

UNITED STATES DEPARTMENT OF THE TREASURY
1500 PENNSYLVANIA AVENUE, NW
WASHINGTON, D.C. 20220

Dear Ladies and Gentlemen:

The company set forth on the signature page hereto (the “*Company*”) intends to issue in a private placement the number of shares of a series of its preferred stock set forth on Schedule A hereto (the “*Preferred Shares*”) and a warrant to purchase the number of shares of a series of its preferred stock set forth on Schedule A hereto (the “*Warrant*” and, together with the Preferred Shares, the “*Purchased Securities*”) and the United States Department of the Treasury (the “*Investor*”) intends to purchase from the Company the Purchased Securities.

The purpose of this letter agreement is to confirm the terms and conditions of the purchase by the Investor of the Purchased Securities. Except to the extent supplemented or superseded by the terms set forth herein or in the Schedules hereto, the provisions contained in the Securities Purchase Agreement — Standard Terms attached hereto as Exhibit A (the “*Securities Purchase Agreement*”) are incorporated by reference herein. Terms that are defined in the Securities Purchase Agreement are used in this letter agreement as so defined. In the event of any inconsistency between this letter agreement and the Securities Purchase Agreement, the terms of this letter agreement shall govern.

Each of the Company and the Investor hereby confirms its agreement with the other party with respect to the issuance by the Company of the Purchased Securities and the purchase by the Investor of the Purchased Securities pursuant to this letter agreement and the Securities Purchase Agreement on the terms specified on Schedule A hereto.

This letter agreement (including the Schedules hereto), the Securities Purchase Agreement (including the Annexes thereto), the Disclosure Schedules and the Warrant constitute the entire agreement, and supersede all other prior agreements, understandings, representations and warranties, both written and oral, between the parties, with respect to the subject matter hereof. This letter agreement constitutes the “*Letter Agreement*” referred to in the Securities Purchase Agreement.

This letter agreement may be executed in any number of separate counterparts, each such counterpart being deemed to be an original instrument, and all such counterparts will together constitute the same agreement. Executed signature pages to this letter agreement may be delivered by facsimile and such facsimiles will be deemed as sufficient as if actual signature pages had been delivered.

* * *

In witness whereof, this letter agreement has been duly executed and delivered by the duly authorized representatives of the parties hereto as of the date written below.

UNITED STATES DEPARTMENT OF THE
TREASURY

By: _____

Name:

Title:

COMPANY:

NORTHWAY FINANCIAL, INC.

By:  _____


Name: William J. Woodward

Title: Chairman, President and Chief Executive
Officer

Date: January 30, 2009

In witness whereof, this letter agreement has been duly executed and delivered by the duly authorized representatives of the parties hereto as of the date written below.

UNITED STATES DEPARTMENT OF THE
TREASURY

By:  _____

Name: **Neel Kashkari**
Title: **Interim Assistant Secretary
For Financial Stability**

COMPANY:

NORTHWAY FINANCIAL, INC.

By: _____

Name: William J. Woodward
Title: Chairman, President and Chief Executive
Officer

Date: _____

SECURITIES PURCHASE AGREEMENT

EXHIBIT A

(Non-Exchange-Traded QFIs, excluding S Corps
and Mutual Organizations)

SECURITIES PURCHASE AGREEMENT

STANDARD TERMS

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SECURITIES PURCHASE AGREEMENT - STANDARD TERMS

Recitals:

WHEREAS, the United States Department of the Treasury (the “*Investor*”) may from time to time agree to purchase shares of preferred stock and warrants from eligible financial institutions which elect to participate in the Troubled Asset Relief Program Capital Purchase Program (“*CPP*”);

WHEREAS, an eligible financial institution electing to participate in the CPP and issue securities to the Investor (referred to herein as the “*Company*”) shall enter into a letter agreement (the “*Letter Agreement*”) with the Investor which incorporates this Securities Purchase Agreement - Standard Terms;

WHEREAS, the Company agrees to expand the flow of credit to U.S. consumers and businesses on competitive terms to promote the sustained growth and vitality of the U.S. economy;

WHEREAS, the Company agrees to work diligently, under existing programs, to modify the terms of residential mortgages as appropriate to strengthen the health of the U.S. housing market;

WHEREAS, the Company intends to issue in a private placement the number of shares of the series of its Preferred Stock (“*Preferred Stock*”) set forth on Schedule A to the Letter Agreement (the “*Preferred Shares*”) and a warrant to purchase the number of shares of the series of its Preferred Stock (“*Warrant Preferred Stock*”) set forth on Schedule A to the Letter Agreement (the “*Warrant*” and, together with the Preferred Shares, the “*Purchased Securities*”) and the Investor intends to purchase (the “*Purchase*”) from the Company the Purchased Securities; and

WHEREAS, the Purchase will be governed by this Securities Purchase Agreement Standard Terms and the Letter Agreement, including the schedules thereto (the “*Schedules*”), specifying additional terms of the Purchase. This Securities Purchase Agreement Standard Terms (including the Annexes hereto) and the Letter Agreement (including the Schedules thereto) are together referred to as this “*Agreement*”. All references in this Securities Purchase Agreement - Standard Terms to “*Schedules*” are to the Schedules attached to the Letter Agreement.

NOW, THEREFORE, in consideration of the premises, and of the representations, warranties, covenants and agreements set forth herein, the parties agree as follows:

ARTICLE I PURCHASE; CLOSING

1.1 Purchase. On the terms and subject to the conditions set forth in this Agreement, the Company agrees to sell to the Investor, and the Investor agrees to purchase from the Company, at the Closing (as hereinafter defined), the Purchased Securities for the price set forth on Schedule A (the “*Purchase Price*”).

1.2 Closing.

(a) On the terms and subject to the conditions set forth in this Agreement, the closing of the Purchase (the "*Closing*") will take place at the location specified in Schedule A, at the time and on the date set forth in Schedule A or as soon as practicable thereafter, or at such other place, time and date as shall be agreed between the Company and the Investor. The time and date on which the Closing occurs is referred to in this Agreement as the "*Closing Date*".

(b) Subject to the fulfillment or waiver of the conditions to the Closing in this Section 1.2, at the Closing the Company will deliver the Preferred Shares and the Warrant, in each case as evidenced by one or more certificates dated the Closing Date and bearing appropriate legends as hereinafter provided for, in exchange for payment in full of the Purchase Price by wire transfer of immediately available United States funds to a bank: account designated by the Company on Schedule A.

(c) The respective obligations of each of the Investor and the Company to consummate the Purchase are subject to the fulfillment (or waiver by the Investor and the Company, as applicable) prior to the Closing of the conditions that (i) any approvals or authorizations of all United States and other governmental, regulatory or judicial authorities (collectively, "*Governmental Entities*") required for the consummation of the Purchase shall have been obtained or made in form and substance reasonably satisfactory to each party and shall be in full force and effect and all waiting periods required by United States and other applicable law, if any, shall have expired and (ii) no provision of any applicable United States or other law and no judgment, injunction, order or decree of any Governmental Entity shall prohibit the purchase and sale of the Purchased Securities as contemplated by this Agreement.

(d) The obligation of the Investor to consummate the Purchase is also subject to the fulfillment (or waiver by the Investor) at or prior to the Closing of each of the following conditions:

(i) (A) the representations and warranties of the Company set forth in (x) Section 2.2(g) of this Agreement shall be true and correct in all respects as though made on and as of the Closing Date, (y) Sections 2.2(a) through (t) shall be true and correct in all material respects as though made on and as of the Closing Date (other than representations and warranties that by their terms speak as of another date, which representations and warranties shall be true and correct in all material respects as of such other date) and (z) Sections 2.2(h) through (v) (disregarding all qualifications or limitations set forth in such representations and warranties as to "materiality", "Company Material Adverse Effect" and words of similar import) shall be true and correct as though made on and as of the Closing Date (other than representations and warranties that by their terms speak as of another date, which representations and warranties shall be true and correct as of such other date), except to the extent that the failure of such representations and warranties referred to in this Section 1.2(d)(i)(A)(z) to be so true and correct, individually or in the aggregate, does not have and would not reasonably be expected to have a Company Material Adverse Effect and (B) the Company shall have performed in all material respects all obligations required to be performed by it under this Agreement at or prior to the Closing;

(ii) the Investor shall have received a certificate signed on behalf of the Company by a senior executive officer certifying to the effect that the conditions set forth in Section 1.2(d)(i) have been satisfied;

(iii) the Company shall have duly adopted and filed with the Secretary of State of its jurisdiction of organization or other applicable Governmental Entity the amendments to its certificate or articles of incorporation, articles of association, or similar organizational document ("*Charter*") in substantially the forms attached hereto as Annex A and Annex B (the "*Certificates of Designations*") and such filing shall have been accepted;

(iv) (A) the Company shall have effected such changes to its compensation, bonus, incentive and other benefit plans, arrangements and agreements (including golden parachute, severance and employment agreements) (collectively, "*Benefit Plans*") with respect to its Senior Executive Officers (and to the extent necessary for such changes to be legally enforceable, each of its Senior Executive Officers shall have duly consented in writing to such changes), as may be necessary, during the period that the Investor owns any debt or equity securities of the Company acquired pursuant to this Agreement or the Warrant, in order to comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008 ("*EESA*") as implemented by guidance or regulation thereunder that has been issued and is in effect as of the Closing Date, and (B) the Investor shall have received a certificate signed on behalf of the Company by a senior executive officer certifying to the effect that the condition set forth in Section 1.2(d)(iv)(A) has been satisfied;

(v) each of the Company's Senior Executive Officers shall have delivered to the Investor a written waiver in the form attached hereto as Annex C releasing the Investor from any claims that such Senior Executive Officers may otherwise have as a result of the issuance, on or prior to the Closing Date, of any regulations which require the modification of, and the agreement of the Company hereunder to modify, the terms of any Benefit Plans with respect to its Senior Executive Officers to eliminate any provisions of such Benefit Plans that would not be in compliance with the requirements of Section III (b) of the EESA as implemented by guidance or regulation thereunder that has been issued and is in effect as of the Closing Date;

(vi) the Company shall have delivered to the Investor a written opinion from counsel to the Company (which may be internal counsel), addressed to the Investor and dated as of the Closing Date, in substantially the form attached hereto as Annex D;

(vii) the Company shall have delivered certificates in proper form or, with the prior consent of the Investor, evidence of shares in book-entry form, evidencing the Preferred Shares to Investor or its designee(s); and

(viii) the Company shall have duly executed the Warrant in substantially the form attached hereto as Annex E and delivered such executed Warrant to the Investor or its designee(s).

1.3 Interpretation. When a reference is made in this Agreement to “*Recitals*,” “Articles,” “Sections,” or “Annexes” such reference shall be to a Recital, Article or Section of, or Annex to, this Securities Purchase Agreement - Standard Terms, and a reference to “Schedules” shall be to a Schedule to the Letter Agreement, in each case, unless otherwise indicated. The terms defined in the singular have a comparable meaning when used in the plural, and vice versa. References to “herein”, “hereof”, “hereunder” and the like refer to this Agreement as a whole and not to any particular section or provision, unless the context requires otherwise. The table of contents and headings contained in this Agreement are for reference purposes only and are not part of this Agreement. Whenever the words “include,” “includes” or “including” are used in this Agreement, they shall be deemed followed by the words “without limitation.” No rule of construction against the draftsman shall be applied in connection with the interpretation or enforcement of this Agreement, as this Agreement is the product of negotiation between sophisticated parties advised by counsel. All references to “\$” or “dollars” mean the lawful currency of the United States of America. Except as expressly stated in this Agreement, all references to any statute, rule or regulation are to the statute, rule or regulation as amended, modified, supplemented or replaced from time to time (and, in the case of statutes, include any rules and regulations promulgated under the statute) and to any section of any statute, rule or regulation include any successor to the section. References to a “*business day*” shall mean any day except Saturday, Sunday and any day on which banking institutions in the State of New York generally are authorized or required by law or other governmental actions to close.

ARTICLE II REPRESENTATIONS AND WARRANTIES

2.1 Disclosure.

(a) On or prior to the Signing Date, the Company delivered to the Investor a schedule (“*Disclosure Schedule*”) setting forth, among other things, items the disclosure of which is necessary or appropriate either in response to an express disclosure requirement contained in a provision hereof or as an exception to one or more representations or warranties contained in Section 2.2.

(b) “*Company Material Adverse Effect*” means a material adverse effect on (i) the business, results of operation or financial condition of the Company and its consolidated subsidiaries taken as a whole; *provided, however*, that Company Material Adverse Effect shall not be deemed to include the effects of (A) changes after the date of the Letter Agreement (the “*Signing Date*”) in general business, economic or market conditions (including changes generally in prevailing interest rates, credit availability and liquidity, currency exchange rates and price levels or trading volumes in the United States or foreign securities or credit markets), or any outbreak or escalation of hostilities, declared or undeclared acts of war or terrorism, in each case generally affecting the industries in which the Company and its subsidiaries operate, (B) changes or proposed changes after the Signing Date in generally accepted accounting principles in the United States (“*GAAP*”) or regulatory accounting requirements, or authoritative interpretations thereof, or (C) changes or proposed changes after the Signing Date in securities, banking and other laws of general applicability or related policies or interpretations of Governmental Entities (in the case of each of these clauses (A), (B) and (C), other than changes

or occurrences to the extent that such changes or occurrences have or would reasonably be expected to have a materially disproportionate adverse effect on the Company and its consolidated subsidiaries taken as a whole relative to comparable U.S. banking or financial services organizations); or (ii) the ability of the Company to consummate the Purchase and other transactions contemplated by this Agreement and the Warrant and perform its obligations hereunder or thereunder on a timely basis.

(c) *“Previously Disclosed”* means information set forth on the Disclosure Schedule, provided, however, that disclosure in any section of such Disclosure Schedule shall apply only to the indicated section of this Agreement except to the extent that it is reasonably apparent from the face of such disclosure that such disclosure is relevant to another section of this Agreement.

2.2 Representations and Warranties of the Company. Except as Previously Disclosed, the Company represents and warrants to the Investor that as of the Signing Date and as of the Closing Date (or such other date specified herein):

(a) Organization, Authority and Significant Subsidiaries. The Company has been duly incorporated and is validly existing and in good standing under the laws of its jurisdiction of organization, with the necessary power and authority to own its properties and conduct its business in all material respects as currently conducted, and except as has not, individually or in the aggregate, had and would not reasonably be expected to have a Company Material Adverse Effect, has been duly qualified as a foreign corporation for the transaction of business and is in good standing under the laws of each other jurisdiction in which it owns or leases properties or conducts any business so as to require such qualification; each subsidiary of the Company that would be considered a “significant subsidiary” within the meaning of Rule 1-02(w) of Regulation S-X under the Securities Act of 1933 (the “*Securities Act*”), has been duly organized and is validly existing in good standing under the laws of its jurisdiction of organization. The Charter and bylaws of the Company, copies of which have been provided to the Investor prior to the Signing Date, are true, complete and correct copies of such documents as in full force and effect as of the Signing Date.

(b) Capitalization. The authorized capital stock of the Company, and the outstanding capital stock of the Company (including securities convertible into, or exercisable or exchangeable for, capital stock of the Company) as of the most recent fiscal month-end preceding the Signing Date (the “*Capitalization Date*”) is set forth on Schedule B. The outstanding shares of capital stock of the Company have been duly authorized and are validly issued and outstanding, fully paid and nonassessable, and subject to no preemptive rights (and were not issued in violation of any preemptive rights). As of the Signing Date, the Company does not have outstanding any securities or other obligations providing the holder the right to acquire its Common Stock (“Common Stock:”) that is not reserved for issuance as specified on Schedule B, and the Company has not made any other commitment to authorize, issue or sell any Common Stock. Since the Capitalization Date, the Company has not issued any shares of Common Stock, other than (i) shares issued upon the exercise of stock options or delivered under other equity-based awards or other convertible securities or warrants which were issued and outstanding on the Capitalization Date and disclosed on Schedule B and (ii) shares disclosed on Schedule B. Each holder of 5% or more of any class of capital stock of the Company and such holder's primary address are set forth on Schedule B.

(c) Preferred Shares. The Preferred Shares have been duly and validly authorized, and, when issued and delivered pursuant to this Agreement, such Preferred Shares will be duly and validly issued and fully paid and non-assessable, will not be issued in violation of any preemptive rights, and will rank *pari passu* with or senior to all other series or classes of Preferred Stock, whether or not issued or outstanding, with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Company.

(d) The Warrant and Warrant Shares. The Warrant has been duly authorized and, when executed and delivered as contemplated hereby, will constitute a valid and legally binding obligation of the Company enforceable against the Company in accordance with its terms, except as the same may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors' rights generally and general equitable principles, regardless of whether such enforceability is considered in a proceeding at law or in equity ("*Bankruptcy Exceptions*"). The shares of Warrant Preferred Stock issuable upon exercise of the Warrant (the "*Warrant Shares*") have been duly authorized and reserved for issuance upon exercise of the Warrant and when so issued in accordance with the terms of the Warrant will be validly issued, fully paid and non-assessable, and will rank *pari passu* with or senior to all other series or classes of Preferred Stock, whether or not issued or outstanding, with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Company.

(e) Authorization, Enforceability.

(i) The Company has the corporate power and authority to execute and deliver this Agreement and the Warrant and to carry out its obligations hereunder and thereunder (which includes the issuance of the Preferred Shares, Warrant and Warrant Shares). The execution, delivery and performance by the Company of this Agreement and the Warrant and the consummation of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action on the part of the Company and its stockholders, and no further approval or authorization is required on the part of the Company. This Agreement is a valid and binding obligation of the Company enforceable against the Company in accordance with its terms, subject to the Bankruptcy Exceptions.

