks and interest bearing deposits	$ 15,555	$
Federal funds sold	3,225	
Securities available-for-sale	91,407	
Federal Home Loan Bank stock	5,515	
Federal Reserve Bank stock	365	
Loans held-for-sale	532	
Loans, net before allowance for loan losses	483,526	4
Less: allowance for loan losses	5,207	
Loans, net	478,319	4
Premises and equipment, net	13,884	
Core deposit intangible	3,188	
Goodwill	10,152	
Other assets	9,001	
Total assets	$631,143	$6
Liabilities and Stockholders' Equity:		
Liabilities		
Interest bearing deposits	$384,680	$3
Noninterest bearing deposits	81,183	
Short-term borrowings	10,635	
Long-term debt	98,620	
Other liabilities	7,161	
Total liabilities	582,279	5
Stockholders' equity		
Preferred stock, $1.00 par value; 1,000,000 shares authorized; none issued	-	
Common stock, $1.00 par value; 9,000,000 shares authorized; 1,731,969 issued at September 30, 2004 and December 31, 2003 and 1,499,574 outstanding at September 30, 2004 and December 31, 2003	1,732	
Surplus	2,088	
Retained earnings	51,805	
Treasury stock, at cost (232,395 shares at September 30, 2004 and December 31, 2003)	(6,213)	
Accumulated other comprehensive (loss) income, net of tax	(548)	
Total stockholders' equity	48,864	
Total liabilities and stockholders' equity	$631,143	$6

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

NORTHWAY FINANCIAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Dollars in thousands, except per share data)	Three Months Ended Sep. 30, 2004	2003	N En 2004
Interest and dividend income:			
Loans	$6,655	$6,814	$19,
Interest on debt securities:			
Taxable	809	744	2,
Tax-exempt	32	41	
Dividends	65	59	
Federal funds sold	33	54	
Interest bearing deposits	1	1	
Total interest and dividend income	7,595	7,713	22,
Interest expense:			
Deposits	793	1,057	2,
Borrowed funds	1,074	1,027	3,
Total interest expense	1,867	2,084	5,
Net interest and dividend income	5,728	5,629	16,
Provision for loan losses	120	210	
Net interest and dividend income after provision for loan losses	5,608	5,419	16,
Noninterest income:			
Service charges and fees on deposit accounts	591	404	1,
Securities gains, net	20	614	
Gain on sales of loans, net	319	143	
Other	513	562	1,
Total noninterest income	1,443	1,723	4,
Noninterest expense:			
Salaries and employee benefits	3,009	2,861	9,
Office occupancy and equipment	908	894	2,
Amortization of core deposit intangible	238	238	
Write-down of equity securities	-	65	
Other	1,412	1,548	4,
Total noninterest expense	5,567	5,606	16,
Income before income tax expense	1,484	1,536	3,
Income tax expense	507	558	1,
Net income	$ 977	$ 978	$ 2,
Comprehensive net income	$ 2,037	$ 141	$ 1,

Per share data:			
Earnings per common share	$ 0.65	$ 0.65	$ 1
Earnings per common share (fully diluted)	$ 0.64	$ 0.65	$ 1
Cash dividends declared	$ 0.17	$ 0.17	$ 0
Weighted average number of common shares, basic	1,499,574	1,502,563	1,499,
Weighted average number of common shares, diluted	1,509,419	1,509,503	1,511,

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

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

(Dollars in thousands)	For t En 2
Cash flows from operating activities:	
Net income	$ 2
Adjustments to reconcile net income to net cash provided by operating activities:	
Provision for loan losses	
Depreciation and amortization	1
Write-down of equity securities	
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) increase in unearned income, net	
Amortization of discount on loans acquired	
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	5
Cash flows from investing activities:	
Proceeds from sales of securities available-for-sale	16
Proceeds from maturities of securities available-for-sale	18
Purchases of securities available-for-sale	(55
Purchases of Federal Home Loan Bank stock	
Purchases of Federal Reserve Bank stock	
Loan originations and principal collections, net	(10
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	(2
Net cash used in investing activities	(33
Cash flows from financing activities:	
Net increase (decrease) in deposits	2
Advances from FHLB	20
Repayment of FHLB Advances	(9
Net increase in securities sold under agreements to repurchase	3
Purchases of treasury stock	
Cash dividends paid	
Net cash provided by financing activities	16

Net (decrease) increase in cash and cash equivalents	(12
Cash and cash equivalents at beginning of period	31
Cash and cash equivalents at end of period	$ 18
Supplemental disclosure of cash flows:	
Interest paid	$ 5
Taxes paid	$ 1
Loans transferred to other real estate owned	$
Loans transferred to other personal property	$
Amount due to broker for pending securities purchases	$ 3

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

NORTHWAY FINANCIAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2004
(Unaudited)

1. Basis of Presentation.

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

The results of operations for the three month and nine month periods ended September 30, 2004 and 2003 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, 2003.