(ii) The execution, delivery and performance by the Company of this Agreement and the Warrant and the consummation of the transactions contemplated hereby and thereby and compliance by the Company with the provisions hereof and thereof, will not (A) violate, conflict with, or result in a breach of any provision of, or constitute a default (or an event which, with notice or lapse of time or both, would constitute a default) under, or result in the termination of, or accelerate the performance required by, or result in a right of termination or acceleration of, or result in the creation of, any lien, security interest, charge or encumbrance upon any of the properties or assets of the Company or any subsidiary of the Company (each a "*Company Subsidiary*" and, collectively, the "*Company Subsidiaries*") under any of the terms, conditions or provisions of (i) its organizational documents or (ii) any note, bond, mortgage, indenture, deed of trust, license, lease, agreement or other instrument or obligation to which the

Company or any Company Subsidiary is a party or by which it or any Company Subsidiary may be bound, or to which the Company or any Company Subsidiary or any of the properties or assets of the Company or any Company Subsidiary may be subject, or (B) subject to compliance with the statutes and regulations referred to in the next paragraph, violate any statute, rule or regulation or any judgment, ruling, order, writ, injunction or decree applicable to the Company or any Company Subsidiary or any of their respective properties or assets except, in the case of clauses (A)(ii) and (B), for those occurrences that, individually or in the aggregate, have not had and would not reasonably be expected to have a Company Material Adverse Effect.

(iii) Other than the filing of the Certificates of Designations with the Secretary of State of its jurisdiction of organization or other applicable Governmental Entity, such filings and approvals as are required to be made or obtained under any state “blue sky” laws and such as have been made or obtained, no notice to, filing with, exemption or review by, or authorization, consent or approval of, any Governmental Entity is required to be made or obtained by the Company in connection with the consummation by the Company of the Purchase except for any such notices, filings, exemptions, reviews, authorizations, consents and approvals the failure of which to make or obtain would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

(f) Anti-takeover Provisions and Rights Plan. The Board of Directors of the Company (the “*Board of Directors*”) has taken all necessary action to ensure that the transactions contemplated by this Agreement and the Warrant and the consummation of the transactions contemplated hereby and thereby, including the exercise of the Warrant in accordance with its terms, will be exempt from any anti-takeover or similar provisions of the Company's Charter and bylaws, and any other provisions of any applicable “moratorium”, “control share”, “fair price”, “interested stockholder” or other anti-takeover laws and regulations of any jurisdiction.

(g) No Company Material Adverse Effect. Since the last day of the last completed fiscal period for which financial statements are included in the Company Financial Statements (as defined below), no fact, circumstance, event, change, occurrence, condition or development has occurred that, individually or in the aggregate, has had or would reasonably be expected to have a Company Material Adverse Effect.

(h) Company Financial Statements. The Company has Previously Disclosed each of the consolidated financial statements of the Company and its consolidated subsidiaries for each of the last three completed fiscal years of the Company (which shall be audited to the extent audited financial statements are available prior to the Signing Date) and each completed quarterly period since the last completed fiscal year (collectively the “*Company Financial Statements*”). The Company Financial Statements present fairly in all material respects the consolidated financial position of the Company and its consolidated subsidiaries as of the dates indicated therein and the consolidated results of their operations for the periods specified therein; and except as stated therein, such financial statements (A) were prepared in conformity with GAAP applied on a consistent basis (except as may be noted therein) and (B) have been prepared

from, and are in accordance with, the books and records of the Company and the Company Subsidiaries.

(i) Reports.

(i) Since December 31, 2006, the Company and each Company Subsidiary has filed all reports, registrations, documents, filings, statements and submissions, together with any amendments thereto, that it was required to file with any Governmental Entity (the foregoing, collectively, the “*Company Reports*”) and has paid all fees and assessments due and payable in connection therewith, except, in each case, as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect. As of their respective dates of filing, the Company Reports complied in all material respects with all statutes and applicable rules and regulations of the applicable Governmental Entities.

(ii) The records, systems, controls, data and information of the Company and the Company Subsidiaries are recorded, stored, maintained and operated under means (including any electronic, mechanical or photographic process, whether computerized or not) that are under the exclusive ownership and direct control of the Company or the Company Subsidiaries or their accountants (including all means of access thereto and therefrom), except for any non-exclusive ownership and non-direct control that would not reasonably be expected to have a material adverse effect on the system of internal accounting controls described below in this Section 2.2(i)(ii). The Company (A) has implemented and maintains adequate disclosure controls and procedures to ensure that material information relating to the Company, including the consolidated Company Subsidiaries, is made known to the chief executive officer and the chief financial officer of the Company by others within those entities, and (B) has disclosed, based on its most recent evaluation prior to the Signing Date, to the Company's outside auditors and the audit committee of the Board of Directors (x) any significant deficiencies and material weaknesses in the design or operation of internal controls that are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information and (y) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls over financial reporting.

(j) No Undisclosed Liabilities. Neither the Company nor any of the Company Subsidiaries has any liabilities or obligations of any nature (absolute, accrued, contingent or otherwise) which are not properly reflected or reserved against in the Company Financial Statements to the extent required to be so reflected or reserved against in accordance with GAAP, except for (A) liabilities that have arisen since the last fiscal year end in the ordinary and usual course of business and consistent with past practice and (B) liabilities that, individually or in the aggregate, have not had and would not reasonably be expected to have a Company Material Adverse Effect.

(k) Offering of Securities. Neither the Company nor any person acting on its behalf has taken any action (including any offering of any securities of the Company under circumstances which would require the integration of such offering with the offering of any of

the Purchased Securities under the Securities Act, and the rules and regulations of the Securities and Exchange Commission (the “SEC”) promulgated thereunder), which might subject the offering, issuance or sale of any of the Purchased Securities to Investor pursuant to this Agreement to the registration requirements of the Securities Act.

(l) Litigation and Other Proceedings. Except (i) as set forth on Schedule C or (ii) as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, there is no (A) pending or, to the knowledge of the Company, threatened, claim, action, suit, investigation or proceeding, against the Company or any Company Subsidiary or to which any of their assets are subject nor is the Company or any Company Subsidiary subject to any order, judgment or decree or (B) unresolved violation, criticism or exception by any Governmental Entity with respect to any report or relating to any examinations or inspections of the Company or any Company Subsidiaries.

(m) Compliance with Laws. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, the Company and the Company Subsidiaries have all permits, licenses, franchises, authorizations, orders and approvals of, and have made all filings, applications and registrations with, Governmental Entities that are required in order to permit them to own or lease their properties and assets and to carry on their business as presently conducted and that are material to the business of the Company or such Company Subsidiary. Except as set forth on Schedule D, the Company and the Company Subsidiaries have complied in all respects and are not in default or violation of, and none of them is, to the knowledge of the Company, under investigation with respect to or, to the knowledge of the Company, have been threatened to be charged with or given notice of any violation of, any applicable domestic (federal, state or local) or foreign law, statute, ordinance, license, rule, regulation, policy or guideline, order, demand, writ, injunction, decree or judgment of any Governmental Entity, other than such noncompliance, defaults or violations that would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect. Except for statutory or regulatory restrictions of general application or as set forth on Schedule D, no Governmental Entity has placed any restriction on the business or properties of - the Company or any Company Subsidiary that would, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

(n) Employee Benefit Matters. Except as would not reasonably be expected to have, either individually or in the aggregate, a Company Material Adverse Effect: (A) each “employee benefit plan” (within the meaning of Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”)) providing benefits to any current or former employee, officer or director of the Company or any member of its “Controlled Group” (defined as any organization which is a member of a controlled group of corporations within the meaning of Section 414 of the Internal Revenue Code of 1986, as amended (the “Code”)) that is sponsored, maintained or contributed to by the Company or any member of its Controlled Group and for which the Company or any member of its Controlled Group would have any liability, whether actual or contingent (each, a “Plan”) has been maintained in compliance with its terms and with the requirements of all applicable statutes, rules and regulations, including ERISA and the Code; (B) with respect to each Plan subject to Title IV of ERISA (including, for purposes of this clause (B), any plan subject to Title IV of ERISA that the Company or any member of its Controlled Group previously maintained or contributed to in the six years prior to the Signing

Date), (1) no “reportable event” (within the meaning of Section 4043(c) of ERISA), other than a reportable event for which the notice period referred to in Section 4043(c) of ERISA has been waived, has occurred in the three years prior to the Signing Date or is reasonably expected to occur, (2) no “accumulated funding deficiency” (within the meaning of Section 302 of ERISA or Section 412 of the Code), whether or not waived, has occurred in the three years prior to the Signing Date or is reasonably expected to occur, (3) the fair market value of the assets under each Plan exceeds the present value of all benefits accrued under such Plan (determined based on the assumptions used to fund such Plan) and (4) neither the Company nor any member of its Controlled Group has incurred in the six years prior to the Signing Date, or reasonably expects to incur, any liability under Title IV of ERISA (other than contributions to the Plan or premiums to the PBGC in the ordinary course and without default) in respect of a Plan (including any Plan that is a “multiemployer plan”, within the meaning of Section 4001 (c)(3) of ERISA); and (C) each Plan that is intended to be qualified under Section 401 (a) of the Code has received a favorable determination letter from the Internal Revenue Service with respect to its qualified status that has not been revoked, or such a determination letter has been timely applied for but not received by the Signing Date, and nothing has occurred, whether by action or by failure to act, which could reasonably be expected to cause the loss, revocation or denial of such qualified status or favorable determination letter.

(o) Taxes. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, (i) the Company and the Company Subsidiaries have filed all federal, state, local and foreign income and franchise Tax returns required to be filed through the Signing Date, subject to permitted extensions, and have paid all Taxes due thereon, and (ii) no Tax deficiency has been determined adversely to the Company or any of the Company Subsidiaries, nor does the Company have any knowledge of any Tax deficiencies. “Tax” or “Taxes” means any federal, state, local or foreign income, gross receipts, property, sales, use, license, excise, franchise, employment, payroll, withholding, alternative or add on minimum, ad valorem, transfer or excise tax, or any other tax, custom, duty, governmental fee or other like assessment or charge of any kind whatsoever, together with any interest or penalty, imposed by any Governmental Entity.

(p) Properties and Leases. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, the Company and the Company Subsidiaries have good and marketable title to all real properties and all other properties and assets owned by them, in each case free from liens, encumbrances, claims and defects that would affect the value thereof or interfere with the use made or to be made thereof by them. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, the Company and the Company Subsidiaries hold all leased real or personal property under valid and enforceable leases with no exceptions that would interfere with the use made or to be made thereof by them.

(q) Environmental Liability. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect:

(i) there is no legal, administrative, or other proceeding, claim or action of any nature seeking to impose, or that would reasonably be expected to result in the imposition of, on the Company or any Company Subsidiary, any liability relating to the

release of hazardous substances as defined under any local, state or federal environmental statute, regulation or ordinance, including the Comprehensive Environmental Response, Compensation and Liability Act of 1980, pending or, to the Company's knowledge, threatened against the Company or any Company Subsidiary;

(ii) to the Company's knowledge, there is no reasonable basis for any such proceeding, claim or action; and

(iii) neither the Company nor any Company Subsidiary is subject to any agreement, order, judgment or decree by or with any court, Governmental Entity or third party imposing any such environmental liability.

(r) Risk Management Instruments. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, all derivative instruments, including, swaps, caps, floors and option agreements, whether entered into for the Company's own account, or for the account of one or more of the Company Subsidiaries or its or their customers, were entered into (i) only in the ordinary course of business, (ii) in accordance with prudent practices and in all material respects with all applicable laws, rules, regulations and regulatory policies and (iii) with counterparties believed to be financially responsible at the time; and each of such instruments constitutes the valid and legally binding obligation of the Company or one of the Company Subsidiaries, enforceable in accordance with its terms, except as may be limited by the Bankruptcy Exceptions. Neither the Company or the Company Subsidiaries, nor, to the knowledge of the Company, any other party thereto, is in breach of any of its obligations under any such agreement or arrangement other than such breaches that would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

(s) Agreements with Regulatory Agencies. Except as set forth on Schedule E, neither the Company nor any Company Subsidiary is subject to any material cease-and-desist or other similar order or enforcement action issued by, or is a party to any material written agreement, consent agreement or memorandum of understanding with, or is a party to any commitment letter or similar undertaking to, or is subject to any capital directive by, or since December 31, 2006, has adopted any board resolutions at the request of, any Governmental Entity (other than the Appropriate Federal Banking Agencies with jurisdiction over the Company and the Company Subsidiaries) that currently restricts in any material respect the conduct of its business or that in any material manner relates to its capital adequacy, its liquidity and funding policies and practices, its ability to pay dividends, its credit, risk management or compliance policies or procedures, its internal controls, its management or its operations or business (each item in this sentence, a "*Regulatory Agreement*"), nor has the Company or any Company Subsidiary been advised since December 31, 2006 by any such Governmental Entity that it is considering issuing, initiating, ordering, or requesting any such Regulatory Agreement. The Company and each Company Subsidiary are in compliance in all material respects with each Regulatory Agreement to which it is party or subject, and neither the Company nor any Company Subsidiary has received any notice from any Governmental Entity indicating that either the Company or any Company Subsidiary is not in compliance in all material respects with any such Regulatory Agreement. "*Appropriate Federal Banking Agency*" means the "appropriate Federal banking agency" with respect to the Company or such Company Subsidiaries, as applicable, as defined in Section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. Section 1813(q)).

(t) Insurance. The Company and the Company Subsidiaries are insured with reputable insurers against such risks and in such amounts as the management of the Company reasonably has determined to be prudent and consistent with industry practice. The Company and the Company Subsidiaries are in material compliance with their insurance policies and are not in default under any of the material terms thereof, each such policy is outstanding and in full force and effect, all premiums and other payments due under any material policy have been paid, and all claims thereunder have been filed in due and timely fashion, except, in each case, as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.

(u) Intellectual Property. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, (i) the Company and each Company Subsidiary owns or otherwise has the right to use, all intellectual property rights, including all trademarks, trade dress, trade names, service marks, domain names, patents, inventions, trade secrets, know-how, works of authorship and copyrights therein, that are used in the conduct of their existing businesses and all rights relating to the plans, design and specifications of any of its branch facilities ("*Proprietary Rights*") free and clear of all liens and any claims of ownership by current or former employees, contractors, designers or others and (ii) neither the Company nor any of the Company Subsidiaries is materially infringing, diluting, misappropriating or violating, nor has the Company or any or the Company Subsidiaries received any written (or, to the knowledge of the Company, oral) communications alleging that any of them has materially infringed, diluted, misappropriated or violated, any of the Proprietary Rights owned by any other person. Except as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect, to the Company's knowledge, no other person is infringing, diluting, misappropriating or violating, nor has the Company or any or the Company Subsidiaries sent any written communications since January 1, 2006 alleging that any person has infringed, diluted, misappropriated or violated, any of the Proprietary Rights owned by the Company and the Company Subsidiaries.

(v) Brokers and Finders. No broker, finder or investment banker is entitled to any financial advisory, brokerage, finder's or other fee or commission in connection with this Agreement or the Warrant or the transactions contemplated hereby or thereby based upon arrangements made by or on behalf of the Company or any Company Subsidiary for which the Investor could have any liability.

ARTICLE III COVENANTS

3.1 Commercially Reasonable Efforts. Subject to the terms and conditions of this Agreement, each of the parties will use its commercially reasonable efforts in good faith to take, or cause to be taken, all actions, and to do, or cause to be done, all things necessary, proper or desirable, or advisable under applicable laws, so as to permit consummation of the Purchase as promptly as practicable and otherwise to enable consummation of the transactions contemplated hereby and shall use commercially reasonable efforts to cooperate with the other party to that end.

3.2 Expenses. Unless otherwise provided in this Agreement or the Warrant, each of the parties hereto will bear and pay all costs and expenses incurred by it or on its behalf in connection with the transactions contemplated under this Agreement and the Warrant, including fees and expenses of its own financial or other consultants, investment bankers, accountants and counsel.

3.3 Sufficiency of Authorized Warrant Preferred Stock; Exchange Listing.

(a) During the period from the Closing Date until the date on which the Warrant has been fully exercised, the Company shall at all times have reserved for issuance, free of preemptive or similar rights, a sufficient number of authorized and unissued Warrant Shares to effectuate such exercise.

(b) If the Company lists its Common Stock on any national securities exchange, the Company shall, if requested by the Investor, promptly use its reasonable best efforts to cause the Preferred Shares and Warrant Shares to be approved for listing on a national securities exchange as promptly as practicable following such request.

3.4 Certain Notifications Until Closing. From the Signing Date until the Closing, the Company shall promptly notify the Investor of (i) any fact, event or circumstance of which it is aware and which would reasonably be expected to cause any representation or warranty of the Company contained in this Agreement to be untrue or inaccurate in any material respect or to - cause any covenant or agreement of the Company contained in this Agreement not to be complied with or satisfied in any material respect and (ii) except as Previously Disclosed, any fact, circumstance, event, change, occurrence, condition or development of which the Company is aware and which, individually or in the aggregate, has had or would reasonably be expected to have a Company Material Adverse Effect; provided, however, that delivery of any notice pursuant to this Section 3.4 shall not limit or affect any rights of or remedies available to the Investor; provided further, that a failure to comply with this Section 3.4 shall not constitute a breach of this Agreement or the failure of any condition set forth in Section 1.2 to be satisfied unless the underlying Company Material Adverse Effect or material breach would independently result in the failure of a condition set forth in Section 1.2 to be satisfied.

3.5 Access, Information and Confidentiality.

(a) From the Signing Date until the date when the Investor holds an amount of Preferred Shares having an aggregate liquidation value of less than 10% of the Purchase Price, the Company will permit the Investor and its agents, consultants, contractors and advisors (x) acting through the Appropriate Federal Banking Agency, or otherwise to the extent necessary to evaluate, manage, or transfer its investment in the Company, to examine the corporate books and make copies thereof and to discuss the affairs, finances and accounts of the Company and the Company Subsidiaries with the principal officers of the Company, all upon reasonable notice and at such reasonable times and as often as the Investor may reasonably request and (y) to review any information material to the Investor's investment in the Company provided by the Company to its Appropriate Federal Banking Agency. Any investigation pursuant to this Section 3.5 shall be conducted during normal business hours and in such manner as not to interfere unreasonably with the conduct of the business of the Company, and nothing herein shall require the Company

or any Company Subsidiary to disclose any information to the Investor to the extent (i) prohibited by applicable law or regulation, or (ii) that such disclosure would reasonably be expected to cause a violation of any agreement to which the Company or any Company Subsidiary is a party or would cause a risk of a loss of privilege to the Company or any Company Subsidiary (*provided* that the Company shall use commercially reasonable efforts to make appropriate substitute disclosure arrangements under circumstances where the restrictions in this clause (ii) apply).

(b) From the Signing Date until the date on which all of the Preferred Shares and Warrant Shares have been redeemed in whole, the Company will deliver, or will cause to be delivered, to the Investor:

(i) as soon as available after the end of each fiscal year of the Company, and in any event within 90 days thereafter, a consolidated balance sheet of the Company as of the end of such fiscal year, and consolidated statements of income, retained earnings and cash flows of the Company for such year, in each case prepared in accordance with GAAP and setting forth in each case in comparative form the figures for the previous fiscal year of the Company, and which shall be audited to the extent audited financial statements are available; and

(ii) as soon as available after the end of the first, second and third quarterly periods in each fiscal year of the Company, a copy of any quarterly reports provided to other stockholders of the Company or Company management.

(c) The Investor will use reasonable best efforts to hold, and will use reasonable best efforts to cause its agents, consultants, contractors and advisors to hold, in confidence all nonpublic records, books, contracts, instruments, computer data and other data and information (collectively, "*Information*") concerning the Company furnished or made available to it by the Company or its representatives pursuant to this Agreement (except to the extent that such information can be shown to have been (i) previously known by such party on a non-confidential basis, (ii) in the public domain through no fault of such party or (iii) later lawfully acquired from other sources by the party to which it was furnished (and without violation of any other confidentiality obligation)); *provided* that nothing herein shall prevent the Investor from disclosing any Information to the extent required by applicable laws or regulations or by any subpoena or similar legal process.

(d) The Investor's information rights pursuant to Section 3.5(b) may be assigned by the Investor to a transferee or assignee of the Purchased Securities or the Warrant Shares or with a liquidation preference or, in the case of the Warrant, the liquidation preference of the underlying shares of Warrant Preferred Stock, no less than an amount equal to 2% of the initial aggregate liquidation preference of the Preferred Shares.

ARTICLE IV ADDITIONAL AGREEMENTS

4.1 Purchase for Investment. The Investor acknowledges that the Purchased Securities and the Warrant Shares have not been registered under the Securities Act or under any

state securities laws. The Investor (a) is acquiring the Purchased Securities pursuant to an exemption from registration under the Securities Act solely for investment with no present intention to distribute them to any person in violation of the Securities Act or any applicable U.S. state securities laws, (b) will not sell or otherwise dispose of any of the Purchased Securities or the Warrant Shares, except in compliance with the registration requirements or exemption provisions of the Securities Act and any applicable U.S. state securities laws, and (c) has such knowledge and experience in financial and business matters and in investments of this type that it is capable of evaluating the merits and risks of the Purchase and of making an informed investment decision.

4.2 Legends.

(a) The Investor agrees that all certificates or other instruments representing the Warrant will bear a legend substantially to the following effect:

“THE SECURITIES REPRESENTED BY THIS INSTRUMENT HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR THE SECURITIES LAWS OF ANY STATE AND MAY NOT BE TRANSFERRED, SOLD OR OTHERWISE DISPOSED OF EXCEPT WHILE A REGISTRATION STATEMENT RELATING THERETO IS IN EFFECT UNDER SUCH ACT AND APPLICABLE STATE SECURITIES LAWS OR PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT OR SUCH LAWS.

THIS INSTRUMENT IS ISSUED SUBJECT TO THE RESTRICTIONS ON TRANSFER AND OTHER PROVISIONS OF A SECURITIES PURCHASE AGREEMENT BETWEEN THE ISSUER OF THESE SECURITIES AND THE INVESTOR REFERRED TO THEREIN, A COPY OF WHICH IS ON FILE WITH THE ISSUER. THE SECURITIES REPRESENTED BY THIS INSTRUMENT MAY NOT BE SOLD OR OTHERWISE TRANSFERRED EXCEPT IN COMPLIANCE WITH SAID AGREEMENT. ANY SALE OR OTHER TRANSFER NOT IN COMPLIANCE WITH SAID AGREEMENT WILL BE VOID.”

(b) In addition, the Investor agrees that all certificates or other instruments representing the Preferred Shares and the Warrant Shares will bear a legend substantially to the following effect:

“THE SECURITIES REPRESENTED BY THIS INSTRUMENT ARE NOT SAVINGS ACCOUNTS, DEPOSITS OR OTHER OBLIGATIONS OF A BANK AND ARE NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION OR ANY OTHER GOVERNMENTAL AGENCY.

THE SECURITIES REPRESENTED BY THIS INSTRUMENT HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), OR THE SECURITIES LAWS OF ANY STATE AND MAY NOT BE TRANSFERRED, SOLD OR OTHERWISE DISPOSED OF EXCEPT WHILE A REGISTRATION STATEMENT RELATING THERETO IS IN EFFECT UNDER SUCH ACT AND APPLICABLE STATE SECURITIES LAWS OR PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT OR SUCH LAWS. EACH PURCHASER OF

THE SECURITIES REPRESENTED BY THIS INSTRUMENT IS NOTIFIED THAT THE SELLER MAY BE RELYING ON THE EXEMPTION FROM SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A THEREUNDER. ANY TRANSFEREE OF THE SECURITIES REPRESENTED BY THIS INSTRUMENT BY ITS ACCEPTANCE HEREOF (1) REPRESENTS THAT IT IS A "QUALIFIED INSTITUTIONAL BUYER" (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT), (2) AGREES THAT IT WILL NOT OFFER, SELL OR OTHERWISE TRANSFER THE SECURITIES REPRESENTED BY THIS INSTRUMENT EXCEPT (A) PURSUANT TO A REGISTRATION STATEMENT WHICH IS THEN EFFECTIVE UNDER THE SECURITIES ACT, (B) FOR SO LONG AS THE SECURITIES REPRESENTED BY THIS INSTRUMENT ARE ELIGIBLE FOR RESALE PURSUANT TO RULE 144A, TO A PERSON IT REASONABLY BELIEVES IS A "QUALIFIED INSTITUTIONAL BUYER" AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT THAT PURCHASES FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER TO WHOM NOTICE IS GIVEN THAT THE TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (C) TO THE ISSUER OR (D) PURSUANT TO ANY OTHER AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND (3) AGREES THAT IT WILL GIVE TO EACH PERSON TO WHOM THE SECURITIES REPRESENTED BY THIS INSTRUMENT ARE TRANSFERRED A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND.

THIS INSTRUMENT IS ISSUED SUBJECT TO THE RESTRICTIONS ON TRANSFER AND OTHER PROVISIONS OF A SECURITIES PURCHASE AGREEMENT BETWEEN THE ISSUER OF THESE SECURITIES AND THE INVESTOR REFERRED TO THEREIN, A COPY OF WHICH IS ON FILE WITH THE ISSUER. THE SECURITIES REPRESENTED BY THIS INSTRUMENT MAY NOT BE SOLD OR OTHERWISE TRANSFERRED EXCEPT IN COMPLIANCE WITH SAID AGREEMENT. ANY SALE OR OTHER TRANSFER NOT IN COMPLIANCE WITH SAID AGREEMENT WILL BE VOID."

(c) In the event that any Purchased Securities or Warrant Shares (i) become registered under the Securities Act or (ii) are eligible to be transferred without restriction in accordance with Rule 144 or another exemption from registration under the Securities Act (other than Rule 144A), the Company shall issue new certificates or other instruments representing such Purchased Securities or Warrant Shares, which shall not contain the applicable legends in Sections 4.2(a) and (b) above; provided that the Investor surrenders to the Company the previously issued certificates or other instruments.

4.3 Certain Transactions. The Company will not merge or consolidate with, or sell, transfer or lease all or substantially all of its property or assets to, any other party unless the successor, transferee or lessee party (or its ultimate parent entity), as the case may be (if not the Company), expressly assumes the due and punctual performance and observance of each and every covenant, agreement and condition of this Agreement to be performed and observed by the Company.

4.4 Transfer of Purchased Securities and Warrant Shares; Restrictions on Exercise of the Warrant. Subject to compliance with applicable securities laws, the Investor shall be permitted to transfer, sell, assign or otherwise dispose of ("Transfer") all or a portion of the

Purchased Securities or Warrant Shares at any time, and the Company shall take all steps as may be reasonably requested by the Investor to facilitate the Transfer of the Purchased Securities and the Warrant Shares; provided that the Investor shall not Transfer any Purchased Securities or Warrant Shares if such transfer would require the Company to be subject to the periodic reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"). In furtherance of the foregoing, the Company shall provide reasonable cooperation to facilitate any Transfers of the Purchased Securities or Warrant Shares, including, as is reasonable under the circumstances, by furnishing such information concerning the Company and its business as a proposed transferee may reasonably request (including such information as is required by Section 4.5(k)) and making management of the Company reasonably available to respond to questions of a proposed transferee in accordance with customary practice, subject in all cases to the proposed transferee agreeing to a customary confidentiality agreement.

4.5 Registration Rights.

(a) Unless and until the Company becomes subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, the Company shall have no obligation to comply with the provisions of this Section 4.5 (other than Section 4.5(b)(iv)-(vi)); provided that the Company covenants and agrees that it shall comply with this Section 4.5 as soon as practicable after the date that it becomes subject to such reporting requirements.

(b) Registration.

(i) Subject to the terms and conditions of this Agreement, the Company covenants and agrees that as promptly as practicable after the date that the Company becomes subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act (and in any event no later than 30 days thereafter), the Company shall prepare and file with the SEC a Shelf Registration Statement covering all Registrable Securities (or otherwise designate an existing Shelf Registration Statement filed with the SEC to cover the Registrable Securities), and, to the extent the Shelf Registration Statement has not theretofore been declared effective or is not automatically effective upon such filing, the Company shall use reasonable best efforts to cause such Shelf Registration Statement to be declared or become effective and to keep such Shelf Registration Statement continuously effective and in compliance with the Securities Act and usable for resale of such Registrable Securities for a period from the date of its initial effectiveness until such time as there are no Registrable Securities remaining (including by refiling such Shelf Registration Statement (or a new Shelf Registration Statement) if the initial Shelf Registration Statement expires). Notwithstanding the foregoing, if the Company is not eligible to file a registration statement on Form S-3, then the Company shall not be obligated to file a Shelf Registration Statement unless and until requested to do so in writing by the Investor.

(ii) Any registration pursuant to Section 4.5(b)(i) shall be effected by means of a shelf registration on an appropriate form under Rule 415 under the Securities Act (a "*Shelf Registration Statement*"). If the Investor or any other Holder intends to distribute any Registrable Securities by means of an underwritten offering it shall promptly so

advise the Company and the Company shall take all reasonable steps to facilitate such distribution, including the actions required pursuant to Section 4.5(d); *provided* that the Company shall not be required to facilitate an underwritten offering of Registrable Securities unless the expected gross proceeds from such offering exceed (i) 2% of the initial aggregate liquidation preference of the Preferred Shares if such initial aggregate liquidation preference is less than \$2 billion and (ii) \$200 million if the initial aggregate liquidation preference of the Preferred Shares is equal to or greater than \$2 billion. The lead underwriters in any such distribution shall be selected by the Holders of a majority of the Registrable Securities to be distributed; provided that to the extent appropriate and permitted under applicable law, such Holders shall consider the qualifications of any broker-dealer Affiliate of the Company in selecting the lead underwriters in any such distribution.

(iii) The Company shall not be required to effect a registration (including a resale of Registrable Securities from an effective Shelf Registration Statement) or an underwritten offering pursuant to Section 4.5(b): (A) with respect to securities that are not Registrable Securities; or (B) if the Company has notified the Investor and all other Holders that in the good faith judgment of the Board of Directors, it would be materially detrimental to the Company or its security holders for such registration or underwritten offering to be effected at such time, in which event the Company shall have the right to defer such registration for a period of not more than 45 days after receipt of the request of the Investor or any other Holder; provided that such right to delay a registration or underwritten offering shall be exercised by the Company (1) only if the Company has generally exercised (or is concurrently exercising) similar black-out rights against holders of similar securities that have registration rights and (2) not more than three times in any 12-month period and not more than 90 days in the aggregate in any 12-month period.

(iv) If during any period when an effective Shelf Registration Statement is not available, the Company proposes to register any of its equity securities, other than a registration pursuant to Section 4.5(b)(i) or a Special Registration, and the registration form to be filed may be used for the registration or qualification for distribution of Registrable Securities, the Company will give prompt written notice to the Investor and all other Holders of its intention to effect such a registration (but in no event less than ten days prior to the anticipated filing date) and will include in such registration all Registrable Securities with respect to which the Company has received written requests for inclusion therein within ten business days after the date of the Company's notice (a "*Piggyback Registration*"). Any such person that has made such a written request may withdraw its Registrable Securities from such Piggyback Registration by giving written notice to the Company and the managing underwriter, if any, on or before the fifth business day prior to the planned effective date of such Piggyback Registration. The Company may terminate or withdraw any registration under this Section 4.5(b)(iv) prior to the effectiveness of such registration, whether or not Investor or any other Holders have elected to include Registrable Securities in such registration.

(v) If the registration referred to in Section 4.5(b)(iv) is proposed to be underwritten, the Company will so advise Investor and all other Holders as a part of the written notice given pursuant to Section 4.5(b)(iv). In such event, the right of Investor

and all other Holders to registration pursuant to Section 4.5(b) will be conditioned upon such persons' participation in such underwriting and the inclusion of such person's Registrable Securities in the underwriting if such securities are of the same class of securities as the securities to be offered in the underwritten offering, and each such person will (together with the Company and the other persons distributing their securities through such underwriting) enter into an underwriting agreement in customary form with the underwriter or underwriters selected for such underwriting by the Company; provided that the Investor (as opposed to other Holders) shall not be required to indemnify any person in connection with any registration. If any participating person disapproves of the terms of the underwriting, such person may elect to withdraw therefrom by written notice to the Company, the managing underwriters and the Investor (if the Investor is participating in the underwriting).

(vi) If either (x) the Company grants “piggyback” registration rights to one or more third parties to include their securities in an underwritten offering under the Shelf Registration Statement pursuant to Section 4.5(b)(ii) or (y) a Piggyback Registration under Section 4.5(b)(iv) relates to an underwritten offering on behalf of the Company, and in either case the managing underwriters advise the Company that in their reasonable opinion the number of securities requested to be included in such offering exceeds the number which can be sold without adversely affecting the marketability of such offering (including an adverse effect on the per share offering price), the Company will include in such offering only such number of securities that in the reasonable opinion of such managing underwriters can be sold without adversely affecting the marketability of the offering (including an adverse effect on the per share offering price), which securities will be so included in the following order of priority: (A) first, in the case of a Piggyback Registration under Section 4.5(b)(iv), the securities the Company proposes to sell, (B) then the Registrable Securities of the Investor and all other Holders who have requested inclusion of Registrable Securities pursuant to Section 4.5(b)(ii) or Section 4.5(b)(iv), as applicable, *pro rata* on the basis of the aggregate number of such securities or shares owned by each such person and (C) lastly, any other securities of the Company that have been requested to be so included, subject to the terms of this Agreement; *provided*, however, that if the Company has, prior to the Signing Date, entered into an agreement with respect to its securities that is inconsistent with the order of priority contemplated hereby then it shall apply the order of priority in such conflicting agreement to the extent that it would otherwise result in a breach under such agreement.

(c) Expenses of Registration. All Registration Expenses incurred in connection with any registration, qualification or compliance hereunder shall be borne by the Company. All Selling Expenses incurred in connection with any registrations hereunder shall be borne by the holders of the securities so registered *pro rata* on the basis of the aggregate offering or sale price of the securities so registered.

(d) Obligations of the Company. Whenever required to effect the registration of any Registrable Securities or facilitate the distribution of Registrable Securities pursuant to an effective Shelf Registration Statement, the Company shall, as expeditiously as reasonably practicable:

(i) Prepare and file with the SEC a prospectus supplement or post-effective amendment with respect to a proposed offering of Registrable Securities pursuant to an effective registration statement, subject to Section 4.5(d), keep such registration statement effective and keep such prospectus supplement current until the securities described therein are no longer Registrable Securities.

(ii) Prepare and file with the SEC such amendments and supplements to the applicable registration statement and the prospectus or prospectus supplement used in connection with such registration statement as may be necessary to comply with the provisions of the Securities Act with respect to the disposition of all securities covered by such registration statement.

(iii) Furnish to the Holders and any underwriters such number of copies of the applicable registration statement and each such amendment and supplement thereto (including in each case all exhibits) and of a prospectus, including a preliminary prospectus, in conformity with the requirements of the Securities Act, and such other documents as they may reasonably request in order to facilitate the disposition of Registrable Securities owned or to be distributed by them.

(iv) Use its reasonable best efforts to register and qualify the securities covered by such registration statement under such other securities or Blue Sky laws of such jurisdictions as shall be reasonably requested by the Holders or any managing underwriter(s), to keep such registration or qualification in effect for so long as such registration statement remains in effect, and to take any other action which may be reasonably necessary to enable such seller to consummate the disposition in such jurisdictions of the securities owned by such Holder; provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions.

(v) Notify each Holder of Registrable Securities at any time when a prospectus relating thereto is required to be delivered under the Securities Act of the happening of any event as a result of which the applicable prospectus, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing.

(vi) Give written notice to the Holders:

(A) when any registration statement filed pursuant to Section 4.5(a) or any amendment thereto has been filed with the SEC (except for any amendment effected by the filing of a document with the SEC pursuant to the Exchange Act) and when such registration statement or any post-effective amendment thereto has become effective;

(B) of any request by the SEC for amendments or supplements to any registration statement or the prospectus included therein or for additional information;

(C) of the issuance by the SEC of any stop order suspending the effectiveness of any registration statement or the initiation of any proceedings for that purpose;

(D) of the receipt by the Company or its legal counsel of any notification with respect to the suspension of the qualification of the applicable Registrable Securities for sale in any jurisdiction or the initiation or threatening of any proceeding for such purpose;

(E) of the happening of any event that requires the Company to make changes in any effective registration statement or the prospectus related to the registration statement in order to make the statements therein not misleading (which notice shall be accompanied by an instruction to suspend the use of the prospectus until the requisite changes have been made); and

(F) if at any time the representations and warranties of the Company contained in any underwriting agreement contemplated by Section 4.5(d)(x) cease to be true and correct.