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

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

2 Stock-Based Compensation

As of September 30, 2004, 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, 2003. 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 ("SFAS") No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

		($000 Omitt Three Month Ended Sep. 3 2004	2003
Net income	As reported	$ 977	$
Deduct: Total stock-based employee compensation expense determined under fair value based methods awards, net of related tax effects		-	
	Pro forma	$ 977	$
Earnings per common share	As reported	$0.65	$
	Pro forma	$0.65	$
Earnings per common share (fully diluted)	As reported	$0.64	$
	Pro forma	$0.64	$

3. Impact of New Accounting Standards.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 elaborates on the disclosure to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. FIN 45 clarifies that a guarantor is required to disclose (a) the nature of the guarantee; (b) the maximum potential amount of future payments under the guarantee; (c) the carrying amount of the liability; (d) the nature and extent of any recourse provisions or available collateral that would enable the guarantor to recover the amounts paid under the guarantee.

The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after

December 31, 2002. The disclosure requirements in FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002. The Company adopted the initial recognition and initial measurement provisions of FIN 45 effective as of January 1, 2003 and adopted the disclosure requirements effective as of December 31, 2002. The adoption of this interpretation did not have a material effect on the Company's financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement No. 133 on Derivative Instruments and Hedging Activities" ("SFAS No. 149"), which amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." This Statement (a) clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative, (b) clarifies when a derivative contains a financing component, (c) amends the definition of an underlying to conform to language used in FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," and (d) amends certain other existing pronouncements. The provisions of SFAS No. 149 are effective for contracts entered into or modified after June 30, 2003. There was no substantial impact on the Company's consolidated financial statements on adoption of this Statement.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS No. 150"). This Statement establishes standards for the classification and measurement of certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that certain financial instruments that were previously classified as equity must be classified as a liability. Most of the guidance in SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. This Statement did not have any material effect on the Company's consolidated financial statements.

In January 2003, 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, 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, as revised, 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, as revised, 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)"). This Statement 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. It requires additional disclosures to those in the original Statement 132 about assets, obligations, cash flows and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. This Statement is effective for financial statements with fiscal years ending after December 15, 2003 and interim periods beginning after December 15, 2003. Adoption of this Statement 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.

4. Pension Benefits.

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

	($000 Omitted)		
	Three Months Ended September 30,		Ni
	2004	2003	2004
Service cost	$120	$110	$356
Interest cost	75	68	227
Expected return on plan assets	(72)	(56)	(216)
Amortization of prior service cost	(21)	(21)	(63)
Recognized net actuarial loss	33	52	106
Amortization of transition asset	-	(1)	-
Special recognition of prior service costs	-	-	-
Net periodic benefit cost	$135	$152	$410

The Company previously disclosed in its consolidated financial statements for the year ended December 31, 2003 that it expected pension plan contributions to be $430,000 in 2004. During the first nine months of 2004, there were no cash contributions to the pension plan. The Company anticipates contributing $430,000 to fund its pension plan on December 31, 2004.

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

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The following discussion and analysis and the related condensed consolidated financial statements relate to Northway Financial, Inc. and its wholly-owned subsidiaries, The Berlin City Bank, and The Pemigewasset National Bank of Plymouth, New Hampshire (collectively, 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 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, 2003, 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.

Exit from Indirect Automobile Lending Line of Business.

The Company announced its exit from the indirect automobile lending line of business effective August 31, 2004. The Bank continues to service the existing $134 million portfolio and expects to retain, for a period of twelve months, a majority of the staff that performs this function. As a result of this decision, several employees were terminated on September 10, 2004, while others were offered positions within the Company.

The decision to exit this line of business was predicated on the low interest rate environment and competitive pressures of the past eighteen months. The Company expects that the next twenty-four months cash flows from the remaining portfolio will be redeployed into commercial loans, residential mortgage loans, consumer loans such as home equity loans and automobile loans, and the Company's investment portfolio, which in recent years have generated higher yields for the Company.

Under SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", the Company is required to create a liability for the cost associated with one-time termination benefits and reflect the expense from continuing operations before income taxes in the period in which they are incurred. Therefore, one-time termination benefits associated with terminated employees totaled $19,000 and is reflected in the financial statements for the three-month and nine-month periods ended September 30, 2004.