(vii) Use its reasonable best efforts to prevent the issuance or obtain the withdrawal of any order suspending the effectiveness of any registration statement referred to in Section 4.5(d)(vi)(C) at the earliest practicable time.

(viii) Upon the occurrence of any event contemplated by Section 4.5(d)(v) or 4.5(d)(vi)(E), promptly prepare a post-effective amendment to such registration statement or a supplement to the related prospectus or file any other required document so that, as thereafter delivered to the Holders and any underwriters, the prospectus will not contain an untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. If the Company notifies the Holders in accordance with Section 4.5(d)(vi)(E) to suspend the use of the prospectus until the requisite changes to the prospectus have been made, then the Holders and any underwriters shall suspend use of such prospectus and use their reasonable best efforts to return to the Company all copies of such prospectus (at the Company's expense) other than permanent file copies then in such Holders' or underwriters' possession. The total number of days that any such suspension may be in effect in any 12-month period shall not exceed 90 days.

(ix) Use reasonable best efforts to procure the cooperation of the Company's transfer agent in settling any offering or sale of Registrable Securities, including with respect to the transfer of physical stock certificates into book-entry form in accordance with any procedures reasonably requested by the Holders or any managing underwriter(s).

(x) If an underwritten offering is requested pursuant to Section 4.5(b)(ii), enter into an underwriting agreement in customary form, scope and substance and take all such other actions reasonably requested by the Holders of a majority of the Registrable Securities being sold in connection therewith or by the managing underwriter(s), if any,

to expedite or facilitate the underwritten disposition of such Registrable Securities, and in connection therewith in any underwritten offering (including making members of management and executives of the Company available to participate in “road shows”, similar sales events and other marketing activities), (A) make such representations and warranties to the Holders that are selling stockholders and the managing underwriter(s), if any, with respect to the business of the Company and its subsidiaries, and the Shelf Registration Statement, prospectus and documents, if any, incorporated or deemed to be incorporated by reference therein, in each case, in customary form, substance and scope, and, if true, confirm the same if and when requested, (B) use its reasonable best efforts to furnish the underwriters with opinions of counsel to the Company, addressed to the managing underwriter(s), if any, covering the matters customarily covered in such opinions requested in underwritten offerings, (C) use its reasonable best efforts to obtain “cold comfort” letters from the independent certified public accountants of the Company (and, if necessary, any other independent certified public accountants of any business acquired by the Company for which financial statements and financial data are included in the Shelf Registration Statement) who have certified the financial statements included in such Shelf Registration Statement, addressed to each of the managing underwriter(s), if any, such letters to be in customary form and covering matters of the type customarily covered in “cold comfort” letters, (D) if an underwriting agreement is entered into, the same shall contain indemnification provisions and procedures customary in underwritten offerings (provided that the Investor shall not be obligated to provide any indemnity), and (E) deliver such documents and certificates as may be reasonably requested by the Holders of a majority of the Registrable Securities being sold in connection therewith, their counsel and the managing underwriter(s), if any, to evidence the continued validity of the representations and warranties made pursuant to clause (i) above and to evidence compliance with any customary conditions contained in the underwriting agreement or other agreement entered into by the Company.

(xi) Make available for inspection by a representative of Holders that are selling stockholders, the managing underwriter(s), if any, and any attorneys or accountants retained by such Holders or managing underwriter(s), at the offices where normally kept, during reasonable business hours, financial and other records, pertinent corporate documents and properties of the Company, and cause the officers, directors and employees of the Company to supply all information in each case reasonably requested (and of the type customarily provided in connection with due diligence conducted in connection with a registered public offering of securities) by any such representative, managing underwriter(s), attorney or accountant in connection with such Shelf Registration Statement.

(xii) Use reasonable best efforts to cause all such Registrable Securities to be listed on each national securities exchange on which similar securities issued by the Company are then listed or, if no similar securities issued by the Company are then listed on any national securities exchange, use its reasonable best efforts to cause all such Registrable Securities to be listed on such securities exchange as the Investor may designate.

(xiii) If requested by Holders of a majority of the Registrable Securities being registered and/or sold in connection therewith, or the managing underwriter(s), if any, promptly include in a prospectus supplement or amendment such information as the Holders of a majority of the Registrable Securities being registered and/or sold in connection therewith or managing underwriter(s), if any, may reasonably request in order to permit the intended method of distribution of such securities and make all required filings of such prospectus supplement or such amendment as soon as practicable after the Company has received such request.

(xiv) Timely provide to its security holders earning statements satisfying the provisions of Section 11 (a) of the Securities Act and Rule 158 thereunder.

(e) Suspension of Sales. Upon receipt of written notice from the Company that a registration statement, prospectus or prospectus supplement contains or may contain an untrue statement of a material fact or omits or may omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading or that circumstances exist that make inadvisable use of such registration statement, prospectus or prospectus supplement, the Investor and each Holder of Registrable Securities shall forthwith discontinue disposition of Registrable Securities until the Investor and/or Holder has received copies of a supplemented or amended prospectus or prospectus supplement, or until the Investor and/or such Holder is advised in writing by the Company that the use of the prospectus and, if applicable, prospectus supplement may be resumed, and, if so directed by the Company, the Investor and/or such Holder shall deliver to the Company (at the Company's expense) all copies, other than permanent file copies then in the Investor and/or such Holder's possession, of the prospectus and, if applicable, prospectus supplement covering such Registrable Securities current at the time of receipt of such notice. The total number of days that any such suspension may be in effect in any 12-month period shall not exceed 90 days.

(f) Termination of Registration Rights. A Holder's registration rights as to any securities held by such Holder (and its Affiliates, partners, members and former members) shall not be available unless such securities are Registrable Securities.

(g) Furnishing Information.

(i) Neither the Investor nor any Holder shall use any free writing prospectus (as defined in Rule 405) in connection with the sale of Registrable Securities without the prior written consent of the Company.

(ii) It shall be a condition precedent to the obligations of the Company to take any action pursuant to Section 4.5(d) that Investor and/or the selling Holders and the underwriters, if any, shall furnish to the Company such information regarding themselves, the Registrable Securities held by them and the intended method of disposition of such securities as shall be required to effect the registered offering of their Registrable Securities.

(h) Indemnification.

(i) The Company agrees to indemnify each Holder and, if a Holder is a person other than an individual, such Holder's officers, directors, employees, agents, representatives and Affiliates, and each Person, if any, that controls a Holder within the meaning of the Securities Act (each, an "*Indemnitee*"), against any and all losses, claims, damages, actions, liabilities, costs and expenses (including reasonable fees, expenses and disbursements of attorneys and other professionals incurred in connection with investigating, defending, settling, compromising or paying any such losses, claims, damages, actions, liabilities, costs and expenses), joint or several, arising out of or based upon any untrue statement or alleged untrue statement of material fact contained in any registration statement, including any preliminary prospectus or final prospectus contained therein or any amendments or supplements thereto or any documents incorporated therein by reference or contained in any free writing prospectus (as such term is defined in Rule 405) prepared by the Company or authorized by it in writing for use by such Holder (or any amendment or supplement thereto); or any omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading; *provided*, that the Company shall not be liable to such Indemnitee in any such case to the extent that any such loss, claim, damage, liability (or action or proceeding in respect thereof) or expense arises out of or is based upon (A) an untrue statement or omission made in such registration statement, including any such preliminary prospectus or final prospectus contained therein or any such amendments or supplements thereto or contained in any free writing prospectus (as such term is defined in Rule 405) prepared by the Company or authorized by it in writing for use by such Holder (or any amendment or supplement thereto), in reliance upon and in conformity with information regarding such Indemnitee or its plan of distribution or ownership interests which was furnished in writing to the Company by such Indemnitee for use in connection with such registration statement, including any such preliminary prospectus or final prospectus contained therein or any such amendments or supplements thereto, or (B) offers or sales effected by or on behalf of such Indemnitee "by means of" (as defined in Rule 159A) a "free writing prospectus" (as defined in Rule 405) that was not authorized in writing by the Company.

(ii) If the indemnification provided for in Section 4.5(h)(i) is unavailable to an Indemnitee with respect to any losses, claims, damages, actions, liabilities, costs or expenses referred to therein or is insufficient to hold the Indemnitee harmless as contemplated therein, then the Company, in lieu of indemnifying such Indemnitee, shall contribute to the amount paid or payable by such Indemnitee as a result of such losses, claims, damages, actions, liabilities, costs or expenses in such proportion as is appropriate to reflect the relative fault of the Indemnitee, on the one hand, and the Company, on the other hand, in connection with the statements or omissions which resulted in such losses, claims, damages, actions, liabilities, costs or expenses as well as any other relevant equitable considerations. The relative fault of the Company, on the one hand, and of the Indemnitee, on the other hand, shall be determined by reference to, among other factors, whether the untrue statement of a material fact or omission to state a material fact relates to information supplied by the Company or by the Indemnitee and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such

statement or omission; the Company and each Holder agree that it would not be just and equitable if contribution pursuant to this Section 4.5(h)(ii) were determined by pro rata allocation or by any other method of allocation that does not take account of the equitable considerations referred to in Section 4.5(h)(i). No Indemnitee guilty of fraudulent misrepresentation (within the meaning of Section 11 (f) of the Securities Act) shall be entitled to contribution from the Company if the Company was not guilty of such fraudulent misrepresentation.

(i) Assignment of Registration Rights. The rights of the Investor to registration of Registrable Securities pursuant to Section 4.5(b) may be assigned by the Investor to a transferee or assignee of Registrable Securities with a liquidation preference or, in the case of the Warrant, the liquidation preference of the underlying shares of Warrant Preferred Stock, no less than an amount equal to (i) 2% of the initial aggregate liquidation preference of the Preferred Shares if such initial aggregate liquidation preference is less than \$2 billion and (ii) \$200 million if the initial aggregate liquidation preference of the Preferred Shares is equal to or greater than \$2 billion; provided, however, the transferor shall, within ten days after such transfer, furnish to the Company written notice of the name and address of such transferee or assignee and the number and type of Registrable Securities that are being assigned.

(j) Clear Market. With respect to any underwritten offering of Registrable Securities by the Investor or other Holders pursuant to this Section 4.5, the Company agrees not to effect (other than pursuant to such registration or pursuant to a Special Registration) any public sale or distribution, or to file any Shelf Registration Statement (other than such registration or a Special Registration) covering any preferred stock of the Company or any securities convertible into or exchangeable or exercisable for preferred stock of the Company, during the period not to exceed ten days prior and 60 days following the effective date of such offering or such longer period up to 90 days as may be requested by the managing underwriter for such underwritten offering. The Company also agrees to cause such of its directors and senior executive officers to execute and deliver customary lock-up agreements in such form and for such time period up to 90 days as may be requested by the managing underwriter. "Special Registration" means the registration of equity securities and/or options or other rights in respect thereof solely registered on Form S4 or Form S-8 (or successor form) or (B) shares of equity securities and/or options or other rights in respect thereof to be offered to directors, members of management, employees, consultants, customers, lenders or vendors of the Company or Company Subsidiaries or in connection with dividend reinvestment plans.

(k) Rule 144; Rule 144A. With a view to making available to the Investor and Holders the benefits of certain rules and regulations of the SEC which may permit the sale of the Registrable Securities to the public without registration, the Company agrees to use its reasonable best efforts to:

(i) make and keep public information available, as those terms are understood and defined in Rule 144(c)(1) or any similar or analogous rule promulgated under the Securities Act, at all times after the Signing Date;

(ii) (A) file with the SEC, in a timely manner, all reports and other documents required of the Company under the Exchange Act, and (B) if at any time the Company is

not required to file such reports, make available, upon the request of any Holder, such information necessary to permit sales pursuant to Rule 144A (including the information required by Rule 144A(d)(4) under the Securities Act);

(iii) so long as the Investor or a Holder owns any Registrable Securities, furnish to the Investor or such Holder forthwith upon request: a written statement by the Company as to its compliance with the reporting requirements of Rule 144 under the Securities Act, and of the Exchange Act; a copy of the most recent annual or quarterly report of the Company; and such other reports and documents as the Investor or Holder may reasonably request in availing itself of any rule or regulation of the SEC allowing it to sell any such securities to the public without registration; and

(iv) take such further action as any Holder may reasonably request, all to the extent required from time to time to enable such Holder to sell Registrable Securities without registration under the Securities Act.

(l) As used in this Section 4.5, the following terms shall have the following respective meanings:

(i) “*Holder*” means the Investor and any other holder of Registrable Securities to whom the registration rights conferred by this Agreement have been transferred in compliance with Section 4.5(h) hereof.

(ii) “*Holders' Counsel*” means one counsel for the selling Holders chosen by Holders holding a majority interest in the Registrable Securities being registered.

(iii) “*Register*,” “*registered*,” and “*registration*” shall refer to a registration effected by preparing and (A) filing a registration statement or amendment thereto in compliance with the Securities Act and applicable rules and regulations thereunder, and the declaration or ordering of effectiveness of such registration statement or amendment thereto or (B) filing a prospectus and/or prospectus supplement in respect of an appropriate effective registration statement on Form S-3.

(iv) “*Registrable Securities*” means (A) all Preferred Shares, (B) the Warrant (subject to Section 4.5(q)) and (C) any equity securities issued or issuable directly or indirectly with respect to the securities referred to in the foregoing clauses (A) or (B) by way of conversion, exercise or exchange thereof, including the Warrant Shares, or share dividend or share split or in connection with a combination of shares, recapitalization, reclassification, merger, amalgamation, arrangement, consolidation or other reorganization, *provided* that, once issued, such securities will not be Registrable Securities when (1) they are sold pursuant to an effective registration statement under the Securities Act, (2) except as provided below in Section 4.5(p), they may be sold pursuant to Rule 144 without limitation thereunder on volume or manner of sale, (3) they shall have ceased to be outstanding or (4) they have been sold in a private transaction in which the transferor's rights under this Agreement are not assigned to the transferee of the securities. No Registrable Securities may be registered under more than one registration statement at any one time.

(v) “*Registration Expenses*” mean all expenses incurred by the Company in effecting any registration pursuant to this Agreement (whether or not any registration or prospectus becomes effective or final) or otherwise complying with its obligations under this Section 4.5, including all registration, filing and listing fees, printing expenses, fees and disbursements of counsel for the Company, blue sky fees and expenses, expenses incurred in connection with any “road show”, the reasonable fees and disbursements of Holders' Counsel, and expenses of the Company's independent accountants in connection with any regular or special reviews or audits incident to or required by any such registration, but shall not include Selling Expenses.

(vi) “*Rule 144*”, “*Rule 144A*”, “*Rule 159A*”, “*Rule 405*” and “*Rule 415*” mean, in each case, such rule promulgated under the Securities Act (or any successor provision), as the same shall be amended from time to time.

(vii) “*Selling Expenses*” mean all discounts, selling commissions and stock transfer taxes applicable to the sale of Registrable Securities and fees and disbursements of counsel for any Holder (other than the fees and disbursements of Holders' Counsel included in Registration Expenses).

(m) At any time, any holder of Securities (including any Holder) may elect to forfeit its rights set forth in this Section 4.5 from that date forward; *provided*, that a Holder forfeiting such rights shall nonetheless be entitled to participate under Section 4.5(b)(iv) - (vi) in any Pending Underwritten Offering to the same extent that such Holder would have been entitled to if the holder had not withdrawn; and *provided, further*, that no such forfeiture shall terminate a Holder's rights or obligations under Section 4.5(g) with respect to any prior registration or Pending Underwritten Offering. “*Pending Underwritten Offering*” means, with respect to any Holder forfeiting its rights pursuant to this Section 4.5(m), any underwritten offering of Registrable Securities in which such Holder has advised the Company of its intent to register its Registrable Securities either pursuant to Section 4.5(b)(ii) or 4.5(b)(iv) prior to the date of such Holder's forfeiture.

(n) Specific Performance. The parties hereto acknowledge that there would be no adequate remedy at law if the Company fails to perform any of its obligations under this Section 4.5 and that the Investor and the Holders from time to time may be irreparably harmed by any such failure, and accordingly agree that the Investor and such Holders, in addition to any other remedy to which they may be entitled at law or in equity, to the fullest extent permitted and enforceable under applicable law shall be entitled to compel specific performance of the obligations of the Company under this Section 4.5 in accordance with the terms and conditions of this Section 4.5.

(o) No Inconsistent Agreements. The Company shall not, on or after the Signing Date, enter into any agreement with respect to its securities that may impair the rights granted to the Investor and the Holders under this Section 4.5 or that otherwise conflicts with the provisions hereof in any manner that may impair the rights granted to the Investor and the Holders under this Section 4.5. In the event the Company has, prior to the Signing Date, entered into any agreement with respect to its securities that is inconsistent with the rights granted to the Investor and the Holders under this Section 4.5 (including agreements that are inconsistent with the order

of priority contemplated by Section 4.5(b)(vi)) or that may otherwise conflict with the provisions hereof, the Company shall use its reasonable best efforts to amend such agreements to ensure they are consistent with the provisions of this Section 4.5.

(p) Certain Offerings by the Investor. In the case of any securities held by the Investor that cease to be Registrable Securities solely by reason of clause (2) in the definition of "Registrable Securities," the provisions of Sections 4.5(b)(ii), clauses (iv), (ix) and (x)-(xii) of Section 4.5(d), Section 4.5(h) and Section 4.50) shall continue to apply until such securities otherwise cease to be Registrable Securities. In any such case, an "underwritten" offering or other disposition shall include any distribution of such securities on behalf of the Investor by one or more broker-dealers, an "underwriting agreement" shall include any purchase agreement entered into by such broker-dealers, and any "registration statement" or "prospectus" shall include any offering document approved by the Company and used in connection with such distribution.

(q) Registered Sales of the Warrant. The Holders agree to sell the Warrant or any portion thereof under the Shelf Registration Statement only beginning 30 days after notifying the Company of any such sale, during which 30-day period the Investor and all Holders of the Warrant shall take reasonable steps to agree to revisions to the Warrant to permit a public distribution of the Warrant, including entering into a warrant agreement and appointing a warrant agent.

4.6 Depository Shares. Upon request by the Investor at any time following the Closing Date, the Company shall promptly enter into a depository arrangement, pursuant to customary agreements reasonably satisfactory to the Investor and with a depository reasonably acceptable to the Investor, pursuant to which the Preferred Shares or the Warrant Shares may be deposited and depository shares, each representing a fraction of a Preferred Share or Warrant Share, as applicable, as specified by the Investor, may be issued. From and after the execution of any such depository arrangement, and the deposit of any Preferred Shares or Warrant Shares, as applicable, pursuant thereto, the depository shares issued pursuant thereto shall be deemed "Preferred Shares", "Warrant Shares" and, as applicable, "Registrable Securities" for purposes of this Agreement.

4.7 Restriction on Dividends and Repurchases.

(a) Prior to the earlier of (x) the third anniversary of the Closing Date and (y) the date on which all of the Preferred Shares and Warrant Shares have been redeemed in whole or the Investor has transferred all of the Preferred Shares and Warrant Shares to third parties which are not Affiliates of the Investor, neither the Company nor any Company Subsidiary shall, without the consent of the Investor, declare or pay any dividend or make any distribution on capital stock or other equity securities of any kind of the Company or any Company Subsidiary (other than (i) regular quarterly cash dividends of not more than the amount of the last quarterly cash dividend per share declared or, if lower, announced to its holders of Common Stock an intention to declare, on the Common Stock prior to November 17, 2008, as adjusted for any stock split, stock dividend, reverse stock split, reclassification or similar transaction, (ii) dividends payable solely in shares of Common Stock, (iii) regular dividends on shares of preferred stock in accordance with the terms thereof and which are permitted under the terms of the Preferred Shares and the

Warrant Shares, (iv) dividends or distributions by any wholly-owned Company Subsidiary or (v) dividends or distributions by any Company Subsidiary required pursuant to binding contractual agreements entered into prior to November 17, 2008).

(b) During the period beginning on the third anniversary of the Closing Date and ending on the earlier of (i) the tenth anniversary of the Closing Date and (ii) the date on which all of the Preferred Shares and Warrant Shares have been redeemed in whole or the Investor has transferred all of the Preferred Shares and Warrant Shares to third parties which are not Affiliates of the Investor, neither the Company nor any Company Subsidiary shall, without the consent of the Investor, (A) pay any per share dividend or distribution on capital stock or other equity securities of any kind of the Company at a per annum rate that is in excess of 103% of the aggregate per share dividends and distributions for the immediately prior fiscal year (other than regular dividends on shares of preferred stock in accordance with the terms thereof and which are permitted under the terms of the Preferred Shares and the Warrant Shares); provided that no increase in the aggregate amount of dividends or distributions on Common Stock shall be permitted as a result of any dividends or distributions paid in shares of Common Stock, any stock split or any similar transaction or (B) pay aggregate dividends or distributions on capital stock or other equity securities of any kind of any Company Subsidiary that is in excess of 103% of the aggregate dividends and distributions paid for the immediately prior fiscal year (other than in the case of this clause (B), (1) regular dividends on shares of preferred stock in accordance with the terms thereof and which are permitted under the terms of the Preferred Shares and the Warrant Shares, (2) dividends or distributions by any wholly-owned Company Subsidiary, (3) dividends or distributions by any Company Subsidiary required pursuant to binding contractual agreements entered into prior to November 17, 2008) or (4) dividends or distributions on newly issued shares of capital stock for cash or other property.

(c) Prior to the earlier of (x) the tenth anniversary of the Closing Date and (y) the date on which all of the Preferred Shares and Warrant Shares have been redeemed in whole or the Investor has transferred all of the Preferred Shares and Warrant Shares to third parties which are not Affiliates of the Investor, neither the Company nor any Company Subsidiary shall, without the consent of the Investor, redeem, purchase or acquire any shares of Common Stock or other capital stock or other equity securities of any kind of the Company or any Company Subsidiary, or any trust preferred securities issued by the Company or any Affiliate of the Company, other than (i) redemptions, purchases or other acquisitions of the Preferred Shares and Warrant Shares, in connection with the administration of any employee benefit plan in the ordinary course of business and consistent with past practice, (iii) the acquisition by the Company or any of the Company Subsidiaries of record ownership in Junior Stock or Parity Stock for the beneficial ownership of any other persons (other than the Company or any other Company Subsidiary), including as trustees or custodians, (iv) the exchange or conversion of Junior Stock for or into other Junior Stock or of Parity Stock or trust preferred securities for or into other Parity Stock (with the same or lesser aggregate liquidation amount) or Junior Stock, in each case set forth in this clause (iv), solely to the extent required pursuant to binding contractual agreements entered into prior to the Signing Date or any subsequent agreement for the accelerated exercise, settlement or exchange thereof for Common Stock (clauses (ii) and (iii), collectively, the "*Permitted Repurchases*"), (v) redemptions of securities held by the Company or any wholly owned Company Subsidiary or (vi) redemptions, purchases or other acquisitions of capital stock

or other equity securities of any kind of any Company Subsidiary required pursuant to binding contractual agreements entered into prior to November 17, 2008.

(d) Until such time as the Investor ceases to own any Preferred Shares or Warrant Shares, the Company shall not repurchase any Preferred Shares or Warrant Shares from any holder thereof, whether by means of open market purchase, negotiated transaction, or otherwise, other than Permitted Repurchases, unless it offers to repurchase a ratable portion of the Preferred Shares or Warrant Shares, as the case may be, then held by the Investor on the same terms and conditions.

(e) During the period beginning on the tenth anniversary of the Closing and ending on the date on which all of the Preferred Shares and Warrant Shares have been redeemed in whole or the Investor has transferred all of the Preferred Shares and Warrant Shares to third parties which are not Affiliates of the Investor, neither the Company nor any Company Subsidiary shall, without the consent of the Investor, (i) declare or pay any dividend or make any distribution on capital stock or other equity securities of any kind of the Company or any Company Subsidiary; or (ii) redeem, purchase or acquire any shares of Common Stock or other capital stock or other equity securities of any kind of the Company or any Company Subsidiary, or any trust preferred securities issued by the Company or any Affiliate of the Company, other than (A) redemptions, purchases or other acquisitions of the Preferred Shares and Warrant Shares, (B) regular dividends on shares of preferred stock in accordance with the terms thereof and which are permitted under the terms of the Preferred Shares and the Warrant Shares, or (C) dividends or distributions by any wholly-owned Company Subsidiary.

(f) “*Junior Stock*” means Common Stock and any other class or series of stock of the Company the terms of which expressly provide that it ranks junior to the Preferred Shares as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Company. “*Parity Stock*” means any class or series of stock of the Company the terms of which do not expressly provide that such class or series will rank senior or junior to the Preferred Shares as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Company (in each case without regard to whether dividends accrue cumulatively or non-cumulatively).

4.8 Executive Compensation. Until such time as the Investor ceases to own any debt or equity securities of the Company acquired pursuant to this Agreement or the Warrant, the Company shall take all necessary action to ensure that its Benefit Plans with respect to its Senior Executive Officers comply in all respects with Section III (b) of the EESA as implemented by any guidance or regulation thereunder that has been issued and is in effect as of the Closing Date, and shall not adopt any new Benefit Plan with respect to its Senior Executive Officers that does not comply therewith. “*Senior Executive Officers*” means the Company’s “senior executive officers” as defined in subsection 111(b)(3) of the EESA and regulations issued thereunder, including the rules set forth in 31 C.F.R. Part 30.

4.9 Related Party Transactions. Until such time as the Investor ceases to own any Purchased Securities or Warrant Shares, the Company and the Company Subsidiaries shall not enter into transactions with Affiliates or related persons (within the meaning of Item 404 under the SEC’s Regulation S-K) unless (i) such transactions are on terms no less favorable to the Company and the Company Subsidiaries than could be obtained from an unaffiliated third party,

and (ii) have been approved by the audit committee of the Board of Directors or comparable body of independent directors of the Company.

4.10 Bank: and Thrift Holding Company Status. If the Company is a Bank: Holding Company or a Savings and Loan Holding Company on the Signing Date, then the Company shall maintain its status as a Bank: Holding Company or Savings and Loan Holding Company, as the case may be, for as long as the Investor owns any Purchased Securities or Warrant Shares. The Company shall redeem all Purchased Securities and Warrant Shares held by the Investor prior to terminating its status as a Bank Holding Company or Savings and Loan Holding Company, as applicable. “*Bank Holding Company*” means a company registered as such with the Board of Governors of the Federal Reserve System (the “*Federal Reserve*”) pursuant to 12 U.S.C. §1842 and the regulations of the Federal Reserve promulgated thereunder. “*Savings and Loan Holding Company*” means a company registered as such with the Office of Thrift Supervision pursuant to 12 U.S.C. §1467(a) and the regulations of the Office of Thrift Supervision promulgated thereunder.

4.11 Predominantly Financial. For as long as the Investor owns any Purchased Securities or Warrant Shares, the Company, to the extent it is not itself an insured depository institution, agrees to remain predominantly engaged in financial activities. A company is predominantly engaged in financial activities if the annual gross revenues derived by the company and all subsidiaries of the company (excluding revenues derived from subsidiary depository institutions), on a consolidated basis, from engaging in activities that are financial in nature or are incidental to a financial activity under subsection (k) of Section 4 of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)) represent at least 85 percent of the consolidated annual gross revenues of the company.

ARTICLE V MISCELLANEOUS

5.1 Termination. This Agreement may be terminated at any time prior to the Closing:

(a) by either the Investor or the Company if the Closing shall not have occurred by the 30th calendar day following the Signing Date; provided, however, that in the event the Closing has not occurred by such 30th calendar day, the parties will consult in good faith to determine whether to extend the term of this Agreement, it being understood that the parties shall be required to consult only until the fifth day after such 30th calendar day and not be under any obligation to extend the term of this Agreement thereafter; provided, further, that the right to terminate this Agreement under this Section 5.1(a) shall not be available to any party whose breach of any representation or warranty or failure to perform any obligation under this Agreement shall have caused or resulted in the failure of the Closing to occur on or prior to such date; or

(b) by either the Investor or the Company in the event that any Governmental Entity shall have issued an order, decree or ruling or taken any other action restraining, enjoining or otherwise prohibiting the transactions contemplated by this Agreement and such order, decree, ruling or other action shall have become final and nonappealable; or

(c) by the mutual written consent of the Investor and the Company.

In the event of termination of this Agreement as provided in this Section 5.1, this Agreement shall forthwith become void and there shall be no liability on the part of either party hereto except that nothing herein shall relieve either party from liability for any breach of this Agreement.

5.2 Survival of Representations and Warranties. All covenants and agreements, other than those which by their terms apply in whole or in part after the Closing, shall terminate as of the Closing. The representations and warranties of the Company made herein or in any certificates delivered in connection with the Closing shall survive the Closing without limitation.

5.3 Amendment. No amendment of any provision of this Agreement will be effective unless made in writing and signed by an officer or a duly authorized representative of each party; *provided* that the Investor may unilaterally amend any provision of this Agreement to the extent required to comply with any changes after the Signing Date in applicable federal statutes. No failure or delay by any party in exercising any right, power or privilege hereunder shall operate as a waiver thereof nor shall any single or partial exercise thereof preclude any other or further exercise of any other right, power or privilege. The rights and remedies herein provided shall be cumulative of any rights or remedies provided by law.

5.4 Waiver of Conditions. The conditions to each party's obligation to consummate the Purchase are for the sole benefit of such party and may be waived by such party in whole or in part to the extent permitted by applicable law. No waiver will be effective unless it is in a writing signed by a duly authorized officer of the waiving party that makes express reference to the provision or provisions subject to such waiver.

5.5 Governing Law: Submission to Jurisdiction, Etc. **This Agreement will be governed by and construed in accordance with the federal law of the United States if and to the extent such law is applicable, and otherwise in accordance with the laws of the State of New York applicable to contracts made and to be performed entirely within such State. Each of the parties hereto agrees (a) to submit to the exclusive jurisdiction and venue of the United States District Court for the District of Columbia and the United States Court of Federal Claims for any and all civil actions, suits or proceedings arising out of or relating to this Agreement or the Warrant or the transactions contemplated hereby or thereby, and (b) that notice may be served upon (i) the Company at the address and in the manner set forth for notices to the Company in Section 5.6 and (ii) the Investor in accordance with federal law. To the extent permitted by applicable law, each of the parties hereto hereby unconditionally waives trial by jury in any civil legal action or proceeding relating to this Agreement or the Warrant or the transactions contemplated hereby or thereby.**

5.6 Notices. Any notice, request, instruction or other document to be given hereunder by any party to the other will be in writing and will be deemed to have been duly given (a) on the date of delivery if delivered personally, or by facsimile, upon confirmation of receipt, or (b) on the second business day following the date of dispatch if delivered by a recognized next day courier service. All notices to the Company shall be delivered as set forth in Schedule A, or pursuant to such other instruction as may be designated in writing by the Company to the

Investor. All notices to the Investor shall be delivered as set forth below, or pursuant to such other instructions as may be designated in writing by the Investor to the Company.

If to the Investor:

United States Department of the Treasury
1500 Pennsylvania Avenue, NW, Room 2312
Washington, D.C. 20220
Attention: Assistant General Counsel (Banking and Finance)
Facsimile: (202) 622-1974

5.7 Definitions

(a) When a reference is made in this Agreement to a subsidiary of a person, the term “subsidiary” means any corporation, partnership, joint venture, limited liability company or other entity (x) of which such person or a subsidiary of such person is a general partner or (y) of which a majority of the voting securities or other voting interests, or a majority of the securities or other interests of which having by their terms ordinary voting power to elect a majority of the board of directors or persons performing similar functions with respect to such entity, is directly or indirectly owned by such person and/or one or more subsidiaries thereof.

(b) The term “*Affiliate*” means, with respect to any person, any person directly or indirectly controlling, controlled by or under common control with, such other person. For purposes of this definition, “*control*” (including, with correlative meanings, the terms “*controlled by*” and “*under common control with*”) when used with respect to any person, means the possession, directly or indirectly, of the power to cause the direction of management and/or policies of such person, whether through the ownership of voting securities by contract or otherwise.

(c) The terms “*knowledge of the Company*” or “*Company's knowledge*” mean the actual knowledge after reasonable and due inquiry of the “officers” (as such term is defined in Rule 3b-2 under the Exchange Act, but excluding any Vice President or Secretary) of the Company.

5.8 Assignment. Neither this Agreement nor any right, remedy, obligation nor liability arising hereunder or by reason hereof shall be assignable by any party hereto without the prior written consent of the other party, and any attempt to assign any right, remedy, obligation or liability hereunder without such consent shall be void, except (a) an assignment, in the case of a merger, consolidation, statutory share exchange or similar transaction that requires the approval of the Company's stockholders (a “*Business Combination*”) where such party is not the surviving entity, or a sale of substantially all of its assets, to the entity which is the survivor of such Business Combination or the purchaser in such sale and (b) as provided in Sections 3.5 and 4.5.

5.9 Severability. If any provision of this Agreement or the Warrant, or the application thereof to any person or circumstance, is determined by a court of competent jurisdiction to be invalid, void or unenforceable, the remaining provisions hereof, or the

application of such provision to persons or circumstances other than those as to which it has been held invalid or unenforceable, will remain in full force and effect and shall in no way be affected, impaired or invalidated thereby, so long as the economic or legal substance of the transactions contemplated hereby is not affected in any manner materially adverse to any party. Upon such determination, the parties shall negotiate in good faith in an effort to agree upon a suitable and equitable substitute provision to effect the original intent of the parties.

5.10 No Third Party Beneficiaries. Nothing contained in this Agreement, expressed or implied, is intended to confer upon any person or entity other than the Company and the Investor any benefit, right or remedies, except that the provisions of Section 4.5 shall inure to the benefit of the persons referred to in that Section.

* * *

FORM OF CERTIFICATE OF DESIGNATIONS FOR PREFERRED STOCK

[SEE ATTACHED]

FORM OF [CERTIFICATE OF DESIGNATIONS]
OF
FIXED RATE CUMULATIVE PERPETUAL PREFERRED STOCK, SERIES [●]
OF
[●]

[*Insert name of Issuer*], a [corporation/bank/banking association] organized and existing under the laws of the [*Insert jurisdiction of organization*] (the “Issuer”), in accordance with the provisions of Section[s] [●] of the [*Insert applicable statute*] thereof, does hereby certify:

The board of directors of the Issuer (the “Board of Directors”) or an applicable committee of the Board of Directors, in accordance with the [[certificate of incorporation/articles of association] and bylaws] of the Issuer and applicable law, adopted the following resolution on [●] creating a series of [●] shares of Preferred Stock of the Issuer designated as “Fixed Rate Cumulative Perpetual Preferred Stock, Series [●]”.

RESOLVED, that pursuant to the provisions of the [[certificate of incorporation/articles of association] and the bylaws] of the Issuer and applicable law, a series of Preferred Stock, par value \$[●] per share, of the Issuer be and hereby is created, and that the designation and number of shares of such series, and the voting and other powers, preferences and relative, participating, optional or other rights, and the qualifications, limitations and restrictions thereof, of the shares of such series, are as follows:

Part 1. Designation and Number of Shares. There is hereby created out of the authorized and unissued shares of preferred stock of the Issuer a series of preferred stock designated as the “Fixed Rate Cumulative Perpetual Preferred Stock, Series [●]” (the “Designated Preferred Stock”). The authorized number of shares of Designated Preferred Stock shall be [●].

Part 2. Standard Provisions. The Standard Provisions contained in Schedule A attached hereto are incorporated herein by reference in their entirety and shall be deemed to be a part of this [Certificate of Designations] to the same extent as if such provisions had been set forth in full herein.

Part 3. Definitions. The following terms are used in this [Certificate of Designations] (including the Standard Provisions in Schedule A hereto) as defined below:

(a) “Common Stock” means the common stock, par value \$[●] per share, of the Issuer.

(b) “Dividend Payment Date” means February 15, May 15, August 15 and November 15 of each year.