Further, to induce employees to remain and service the portfolio for the next twelve months, the Company has established an incentive to stay bonus arrangement which will be paid out at the end of the twelve month period. The expense of this arrangement is estimated at $88,000 and is being accrued over a twelve month period commencing in September 2004.

Financial Condition

The Company's total assets at September 30, 2004 were $631,143,000 compared to $609,216,000 at December 31, 2003, an increase of $21,927,000. Net loans, including loans held-for-sale, increased $9,756,000 to $478,851,000, the result of increases in residential mortgage loans, commercial real estate loans and commercial loans, which was partially offset by a decrease in both direct and indirect consumer loans. Indirect consumer loans have declined $16,955,000 to $133,851,000 since December 31, 2003. This is the result of portfolio amortization outpacing new loan originations as pricing and competitive pressures have made new loan originations unattractive, prompting the decision to exit this line of business effective August 31, 2004. Securities available-for-sale, including Federal Home Loan Bank ("FHLB") stock and Federal Reserve Bank stock, increased $24,136,000 to $97,287,000, which was primarily the result of mortgage-backed security and U.S. agency security purchases. Securities purchases during the third quarter totaled $10,000,000 and were primarily funded by the cash flows generated from the indirect lending portfolio. Cash and cash equivalents decreased $12,305,000 to $18,780,000, compared to $31,085,000 at December 31, 2003, due primarily to a decrease in federal funds sold.

Deposits increased $2,556,000 to $465,863,000 from December 31, 2003 due to an increase in both DDA and NOW accounts partially offset by a decrease in savings and time accounts. Long-term FHLB advances increased $11,000,000 to $78,000,000 from December 31, 2003. During the first quarter, the Company borrowed $20,000,000 in medium term advances as part of an interest rate arbitrage, investing the funds in mortgage-backed securities at an attractive spread. Total stockholders' equity increased $992,000 to $48,864,000 at September 30, 2004 from $47,872,000 at December 31, 2003. Net income of $2,454,000 was offset by dividends paid of $765,000 and a decrease in the unrealized gain on investment securities available-for-sale of $697,000 due to the recent increase in interest rates.

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. At September 30, 2004 the allowance for loan losses was $5,207,000, or 1.08% of total loans, compared to $5,036,000, or 1.06% of total loans at December 31, 2003. 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. The composition of the allowance for loan losses for the three month and nine month periods ended September 30, 2004 and 2003 is as follows:

	Three Months Ended Sep. 30,		E
(Dollars in thousands)	2004	2003	20

Balance at beginning of period	$5,053	$4,994	$5,
Charge-offs	(147)	(231)	(
Recoveries	181	48	
Net charge-offs	34	(183)	(
Provision for loan losses	120	210	
Balance at end of period	$5,207	$5,021	$5,

Nonperforming loans totaled $3,040,000 as of September 30, 2004, compared to $4,089,000 at December 31, 2003. The ratio of nonperforming loans to loans net of unearned income was 0.63% as of September 30, 2004 compared to 0.86% at December 31, 2003. Nonperforming assets, which include nonperforming loans, other real estate owned and other chattels owned, totaled $3,073,000 as of September 30, 2004, compared to $4,180,000 at December 31, 2003. The ratio of nonperforming assets to total assets was 0.49% as of September 30, 2004 compared to 0.69% at December 31, 2003.

Results of Operations

The Company reported net income of $977,000, or $0.65 per common share, for the three months ended September 30, 2004, compared to $978,000, or $0.65 per common share, for the three months ended September 30, 2003. Net income for the nine months ended September 30, 2004 was $2,454,000, or $1.64 per common share, compared to $2,613,000, or $1.74 per common share, for the nine months ended September 30, 2003, a decrease of $159,000, or 6.1%.

Net interest and dividend income for the third quarter increased $99,000, or 1.8%, to $5,728,000 compared to $5,629,000 for the third quarter of 2003. The increase for the quarter is due primarily to an increase in average earning assets as well as a lower cost of interest bearing liabilities, which is partially offset by a lower yield on earning assets. Net interest and dividend income for the nine months ended September 30, 2004 decreased $444,000, or 2.5%, to $16,970,000 compared to $17,414,000 for the same period last year. The decrease year-to-date is due primarily to a decrease in the yield on earning assets as loans continued to reprice downward. This was partially offset by an increase in average earning assets as well as a decrease in the cost of interest bearing liabilities.