(c) “Junior Stock” means the Common Stock, *[Insert titles of any existing Junior Stock]* and any other class or series of stock of the Issuer the terms of which expressly provide that it ranks junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Issuer.

(d) “Liquidation Amount” means \$[1,000]¹ per share of Designated Preferred Stock.

(e) “Minimum Amount” means \$*[Insert \$ amount equal to 25% of the aggregate value of the Designated Preferred Stock issued on the Original Issue Date]*.

(f) “Parity Stock” means any class or series of stock of the Issuer (other than Designated Preferred Stock) the terms of which do not expressly provide that such class or series will rank senior or junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Issuer (in each case without regard to whether dividends accrue cumulatively or non-cumulatively). Without limiting the foregoing, Parity Stock shall include the Issuer’s *[Insert title(s) of existing classes or series of Parity Stock]*.

(g) “Signing Date” means *[Insert date of applicable securities purchase agreement]*.

Part. 4. Certain Voting Matters. *[To be inserted if the Charter provides for voting in proportion to liquidation preferences:* Whether the vote or consent of the holders of a plurality, majority or other portion of the shares of Designated Preferred Stock and any Voting Parity Stock has been cast or given on any matter on which the holders of shares of Designated Preferred Stock are entitled to vote shall be determined by the Issuer by reference to the specified liquidation amount of the shares voted or covered by the consent as if the Issuer were liquidated on the record date for such vote or consent, if any, or, in the absence of a record date, on the date for such vote or consent. For purposes of determining the voting rights of the holders of Designated Preferred Stock under Section 7 of the Standard Provisions forming part of this [Certificate of Designations], each holder will be entitled to one vote for each \$1,000 of liquidation preference to which such holder’s shares are entitled.] *[To be inserted if the Charter does not provide for voting in proportion to liquidation preferences:* Holders of shares of Designated Preferred Stock will be entitled to one vote for each such share on any matter on which holders of Designated Preferred Stock are entitled to vote, including any action by written consent.]

[Remainder of Page Intentionally Left Blank]

¹ If Issuer desires to issue shares with a higher dollar amount liquidation preference, liquidation preference references will be modified accordingly. In such case (in accordance with Section 4.6 of the Securities Purchase Agreement), the issuer will be required to enter into a deposit agreement.

IN WITNESS WHEREOF, [*Insert name of Issuer*] has caused this [Certificate of Designations] to be signed by [●], its [●], this [●] day of [●].

[Insert name of Issuer]

By: _____

Name:

Title:

STANDARD PROVISIONS

Section 1. General Matters. Each share of Designated Preferred Stock shall be identical in all respects to every other share of Designated Preferred Stock. The Designated Preferred Stock shall be perpetual, subject to the provisions of Section 5 of these Standard Provisions that form a part of the Certificate of Designations. The Designated Preferred Stock shall rank equally with Parity Stock and shall rank senior to Junior Stock with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Issuer.

Section 2. Standard Definitions. As used herein with respect to Designated Preferred Stock:

(a) “Applicable Dividend Rate” means (i) during the period from the Original Issue Date to, but excluding, the first day of the first Dividend Period commencing on or after the fifth anniversary of the Original Issue Date, 5% per annum and (ii) from and after the first day of the first Dividend Period commencing on or after the fifth anniversary of the Original Issue Date, 9% per annum.

(b) “Appropriate Federal Banking Agency” means the “appropriate Federal banking agency” with respect to the Issuer as defined in Section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. Section 1813(q)), or any successor provision.

(c) “Business Combination” means a merger, consolidation, statutory share exchange or similar transaction that requires the approval of the Issuer’s stockholders.

(d) “Business Day” means any day except Saturday, Sunday and any day on which banking institutions in the State of New York generally are authorized or required by law or other governmental actions to close.

(e) “Bylaws” means the bylaws of the Issuer, as they may be amended from time to time.

(f) “Certificate of Designations” means the Certificate of Designations or comparable instrument relating to the Designated Preferred Stock, of which these Standard Provisions form a part, as it may be amended from time to time.

(g) “Charter” means the Issuer’s certificate or articles of incorporation, articles of association, or similar organizational document.

(h) “Dividend Period” has the meaning set forth in Section 3(a).

(i) “Dividend Record Date” has the meaning set forth in Section 3(a).

(j) “Liquidation Preference” has the meaning set forth in Section 4(a).

(k) “Original Issue Date” means the date on which shares of Designated Preferred Stock are first issued.

(l) “Preferred Director” has the meaning set forth in Section 7(b).

(m) “Preferred Stock” means any and all series of preferred stock of the Issuer, including the Designated Preferred Stock.

(n) “Qualified Equity Offering” means the sale and issuance for cash by the Issuer to persons other than the Issuer or any of its subsidiaries after the Original Issue Date of shares of perpetual Preferred Stock, Common Stock or any combination of such stock, that, in each case, qualify as and may be included in Tier 1 capital of the Issuer at the time of issuance under the applicable risk-based capital guidelines of the Issuer’s Appropriate Federal Banking Agency (other than any such sales and issuances made pursuant to agreements or arrangements entered into, or pursuant to financing plans which were publicly announced, on or prior to November 17, 2008).

(o) “Standard Provisions” mean these Standard Provisions that form a part of the Certificate of Designations relating to the Designated Preferred Stock.

(p) “Successor Preferred Stock” has the meaning set forth in Section 5(a).

(q) “Voting Parity Stock” means, with regard to any matter as to which the holders of Designated Preferred Stock are entitled to vote as specified in Sections 7(a) and 7(b) of these Standard Provisions that form a part of the Certificate of Designations, any and all series of Parity Stock upon which like voting rights have been conferred and are exercisable with respect to such matter.

Section 3. Dividends.

(a) Rate. Holders of Designated Preferred Stock shall be entitled to receive, on each share of Designated Preferred Stock if, as and when declared by the Board of Directors or any duly authorized committee of the Board of Directors, but only out of assets legally available therefor, cumulative cash dividends with respect to each Dividend Period (as defined below) at a rate per annum equal to the Applicable Dividend Rate on (i) the Liquidation Amount per share of Designated Preferred Stock and (ii) the amount of accrued and unpaid dividends for any prior Dividend Period on such share of Designated Preferred Stock, if any. Such dividends shall begin to accrue and be cumulative from the Original Issue Date, shall compound on each subsequent Dividend Payment Date (*i.e.*, no dividends shall accrue on other dividends unless and until the first Dividend Payment Date for such other dividends has passed without such other dividends having been paid on such date) and shall be payable quarterly in arrears on each Dividend Payment Date, commencing with the first such Dividend Payment Date to occur at least 20 calendar days after the Original Issue Date. In the event that any Dividend Payment Date would otherwise fall on a day that is not a Business Day, the dividend payment due on that date will be postponed to the next day that is a Business Day and no additional dividends will accrue as a result of that postponement. The period from and including any Dividend Payment Date to, but excluding, the next Dividend Payment Date is a “Dividend Period”, provided that the initial

Dividend Period shall be the period from and including the Original Issue Date to, but excluding, the next Dividend Payment Date.

Dividends that are payable on Designated Preferred Stock in respect of any Dividend Period shall be computed on the basis of a 360-day year consisting of twelve 30-day months. The amount of dividends payable on Designated Preferred Stock on any date prior to the end of a Dividend Period, and for the initial Dividend Period, shall be computed on the basis of a 360-day year consisting of twelve 30-day months, and actual days elapsed over a 30-day month.

Dividends that are payable on Designated Preferred Stock on any Dividend Payment Date will be payable to holders of record of Designated Preferred Stock as they appear on the stock register of the Issuer on the applicable record date, which shall be the 15th calendar day immediately preceding such Dividend Payment Date or such other record date fixed by the Board of Directors or any duly authorized committee of the Board of Directors that is not more than 60 nor less than 10 days prior to such Dividend Payment Date (each, a “Dividend Record Date”). Any such day that is a Dividend Record Date shall be a Dividend Record Date whether or not such day is a Business Day.

Holders of Designated Preferred Stock shall not be entitled to any dividends, whether payable in cash, securities or other property, other than dividends (if any) declared and payable on Designated Preferred Stock as specified in this Section 3 (subject to the other provisions of the Certificate of Designations).

(b) Priority of Dividends. So long as any share of Designated Preferred Stock remains outstanding, no dividend or distribution shall be declared or paid on the Common Stock or any other shares of Junior Stock (other than dividends payable solely in shares of Common Stock) or Parity Stock, subject to the immediately following paragraph in the case of Parity Stock, and no Common Stock, Junior Stock or Parity Stock shall be, directly or indirectly, purchased, redeemed or otherwise acquired for consideration by the Issuer or any of its subsidiaries unless all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been or are contemporaneously declared and paid in full (or have been declared and a sum sufficient for the payment thereof has been set aside for the benefit of the holders of shares of Designated Preferred Stock on the applicable record date). The foregoing limitation shall not apply to (i) redemptions, purchases or other acquisitions of shares of Common Stock or other Junior Stock in connection with the administration of any employee benefit plan in the ordinary course of business and consistent with past practice; (ii) the acquisition by the Issuer or any of its subsidiaries of record ownership in Junior Stock or Parity Stock for the beneficial ownership of any other persons (other than the Issuer or any of its subsidiaries), including as trustees or custodians; and (iii) the exchange or conversion of Junior Stock for or into other Junior Stock or of Parity Stock for or into other Parity Stock (with the same or lesser aggregate liquidation amount) or Junior Stock, in each case, solely to the extent required pursuant to binding contractual agreements entered into prior to the Signing Date or any subsequent agreement for the accelerated exercise, settlement or exchange thereof for Common Stock.

When dividends are not paid (or declared and a sum sufficient for payment thereof set aside for the benefit of the holders thereof on the applicable record date) on any Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within a Dividend Period related to such Dividend Payment Date) in full upon Designated Preferred Stock and any shares of Parity Stock, all dividends declared on Designated Preferred Stock and all such Parity Stock and payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) shall be declared *pro rata* so that the respective amounts of such dividends declared shall bear the same ratio to each other as all accrued and unpaid dividends per share on the shares of Designated Preferred Stock (including, if applicable as provided in Section 3(a) above, dividends on such amount) and all Parity Stock payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) (subject to their having been declared by the Board of Directors or a duly authorized committee of the Board of Directors out of legally available funds and including, in the case of Parity Stock that bears cumulative dividends, all accrued but unpaid dividends) bear to each other. If the Board of Directors or a duly authorized committee of the Board of Directors determines not to pay any dividend or a full dividend on a Dividend Payment Date, the Issuer will provide written notice to the holders of Designated Preferred Stock prior to such Dividend Payment Date.

Subject to the foregoing, and not otherwise, such dividends (payable in cash, securities or other property) as may be determined by the Board of Directors or any duly authorized committee of the Board of Directors may be declared and paid on any securities, including Common Stock and other Junior Stock, from time to time out of any funds legally available for such payment, and holders of Designated Preferred Stock shall not be entitled to participate in any such dividends.

Section 4. Liquidation Rights.

(a) Voluntary or Involuntary Liquidation. In the event of any liquidation, dissolution or winding up of the affairs of the Issuer, whether voluntary or involuntary, holders of Designated Preferred Stock shall be entitled to receive for each share of Designated Preferred Stock, out of the assets of the Issuer or proceeds thereof (whether capital or surplus) available for distribution to stockholders of the Issuer, subject to the rights of any creditors of the Issuer, before any distribution of such assets or proceeds is made to or set aside for the holders of Common Stock and any other stock of the Issuer ranking junior to Designated Preferred Stock as to such distribution, payment in full in an amount equal to the sum of (i) the Liquidation Amount per share and (ii) the amount of any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount), whether or not declared, to the date of payment (such amounts collectively, the "Liquidation Preference").

(b) Partial Payment. If in any distribution described in Section 4(a) above the assets of the Issuer or proceeds thereof are not sufficient to pay in full the amounts payable with respect to all outstanding shares of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as

to such distribution, holders of Designated Preferred Stock and the holders of such other stock shall share ratably in any such distribution in proportion to the full respective distributions to which they are entitled.

(c) Residual Distributions. If the Liquidation Preference has been paid in full to all holders of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as to such distribution has been paid in full, the holders of other stock of the Issuer shall be entitled to receive all remaining assets of the Issuer (or proceeds thereof) according to their respective rights and preferences.

(d) Merger, Consolidation and Sale of Assets Not Liquidation. For purposes of this Section 4, the merger or consolidation of the Issuer with any other corporation or other entity, including a merger or consolidation in which the holders of Designated Preferred Stock receive cash, securities or other property for their shares, or the sale, lease or exchange (for cash, securities or other property) of all or substantially all of the assets of the Issuer, shall not constitute a liquidation, dissolution or winding up of the Issuer.

Section 5. Redemption.

(a) Optional Redemption. Except as provided below, the Designated Preferred Stock may not be redeemed prior to the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date. On or after the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Issuer, at its option, subject to the approval of the Appropriate Federal Banking Agency, may redeem, in whole or in part, at any time and from time to time, out of funds legally available therefor, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i) the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption.

Notwithstanding the foregoing, prior to the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Issuer, at its option, subject to the approval of the Appropriate Federal Banking Agency, may redeem, in whole or in part, at any time and from time to time, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i) the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption; *provided* that (x) the Issuer (or any successor by Business Combination) has received aggregate gross proceeds of not less than the Minimum Amount (plus the "Minimum Amount" as defined in the relevant certificate of designations for each other outstanding series of preferred stock of such successor that was originally issued to the United States Department of the Treasury (the "Successor Preferred Stock") in connection with the Troubled Asset Relief Program Capital Purchase Program) from one or more Qualified Equity Offerings (including Qualified Equity Offerings of such successor), and (y) the aggregate

redemption price of the Designated Preferred Stock (and any Successor Preferred Stock) redeemed pursuant to this paragraph may not exceed the aggregate net cash proceeds received by the Issuer (or any successor by Business Combination) from such Qualified Equity Offerings (including Qualified Equity Offerings of such successor).

The redemption price for any shares of Designated Preferred Stock shall be payable on the redemption date to the holder of such shares against surrender of the certificate(s) evidencing such shares to the Issuer or its agent. Any declared but unpaid dividends payable on a redemption date that occurs subsequent to the Dividend Record Date for a Dividend Period shall not be paid to the holder entitled to receive the redemption price on the redemption date, but rather shall be paid to the holder of record of the redeemed shares on such Dividend Record Date relating to the Dividend Payment Date as provided in Section 3 above.

(b) No Sinking Fund. The Designated Preferred Stock will not be subject to any mandatory redemption, sinking fund or other similar provisions. Holders of Designated Preferred Stock will have no right to require redemption or repurchase of any shares of Designated Preferred Stock.

(c) Notice of Redemption. Notice of every redemption of shares of Designated Preferred Stock shall be given by first class mail, postage prepaid, addressed to the holders of record of the shares to be redeemed at their respective last addresses appearing on the books of the Issuer. Such mailing shall be at least 30 days and not more than 60 days before the date fixed for redemption. Any notice mailed as provided in this Subsection shall be conclusively presumed to have been duly given, whether or not the holder receives such notice, but failure duly to give such notice by mail, or any defect in such notice or in the mailing thereof, to any holder of shares of Designated Preferred Stock designated for redemption shall not affect the validity of the proceedings for the redemption of any other shares of Designated Preferred Stock. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any other similar facility, notice of redemption may be given to the holders of Designated Preferred Stock at such time and in any manner permitted by such facility. Each notice of redemption given to a holder shall state: (1) the redemption date; (2) the number of shares of Designated Preferred Stock to be redeemed and, if less than all the shares held by such holder are to be redeemed, the number of such shares to be redeemed from such holder; (3) the redemption price; and (4) the place or places where certificates for such shares are to be surrendered for payment of the redemption price.

(d) Partial Redemption. In case of any redemption of part of the shares of Designated Preferred Stock at the time outstanding, the shares to be redeemed shall be selected either *pro rata* or in such other manner as the Board of Directors or a duly authorized committee thereof may determine to be fair and equitable. Subject to the provisions hereof, the Board of Directors or a duly authorized committee thereof shall have full power and authority to prescribe the terms and conditions upon which shares of Designated Preferred Stock shall be redeemed from time to time. If fewer than all the shares represented by any certificate are redeemed, a new certificate shall be issued representing the unredeemed shares without charge to the holder thereof.

(e) Effectiveness of Redemption. If notice of redemption has been duly given and if on or before the redemption date specified in the notice all funds necessary for the redemption

have been deposited by the Issuer, in trust for the *pro rata* benefit of the holders of the shares called for redemption, with a bank or trust company doing business in the Borough of Manhattan, The City of New York, and having a capital and surplus of at least \$500 million and selected by the Board of Directors, so as to be and continue to be available solely therefor, then, notwithstanding that any certificate for any share so called for redemption has not been surrendered for cancellation, on and after the redemption date dividends shall cease to accrue on all shares so called for redemption, all shares so called for redemption shall no longer be deemed outstanding and all rights with respect to such shares shall forthwith on such redemption date cease and terminate, except only the right of the holders thereof to receive the amount payable on such redemption from such bank or trust company, without interest. Any funds unclaimed at the end of three years from the redemption date shall, to the extent permitted by law, be released to the Issuer, after which time the holders of the shares so called for redemption shall look only to the Issuer for payment of the redemption price of such shares.

(f) Status of Redeemed Shares. Shares of Designated Preferred Stock that are redeemed, repurchased or otherwise acquired by the Issuer shall revert to authorized but unissued shares of Preferred Stock (*provided* that any such cancelled shares of Designated Preferred Stock may be reissued only as shares of any series of Preferred Stock other than Designated Preferred Stock).

Section 6. Conversion. Holders of Designated Preferred Stock shares shall have no right to exchange or convert such shares into any other securities.

Section 7. Voting Rights.

(a) General. The holders of Designated Preferred Stock shall not have any voting rights except as set forth below or as otherwise from time to time required by law.

(b) Preferred Stock Directors. Whenever, at any time or times, dividends payable on the shares of Designated Preferred Stock have not been paid for an aggregate of six quarterly Dividend Periods or more, whether or not consecutive, the authorized number of directors of the Issuer shall automatically be increased by two and the holders of the Designated Preferred Stock shall have the right, with holders of shares of any one or more other classes or series of Voting Parity Stock outstanding at the time, voting together as a class, to elect two directors (hereinafter the "Preferred Directors" and each a "Preferred Director") to fill such newly created directorships at the Issuer's next annual meeting of stockholders (or at a special meeting called for that purpose prior to such next annual meeting) and at each subsequent annual meeting of stockholders until all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been declared and paid in full at which time such right shall terminate with respect to the Designated Preferred Stock, except as herein or by law expressly provided, subject to reversion in the event of each and every subsequent default of the character above mentioned; *provided* that it shall be a qualification for election for any Preferred Director that the election of such Preferred Director shall not cause the Issuer to violate any corporate governance requirements of any securities exchange or other trading facility on which securities of the Issuer may then be listed or traded that listed or traded companies must have a majority of independent directors. Upon any

termination of the right of the holders of shares of Designated Preferred Stock and Voting Parity Stock as a class to vote for directors as provided above, the Preferred Directors shall cease to be qualified as directors, the term of office of all Preferred Directors then in office shall terminate immediately and the authorized number of directors shall be reduced by the number of Preferred Directors elected pursuant hereto. Any Preferred Director may be removed at any time, with or without cause, and any vacancy created thereby may be filled, only by the affirmative vote of the holders a majority of the shares of Designated Preferred Stock at the time outstanding voting separately as a class together with the holders of shares of Voting Parity Stock, to the extent the voting rights of such holders described above are then exercisable. If the office of any Preferred Director becomes vacant for any reason other than removal from office as aforesaid, the remaining Preferred Director may choose a successor who shall hold office for the unexpired term in respect of which such vacancy occurred.

(c) Class Voting Rights as to Particular Matters. So long as any shares of Designated Preferred Stock are outstanding, in addition to any other vote or consent of stockholders required by law or by the Charter, the vote or consent of the holders of at least 66 2/3% of the shares of Designated Preferred Stock at the time outstanding, voting as a separate class, given in person or by proxy, either in writing without a meeting or by vote at any meeting called for the purpose, shall be necessary for effecting or validating:

(i) Authorization of Senior Stock. Any amendment or alteration of the Certificate of Designations for the Designated Preferred Stock or the Charter to authorize or create or increase the authorized amount of, or any issuance of, any shares of, or any securities convertible into or exchangeable or exercisable for shares of, any class or series of capital stock of the Issuer ranking senior to Designated Preferred Stock with respect to either or both the payment of dividends and/or the distribution of assets on any liquidation, dissolution or winding up of the Issuer;

(ii) Amendment of Designated Preferred Stock. Any amendment, alteration or repeal of any provision of the Certificate of Designations for the Designated Preferred Stock or the Charter (including, unless no vote on such merger or consolidation is required by Section 7(c)(iii) below, any amendment, alteration or repeal by means of a merger, consolidation or otherwise) so as to adversely affect the rights, preferences, privileges or voting powers of the Designated Preferred Stock; or

(iii) Share Exchanges, Reclassifications, Mergers and Consolidations. Any consummation of a binding share exchange or reclassification involving the Designated Preferred Stock, or of a merger or consolidation of the Issuer with another corporation or other entity, unless in each case (x) the shares of Designated Preferred Stock remain outstanding or, in the case of any such merger or consolidation with respect to which the Issuer is not the surviving or resulting entity, are converted into or exchanged for preference securities of the surviving or resulting entity or its ultimate parent, and (y) such shares remaining outstanding or such preference securities, as the case may be, have such rights, preferences, privileges and voting powers, and limitations and restrictions thereof, taken as a whole, as are not materially less favorable to the holders thereof than the rights, preferences, privileges and voting powers, and limitations and restrictions

thereof, of Designated Preferred Stock immediately prior to such consummation, taken as a whole;

provided, however, that for all purposes of this Section 7(c), any increase in the amount of the authorized Preferred Stock, including any increase in the authorized amount of Designated Preferred Stock necessary to satisfy preemptive or similar rights granted by the Issuer to other persons prior to the Signing Date, or the creation and issuance, or an increase in the authorized or issued amount, whether pursuant to preemptive or similar rights or otherwise, of any other series of Preferred Stock, or any securities convertible into or exchangeable or exercisable for any other series of Preferred Stock, ranking equally with and/or junior to Designated Preferred Stock with respect to the payment of dividends (whether such dividends are cumulative or non-cumulative) and the distribution of assets upon liquidation, dissolution or winding up of the Issuer will not be deemed to adversely affect the rights, preferences, privileges or voting powers, and shall not require the affirmative vote or consent of, the holders of outstanding shares of the Designated Preferred Stock.

(d) Changes after Provision for Redemption. No vote or consent of the holders of Designated Preferred Stock shall be required pursuant to Section 7(c) above if, at or prior to the time when any such vote or consent would otherwise be required pursuant to such Section, all outstanding shares of the Designated Preferred Stock shall have been redeemed, or shall have been called for redemption upon proper notice and sufficient funds shall have been deposited in trust for such redemption, in each case pursuant to Section 5 above.

(e) Procedures for Voting and Consents. The rules and procedures for calling and conducting any meeting of the holders of Designated Preferred Stock (including, without limitation, the fixing of a record date in connection therewith), the solicitation and use of proxies at such a meeting, the obtaining of written consents and any other aspect or matter with regard to such a meeting or such consents shall be governed by any rules of the Board of Directors or any duly authorized committee of the Board of Directors, in its discretion, may adopt from time to time, which rules and procedures shall conform to the requirements of the Charter, the Bylaws, and applicable law and the rules of any national securities exchange or other trading facility on which Designated Preferred Stock is listed or traded at the time.

Section 8. Record Holders. To the fullest extent permitted by applicable law, the Issuer and the transfer agent for Designated Preferred Stock may deem and treat the record holder of any share of Designated Preferred Stock as the true and lawful owner thereof for all purposes, and neither the Issuer nor such transfer agent shall be affected by any notice to the contrary.

Section 9. Notices. All notices or communications in respect of Designated Preferred Stock shall be sufficiently given if given in writing and delivered in person or by first class mail, postage prepaid, or if given in such other manner as may be permitted in this Certificate of Designations, in the Charter or Bylaws or by applicable law. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any similar facility, such notices may be given to the holders of Designated Preferred Stock in any manner permitted by such facility.

Section 10. No Preemptive Rights. No share of Designated Preferred Stock shall have any rights of preemption whatsoever as to any securities of the Issuer, or any warrants, rights or options issued or granted with respect thereto, regardless of how such securities, or such warrants, rights or options, may be designated, issued or granted.

Section 11. Replacement Certificates. The Issuer shall replace any mutilated certificate at the holder's expense upon surrender of that certificate to the Issuer. The Issuer shall replace certificates that become destroyed, stolen or lost at the holder's expense upon delivery to the Issuer of reasonably satisfactory evidence that the certificate has been destroyed, stolen or lost, together with any indemnity that may be reasonably required by the Issuer.

Section 12. Other Rights. The shares of Designated Preferred Stock shall not have any rights, preferences, privileges or voting powers or relative, participating, optional or other special rights, or qualifications, limitations or restrictions thereof, other than as set forth herein or in the Charter or as provided by applicable law.

FORM OF CERTIFICATE OF DESIGNATIONS
FOR WARRANT PREFERRED STOCK

[SEE ATTACHED]

FORM OF [CERTIFICATE OF DESIGNATIONS]

OF

FIXED RATE CUMULATIVE PERPETUAL PREFERRED STOCK, SERIES [●]

OF

[●]

[*Insert name of Issuer*], a [corporation/bank/banking association] organized and existing under the laws of the [*Insert jurisdiction of organization*] (the “Issuer”), in accordance with the provisions of Section[s] [●] of the [*Insert applicable statute*] thereof, does hereby certify:

The board of directors of the Issuer (the “Board of Directors”) or an applicable committee of the Board of Directors, in accordance with the [[certificate of incorporation/articles of association] and bylaws] of the Issuer and applicable law, adopted the following resolution on [●] creating a series of [●] shares of Preferred Stock of the Issuer designated as “Fixed Rate Cumulative Perpetual Preferred Stock, Series [●]”.

RESOLVED, that pursuant to the provisions of the [[certificate of incorporation/articles of association] and the bylaws] of the Issuer and applicable law, a series of Preferred Stock, par value \$[●] per share, of the Issuer be and hereby is created, and that the designation and number of shares of such series, and the voting and other powers, preferences and relative, participating, optional or other rights, and the qualifications, limitations and restrictions thereof, of the shares of such series, are as follows:

Part 1. Designation and Number of Shares. There is hereby created out of the authorized and unissued shares of preferred stock of the Issuer a series of preferred stock designated as the “Fixed Rate Cumulative Perpetual Preferred Stock, Series [●]” (the “Designated Preferred Stock”). The authorized number of shares of Designated Preferred Stock shall be [●].

Part 2. Standard Provisions. The Standard Provisions contained in Schedule A attached hereto are incorporated herein by reference in their entirety and shall be deemed to be a part of this [Certificate of Designations] to the same extent as if such provisions had been set forth in full herein.

Part 3. Definitions. The following terms are used in this [Certificate of Designations] (including the Standard Provisions in Schedule A hereto) as defined below:

(a) “Common Stock” means the common stock, par value \$[●] per share, of the Issuer.

(b) “Dividend Payment Date” means February 15, May 15, August 15 and November 15 of each year.

(c) “Junior Stock” means the Common Stock, [*Insert titles of any existing Junior Stock*] and any other class or series of stock of the Issuer the terms of which expressly provide that it ranks junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Issuer.

(d) “Liquidation Amount” means \$[1,000]¹ per share of Designated Preferred Stock.

(e) “Minimum Amount” means \$[*Insert \$ amount equal to 25% of the aggregate value of the Designated Preferred Stock issued on the Original Issue Date*].

(f) “Parity Stock” means any class or series of stock of the Issuer (other than Designated Preferred Stock) the terms of which do not expressly provide that such class or series will rank senior or junior to Designated Preferred Stock as to dividend rights and/or as to rights on liquidation, dissolution or winding up of the Issuer (in each case without regard to whether dividends accrue cumulatively or non-cumulatively). Without limiting the foregoing, Parity Stock shall include the Issuer’s UST Preferred Stock [and] [*Insert title(s) of any other classes or series of Parity Stock*].

(g) “Signing Date” means [*Insert date of applicable securities purchase agreement*].

(h) “UST Preferred Stock” means the Issuer’s Fixed Rate Cumulative Perpetual Preferred Stock, Series [●].

Part. 4. Certain Voting Matters. [*To be inserted if the Charter provides for voting in proportion to liquidation preferences*: Whether the vote or consent of the holders of a plurality, majority or other portion of the shares of Designated Preferred Stock and any Voting Parity Stock has been cast or given on any matter on which the holders of shares of Designated Preferred Stock are entitled to vote shall be determined by the Issuer by reference to the specified liquidation amount of the shares voted or covered by the consent as if the Issuer were liquidated on the record date for such vote or consent, if any, or, in the absence of a record date, on the date for such vote or consent. For purposes of determining the voting rights of the holders of Designated Preferred Stock under Section 7 of the Standard Provisions forming part of this [Certificate of Designations], each holder will be entitled to one vote for each \$1,000 of liquidation preference to which such holder’s shares are entitled.] [*To be inserted if the Charter does not provide for voting in proportion to liquidation preferences*: Holders of shares of Designated Preferred Stock will be entitled to one vote for each such share on any matter on which holders of Designated Preferred Stock are entitled to vote, including any action by written consent.]

[*Remainder of Page Intentionally Left Blank*]

¹ If Issuer desires to issue shares with a higher dollar amount liquidation preference, liquidation preference references will be modified accordingly. In such case (in accordance with Section 4.6 of the Securities Purchase Agreement), the issuer will be required to enter into a deposit agreement.

IN WITNESS WHEREOF, [*Insert name of Issuer*] has caused this [Certificate of Designations] to be signed by [●], its [●], this [●] day of [●].

[Insert name of Issuer]

By: _____

Name:

Title:

STANDARD PROVISIONS

Section 1. General Matters. Each share of Designated Preferred Stock shall be identical in all respects to every other share of Designated Preferred Stock. The Designated Preferred Stock shall be perpetual, subject to the provisions of Section 5 of these Standard Provisions that form a part of the Certificate of Designations. The Designated Preferred Stock shall rank equally with Parity Stock and shall rank senior to Junior Stock with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Issuer.

Section 2. Standard Definitions. As used herein with respect to Designated Preferred Stock:

(a) “Appropriate Federal Banking Agency” means the “appropriate Federal banking agency” with respect to the Issuer as defined in Section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. Section 1813(q)), or any successor provision.

(b) “Business Combination” means a merger, consolidation, statutory share exchange or similar transaction that requires the approval of the Issuer’s stockholders.

(c) “Business Day” means any day except Saturday, Sunday and any day on which banking institutions in the State of New York generally are authorized or required by law or other governmental actions to close.

(d) “Bylaws” means the bylaws of the Issuer, as they may be amended from time to time.

(e) “Certificate of Designations” means the Certificate of Designations or comparable instrument relating to the Designated Preferred Stock, of which these Standard Provisions form a part, as it may be amended from time to time.

(f) “Charter” means the Issuer’s certificate or articles of incorporation, articles of association, or similar organizational document.

(g) “Dividend Period” has the meaning set forth in Section 3(a).

(h) “Dividend Record Date” has the meaning set forth in Section 3(a).

(i) “Liquidation Preference” has the meaning set forth in Section 4(a).

(j) “Original Issue Date” means the date on which shares of Designated Preferred Stock are first issued.

(k) “Preferred Director” has the meaning set forth in Section 7(b).

(l) “Preferred Stock” means any and all series of preferred stock of the Issuer, including the Designated Preferred Stock.

(m) “Qualified Equity Offering” means the sale and issuance for cash by the Issuer to persons other than the Issuer or any of its subsidiaries after the Original Issue Date of shares of perpetual Preferred Stock, Common Stock or any combination of such stock, that, in each case, qualify as and may be included in Tier 1 capital of the Issuer at the time of issuance under the applicable risk-based capital guidelines of the Issuer’s Appropriate Federal Banking Agency (other than any such sales and issuances made pursuant to agreements or arrangements entered into, or pursuant to financing plans which were publicly announced, on or prior to November 17, 2008).

(n) “Standard Provisions” mean these Standard Provisions that form a part of the Certificate of Designations relating to the Designated Preferred Stock.

(o) “Successor Preferred Stock” has the meaning set forth in Section 5(a).

(p) “Voting Parity Stock” means, with regard to any matter as to which the holders of Designated Preferred Stock are entitled to vote as specified in Sections 7(a) and 7(b) of these Standard Provisions that form a part of the Certificate of Designations, any and all series of Parity Stock upon which like voting rights have been conferred and are exercisable with respect to such matter.

Section 3. Dividends.

(a) Rate. Holders of Designated Preferred Stock shall be entitled to receive, on each share of Designated Preferred Stock if, as and when declared by the Board of Directors or any duly authorized committee of the Board of Directors, but only out of assets legally available therefor, cumulative cash dividends with respect to each Dividend Period (as defined below) at a per annum rate of 9.0% on (i) the Liquidation Amount per share of Designated Preferred Stock and (ii) the amount of accrued and unpaid dividends for any prior Dividend Period on such share of Designated Preferred Stock, if any. Such dividends shall begin to accrue and be cumulative from the Original Issue Date, shall compound on each subsequent Dividend Payment Date (*i.e.*, no dividends shall accrue on other dividends unless and until the first Dividend Payment Date for such other dividends has passed without such other dividends having been paid on such date) and shall be payable quarterly in arrears on each Dividend Payment Date, commencing with the first such Dividend Payment Date to occur at least 20 calendar days after the Original Issue Date. In the event that any Dividend Payment Date would otherwise fall on a day that is not a Business Day, the dividend payment due on that date will be postponed to the next day that is a Business Day and no additional dividends will accrue as a result of that postponement. The period from and including any Dividend Payment Date to, but excluding, the next Dividend Payment Date is a “Dividend Period”, provided that the initial Dividend Period shall be the period from and including the Original Issue Date to, but excluding, the next Dividend Payment Date.

Dividends that are payable on Designated Preferred Stock in respect of any Dividend Period shall be computed on the basis of a 360-day year consisting of twelve 30-day months. The amount of dividends payable on Designated Preferred Stock on any date prior to the end of a

Dividend Period, and for the initial Dividend Period, shall be computed on the basis of a 360-day year consisting of twelve 30-day months, and actual days elapsed over a 30-day month.

Dividends that are payable on Designated Preferred Stock on any Dividend Payment Date will be payable to holders of record of Designated Preferred Stock as they appear on the stock register of the Issuer on the applicable record date, which shall be the 15th calendar day immediately preceding such Dividend Payment Date or such other record date fixed by the Board of Directors or any duly authorized committee of the Board of Directors that is not more than 60 nor less than 10 days prior to such Dividend Payment Date (each, a “Dividend Record Date”). Any such day that is a Dividend Record Date shall be a Dividend Record Date whether or not such day is a Business Day.

Holders of Designated Preferred Stock shall not be entitled to any dividends, whether payable in cash, securities or other property, other than dividends (if any) declared and payable on Designated Preferred Stock as specified in this Section 3 (subject to the other provisions of the Certificate of Designations).

(b) Priority of Dividends. So long as any share of Designated Preferred Stock remains outstanding, no dividend or distribution shall be declared or paid on the Common Stock or any other shares of Junior Stock (other than dividends payable solely in shares of Common Stock) or Parity Stock, subject to the immediately following paragraph in the case of Parity Stock, and no Common Stock, Junior Stock or Parity Stock shall be, directly or indirectly, purchased, redeemed or otherwise acquired for consideration by the Issuer or any of its subsidiaries unless all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been or are contemporaneously declared and paid in full (or have been declared and a sum sufficient for the payment thereof has been set aside for the benefit of the holders of shares of Designated Preferred Stock on the applicable record date). The foregoing limitation shall not apply to (i) redemptions, purchases or other acquisitions of shares of Common Stock or other Junior Stock in connection with the administration of any employee benefit plan in the ordinary course of business and consistent with past practice; (ii) the acquisition by the Issuer or any of its subsidiaries of record ownership in Junior Stock or Parity Stock for the beneficial ownership of any other persons (other than the Issuer or any of its subsidiaries), including as trustees or custodians; and (iii) the exchange or conversion of Junior Stock for or into other Junior Stock or of Parity Stock for or into other Parity Stock (with the same or lesser aggregate liquidation amount) or Junior Stock, in each case, solely to the extent required pursuant to binding contractual agreements entered into prior to the Signing Date or any subsequent agreement for the accelerated exercise, settlement or exchange thereof for Common Stock.