The provision for loan losses decreased $90,000 to $120,000 for the third quarter of 2004 compared to $210,000 for the third quarter of 2003. For the nine months ended September 30, 2004, the provision for loan losses was $390,000, a decrease of $265,000 from the $655,000 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 is based upon many factors including the risk characteristics of the portfolio, trends in loan delinquencies, and an assessment of existing economic conditions. In addition, various regulatory agencies, as part of their examination process, review the banks' allowances for loan losses and such review may result in changes to the allowance based on judgments different from those of management.

Noninterest income decreased $280,000 to $1,443,000 in the third quarter of 2004 compared to $1,723,000 in the third quarter of 2003. Service charges and fees on deposit accounts increased $187,000 due to increases in overdraft fee income primarily the result of the introduction of a new overdraft privilege program. Net securities gains decreased $594,000 to $20,000 in the third quarter of 2004 compared to $614,000 for the third quarter of 2003. During 2003 the Company recorded securities gains primarily due to the sale of corporate bonds. Gains on sales of loans increased $176,000 due to the recognition of gains associated with the sale of a pool of commercial loans guaranteed by the Small Business Administration which was partially offset by a combination of lower sales volumes in the secondary mortgage market and the subsequent recognition of lower mortgage servicing asset income.

Noninterest income for the nine months ended September 30, 2004 increased $243,000 to $4,003,000 compared to $3,760,000 for the same period last year. Service charges and fees on deposit accounts increased $409,000 due to increases in overdraft fee income principally the result of the overdraft privilege program. Net securities gains for the nine months ended September 30, 2004 were $740,000, a decrease of $111,000 over the $851,000 reported for the same period a year ago. Gains on sales of loans increased $60,000 over one year ago and other noninterest income decreased $115,000.

Noninterest expense decreased $39,000 to $5,567,000 for the quarter ended September 30, 2004, compared to the $5,606,000 recorded during the same period last year. This was partially due to the fact that the Company recorded no write-down of equity securities for the third quarter of 2004 compared to a write down of $65,000 for the third quarter of 2003. Further, other noninterest expense decreased $136,000 to $1,412,000 for the third quarter 2004 compared to $1,548,000 for the same period last year due primarily to decreases in professional fees, advertising expense, ATM expense, stationery and office supplies, and postage and shipping. This was partially offset by an increase in salaries and employee benefits of $148,000 to $3,009,000 for the third quarter of 2004 compared to $2,861,000 for the third quarter 2003.

For the nine months ended September 30, 2004 noninterest expense totaled $16,877,000, an increase of $460,000 over the same period last year. Salaries and employee benefits increased $766,000 to $9,096,000 for the nine months ended September 30, 2004 compared to $8,330,000 for the same period a year ago due primarily to increases in salaries expense, related payroll taxes and benefits and the recording of a liability to deferred compensation related to a Supplemental Employee Retirement Plan. This was partially offset by the fact that the Company recorded no write-down of equity securities for the nine months ended September 30, 2004 compared to a write down of $184,000 for the nine months ended September 30, 2003. Further, other noninterest expense decreased $113,000 from the same period a year ago.

Income Tax Expense

The Company recognized income tax expense of $1,252,000 and $1,489,000 for the nine months ended September 30, 2004 and 2003, respectively. The effective tax rates were 33.8% and 36.3% for those respective periods.

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 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 11.33% and 13.48%, respectively, at September 30, 2004. The Company's Tier 1 leverage ratio at September 30, 2004 was 8.22%. As of September 30, 2004, 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, 2003, 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 13 through 27 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Company's management conducted an evaluation with the participation of the Company's Chief Executive Officer and Chief Financial Officer, regarding the effectiveness of the Company's disclosure controls and procedures, as of the end of the last fiscal quarter. In designing and evaluating the Company's disclosure controls and procedures, the Company and its management recognize that any controls and procedures, no matter how well designed and operated, can provide only a reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that they believe the Company's disclosure controls and procedures are reasonably effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. We intend to continue to review and document our disclosure controls and procedures, including our internal controls and procedures for financial reporting, and we may from time to time make changes to the disclosure controls and procedures to enhance their effectiveness and to ensure that our systems evolve with our business.

(b) Changes in internal controls.

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings - None

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

Item 3. Defaults Upon Senior Securities - None

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

Item 5. Other Information - None

Item 6. Exhibits

Exhibit Number	Description of Exhibit
11	Statement re Computation of per share earnings
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 the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

NORTHWAY FINANCIAL, INC.

November 10, 2004 BY:/S/William J. Woodward

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

November 10, 2004 BY:/S/Richard P. Orsillo

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

INDEX OF EXHIBITS

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