When dividends are not paid (or declared and a sum sufficient for payment thereof set aside for the benefit of the holders thereof on the applicable record date) on any Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within a Dividend Period related to such Dividend Payment Date) in full upon Designated Preferred Stock and any shares of Parity Stock, all dividends declared on Designated Preferred Stock and all such Parity Stock and payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend

payment dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) shall be declared *pro rata* so that the respective amounts of such dividends declared shall bear the same ratio to each other as all accrued and unpaid dividends per share on the shares of Designated Preferred Stock (including, if applicable as provided in Section 3(a) above, dividends on such amount) and all Parity Stock payable on such Dividend Payment Date (or, in the case of Parity Stock having dividend payment dates different from the Dividend Payment Dates, on a dividend payment date falling within the Dividend Period related to such Dividend Payment Date) (subject to their having been declared by the Board of Directors or a duly authorized committee of the Board of Directors out of legally available funds and including, in the case of Parity Stock that bears cumulative dividends, all accrued but unpaid dividends) bear to each other. If the Board of Directors or a duly authorized committee of the Board of Directors determines not to pay any dividend or a full dividend on a Dividend Payment Date, the Issuer will provide written notice to the holders of Designated Preferred Stock prior to such Dividend Payment Date.

Subject to the foregoing, and not otherwise, such dividends (payable in cash, securities or other property) as may be determined by the Board of Directors or any duly authorized committee of the Board of Directors may be declared and paid on any securities, including Common Stock and other Junior Stock, from time to time out of any funds legally available for such payment, and holders of Designated Preferred Stock shall not be entitled to participate in any such dividends.

Section 4. Liquidation Rights.

(a) Voluntary or Involuntary Liquidation. In the event of any liquidation, dissolution or winding up of the affairs of the Issuer, whether voluntary or involuntary, holders of Designated Preferred Stock shall be entitled to receive for each share of Designated Preferred Stock, out of the assets of the Issuer or proceeds thereof (whether capital or surplus) available for distribution to stockholders of the Issuer, subject to the rights of any creditors of the Issuer, before any distribution of such assets or proceeds is made to or set aside for the holders of Common Stock and any other stock of the Issuer ranking junior to Designated Preferred Stock as to such distribution, payment in full in an amount equal to the sum of (i) the Liquidation Amount per share and (ii) the amount of any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount), whether or not declared, to the date of payment (such amounts collectively, the "Liquidation Preference").

(b) Partial Payment. If in any distribution described in Section 4(a) above the assets of the Issuer or proceeds thereof are not sufficient to pay in full the amounts payable with respect to all outstanding shares of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as to such distribution, holders of Designated Preferred Stock and the holders of such other stock shall share ratably in any such distribution in proportion to the full respective distributions to which they are entitled.

(c) Residual Distributions. If the Liquidation Preference has been paid in full to all holders of Designated Preferred Stock and the corresponding amounts payable with respect of any other stock of the Issuer ranking equally with Designated Preferred Stock as to such

distribution has been paid in full, the holders of other stock of the Issuer shall be entitled to receive all remaining assets of the Issuer (or proceeds thereof) according to their respective rights and preferences.

(d) Merger, Consolidation and Sale of Assets Not Liquidation. For purposes of this Section 4, the merger or consolidation of the Issuer with any other corporation or other entity, including a merger or consolidation in which the holders of Designated Preferred Stock receive cash, securities or other property for their shares, or the sale, lease or exchange (for cash, securities or other property) of all or substantially all of the assets of the Issuer, shall not constitute a liquidation, dissolution or winding up of the Issuer.

Section 5. Redemption.

(a) Optional Redemption. Except as provided below, the Designated Preferred Stock may not be redeemed prior to the later of (i) first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date; and (ii) the date on which all outstanding shares of UST Preferred Stock have been redeemed, repurchased or otherwise acquired by the Issuer. On or after the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Issuer, at its option, subject to the approval of the Appropriate Federal Banking Agency, may redeem, in whole or in part, at any time and from time to time, out of funds legally available therefor, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i) the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption.

Notwithstanding the foregoing, prior to the first Dividend Payment Date falling on or after the third anniversary of the Original Issue Date, the Issuer, at its option, subject to the approval of the Appropriate Federal Banking Agency and subject to the requirement that all outstanding shares of UST Preferred Stock shall previously have been redeemed, repurchased or otherwise acquired by the Issuer, may redeem, in whole or in part, at any time and from time to time, the shares of Designated Preferred Stock at the time outstanding, upon notice given as provided in Section 5(c) below, at a redemption price equal to the sum of (i) the Liquidation Amount per share and (ii) except as otherwise provided below, any accrued and unpaid dividends (including, if applicable as provided in Section 3(a) above, dividends on such amount) (regardless of whether any dividends are actually declared) to, but excluding, the date fixed for redemption; *provided* that (x) the Issuer (or any successor by Business Combination) has received aggregate gross proceeds of not less than the Minimum Amount (plus the “Minimum Amount” as defined in the relevant certificate of designations for each other outstanding series of preferred stock of such successor that was originally issued to the United States Department of the Treasury (the “Successor Preferred Stock”) in connection with the Troubled Asset Relief Program Capital Purchase Program) from one or more Qualified Equity Offerings (including Qualified Equity Offerings of such successor), and (y) the aggregate redemption price of the Designated Preferred Stock (and any Successor Preferred Stock) redeemed pursuant to this paragraph may not exceed the aggregate net cash proceeds received by the Issuer (or any

successor by Business Combination) from such Qualified Equity Offerings (including Qualified Equity Offerings of such successor).

The redemption price for any shares of Designated Preferred Stock shall be payable on the redemption date to the holder of such shares against surrender of the certificate(s) evidencing such shares to the Issuer or its agent. Any declared but unpaid dividends payable on a redemption date that occurs subsequent to the Dividend Record Date for a Dividend Period shall not be paid to the holder entitled to receive the redemption price on the redemption date, but rather shall be paid to the holder of record of the redeemed shares on such Dividend Record Date relating to the Dividend Payment Date as provided in Section 3 above.

(b) No Sinking Fund. The Designated Preferred Stock will not be subject to any mandatory redemption, sinking fund or other similar provisions. Holders of Designated Preferred Stock will have no right to require redemption or repurchase of any shares of Designated Preferred Stock.

(c) Notice of Redemption. Notice of every redemption of shares of Designated Preferred Stock shall be given by first class mail, postage prepaid, addressed to the holders of record of the shares to be redeemed at their respective last addresses appearing on the books of the Issuer. Such mailing shall be at least 30 days and not more than 60 days before the date fixed for redemption. Any notice mailed as provided in this Subsection shall be conclusively presumed to have been duly given, whether or not the holder receives such notice, but failure duly to give such notice by mail, or any defect in such notice or in the mailing thereof, to any holder of shares of Designated Preferred Stock designated for redemption shall not affect the validity of the proceedings for the redemption of any other shares of Designated Preferred Stock. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any other similar facility, notice of redemption may be given to the holders of Designated Preferred Stock at such time and in any manner permitted by such facility. Each notice of redemption given to a holder shall state: (1) the redemption date; (2) the number of shares of Designated Preferred Stock to be redeemed and, if less than all the shares held by such holder are to be redeemed, the number of such shares to be redeemed from such holder; (3) the redemption price; and (4) the place or places where certificates for such shares are to be surrendered for payment of the redemption price.

(d) Partial Redemption. In case of any redemption of part of the shares of Designated Preferred Stock at the time outstanding, the shares to be redeemed shall be selected either *pro rata* or in such other manner as the Board of Directors or a duly authorized committee thereof may determine to be fair and equitable. Subject to the provisions hereof, the Board of Directors or a duly authorized committee thereof shall have full power and authority to prescribe the terms and conditions upon which shares of Designated Preferred Stock shall be redeemed from time to time. If fewer than all the shares represented by any certificate are redeemed, a new certificate shall be issued representing the unredeemed shares without charge to the holder thereof.

(e) Effectiveness of Redemption. If notice of redemption has been duly given and if on or before the redemption date specified in the notice all funds necessary for the redemption have been deposited by the Issuer, in trust for the *pro rata* benefit of the holders of the shares called for redemption, with a bank or trust company doing business in the Borough of

Manhattan, The City of New York, and having a capital and surplus of at least \$500 million and selected by the Board of Directors, so as to be and continue to be available solely therefor, then, notwithstanding that any certificate for any share so called for redemption has not been surrendered for cancellation, on and after the redemption date dividends shall cease to accrue on all shares so called for redemption, all shares so called for redemption shall no longer be deemed outstanding and all rights with respect to such shares shall forthwith on such redemption date cease and terminate, except only the right of the holders thereof to receive the amount payable on such redemption from such bank or trust company, without interest. Any funds unclaimed at the end of three years from the redemption date shall, to the extent permitted by law, be released to the Issuer, after which time the holders of the shares so called for redemption shall look only to the Issuer for payment of the redemption price of such shares.

(f) Status of Redeemed Shares. Shares of Designated Preferred Stock that are redeemed, repurchased or otherwise acquired by the Issuer shall revert to authorized but unissued shares of Preferred Stock (*provided* that any such cancelled shares of Designated Preferred Stock may be reissued only as shares of any series of Preferred Stock other than Designated Preferred Stock).

Section 6. Conversion. Holders of Designated Preferred Stock shares shall have no right to exchange or convert such shares into any other securities.

Section 7. Voting Rights.

(a) General. The holders of Designated Preferred Stock shall not have any voting rights except as set forth below or as otherwise from time to time required by law.

(b) Preferred Stock Directors. Whenever, at any time or times, dividends payable on the shares of Designated Preferred Stock have not been paid for an aggregate of six quarterly Dividend Periods or more, whether or not consecutive, the authorized number of directors of the Issuer shall automatically be increased by two and the holders of the Designated Preferred Stock shall have the right, with holders of shares of any one or more other classes or series of Voting Parity Stock outstanding at the time, voting together as a class, to elect two directors (hereinafter the "Preferred Directors" and each a "Preferred Director") to fill such newly created directorships at the Issuer's next annual meeting of stockholders (or at a special meeting called for that purpose prior to such next annual meeting) and at each subsequent annual meeting of stockholders until all accrued and unpaid dividends for all past Dividend Periods, including the latest completed Dividend Period (including, if applicable as provided in Section 3(a) above, dividends on such amount), on all outstanding shares of Designated Preferred Stock have been declared and paid in full at which time such right shall terminate with respect to the Designated Preferred Stock, except as herein or by law expressly provided, subject to reversion in the event of each and every subsequent default of the character above mentioned; *provided* that it shall be a qualification for election for any Preferred Director that the election of such Preferred Director shall not cause the Issuer to violate any corporate governance requirements of any securities exchange or other trading facility on which securities of the Issuer may then be listed or traded that listed or traded companies must have a majority of independent directors. Upon any termination of the right of the holders of shares of Designated Preferred Stock and Voting Parity Stock as a class to vote for directors as provided above, the Preferred Directors shall cease to be

qualified as directors, the term of office of all Preferred Directors then in office shall terminate immediately and the authorized number of directors shall be reduced by the number of Preferred Directors elected pursuant hereto. Any Preferred Director may be removed at any time, with or without cause, and any vacancy created thereby may be filled, only by the affirmative vote of the holders a majority of the shares of Designated Preferred Stock at the time outstanding voting separately as a class together with the holders of shares of Voting Parity Stock, to the extent the voting rights of such holders described above are then exercisable. If the office of any Preferred Director becomes vacant for any reason other than removal from office as aforesaid, the remaining Preferred Director may choose a successor who shall hold office for the unexpired term in respect of which such vacancy occurred.

(c) Class Voting Rights as to Particular Matters. So long as any shares of Designated Preferred Stock are outstanding, in addition to any other vote or consent of stockholders required by law or by the Charter, the vote or consent of the holders of at least 66 2/3% of the shares of Designated Preferred Stock at the time outstanding, voting as a separate class, given in person or by proxy, either in writing without a meeting or by vote at any meeting called for the purpose, shall be necessary for effecting or validating:

(i) Authorization of Senior Stock. Any amendment or alteration of the Certificate of Designations for the Designated Preferred Stock or the Charter to authorize or create or increase the authorized amount of, or any issuance of, any shares of, or any securities convertible into or exchangeable or exercisable for shares of, any class or series of capital stock of the Issuer ranking senior to Designated Preferred Stock with respect to either or both the payment of dividends and/or the distribution of assets on any liquidation, dissolution or winding up of the Issuer;

(ii) Amendment of Designated Preferred Stock. Any amendment, alteration or repeal of any provision of the Certificate of Designations for the Designated Preferred Stock or the Charter (including, unless no vote on such merger or consolidation is required by Section 7(c)(iii) below, any amendment, alteration or repeal by means of a merger, consolidation or otherwise) so as to adversely affect the rights, preferences, privileges or voting powers of the Designated Preferred Stock; or

(iii) Share Exchanges, Reclassifications, Mergers and Consolidations. Any consummation of a binding share exchange or reclassification involving the Designated Preferred Stock, or of a merger or consolidation of the Issuer with another corporation or other entity, unless in each case (x) the shares of Designated Preferred Stock remain outstanding or, in the case of any such merger or consolidation with respect to which the Issuer is not the surviving or resulting entity, are converted into or exchanged for preference securities of the surviving or resulting entity or its ultimate parent, and (y) such shares remaining outstanding or such preference securities, as the case may be, have such rights, preferences, privileges and voting powers, and limitations and restrictions thereof, taken as a whole, as are not materially less favorable to the holders thereof than the rights, preferences, privileges and voting powers, and limitations and restrictions thereof, of Designated Preferred Stock immediately prior to such consummation, taken as a whole;

provided, however, that for all purposes of this Section 7(c), any increase in the amount of the authorized Preferred Stock, including any increase in the authorized amount of Designated Preferred Stock necessary to satisfy preemptive or similar rights granted by the Issuer to other persons prior to the Signing Date, or the creation and issuance, or an increase in the authorized or issued amount, whether pursuant to preemptive or similar rights or otherwise, of any other series of Preferred Stock, or any securities convertible into or exchangeable or exercisable for any other series of Preferred Stock, ranking equally with and/or junior to Designated Preferred Stock with respect to the payment of dividends (whether such dividends are cumulative or non-cumulative) and the distribution of assets upon liquidation, dissolution or winding up of the Issuer will not be deemed to adversely affect the rights, preferences, privileges or voting powers, and shall not require the affirmative vote or consent of, the holders of outstanding shares of the Designated Preferred Stock.

(d) Changes after Provision for Redemption. No vote or consent of the holders of Designated Preferred Stock shall be required pursuant to Section 7(c) above if, at or prior to the time when any such vote or consent would otherwise be required pursuant to such Section, all outstanding shares of the Designated Preferred Stock shall have been redeemed, or shall have been called for redemption upon proper notice and sufficient funds shall have been deposited in trust for such redemption, in each case pursuant to Section 5 above.

(e) Procedures for Voting and Consents. The rules and procedures for calling and conducting any meeting of the holders of Designated Preferred Stock (including, without limitation, the fixing of a record date in connection therewith), the solicitation and use of proxies at such a meeting, the obtaining of written consents and any other aspect or matter with regard to such a meeting or such consents shall be governed by any rules of the Board of Directors or any duly authorized committee of the Board of Directors, in its discretion, may adopt from time to time, which rules and procedures shall conform to the requirements of the Charter, the Bylaws, and applicable law and the rules of any national securities exchange or other trading facility on which Designated Preferred Stock is listed or traded at the time.

Section 8. Record Holders. To the fullest extent permitted by applicable law, the Issuer and the transfer agent for Designated Preferred Stock may deem and treat the record holder of any share of Designated Preferred Stock as the true and lawful owner thereof for all purposes, and neither the Issuer nor such transfer agent shall be affected by any notice to the contrary.

Section 9. Notices. All notices or communications in respect of Designated Preferred Stock shall be sufficiently given if given in writing and delivered in person or by first class mail, postage prepaid, or if given in such other manner as may be permitted in this Certificate of Designations, in the Charter or Bylaws or by applicable law. Notwithstanding the foregoing, if shares of Designated Preferred Stock are issued in book-entry form through The Depository Trust Company or any similar facility, such notices may be given to the holders of Designated Preferred Stock in any manner permitted by such facility.

Section 10. No Preemptive Rights. No share of Designated Preferred Stock shall have any rights of preemption whatsoever as to any securities of the Issuer, or any warrants, rights or options issued or granted with respect thereto, regardless of how such securities, or such warrants, rights or options, may be designated, issued or granted.

Section 11. Replacement Certificates. The Issuer shall replace any mutilated certificate at the holder's expense upon surrender of that certificate to the Issuer. The Issuer shall replace certificates that become destroyed, stolen or lost at the holder's expense upon delivery to the Issuer of reasonably satisfactory evidence that the certificate has been destroyed, stolen or lost, together with any indemnity that may be reasonably required by the Issuer.

Section 12. Other Rights. The shares of Designated Preferred Stock shall not have any rights, preferences, privileges or voting powers or relative, participating, optional or other special rights, or qualifications, limitations or restrictions thereof, other than as set forth herein or in the Charter or as provided by applicable law.

FORM OF WAIVER

In consideration for the benefits I will receive as a result of my employer's participation in the United States Department of the Treasury's TARP Capital Purchase Program, I hereby voluntarily waive any claim against the United States or my employer for any changes to my compensation or benefits that are required to comply with the regulation issued by the Department of the Treasury as published in the Federal Register on October 20, 2008.

I acknowledge that this regulation may require modification of the compensation, bonus, incentive and other benefit plans, arrangements, policies and agreements (including so-called "golden parachute" agreements) that I have with my employer or in which I participate as they relate to the period the United States holds any equity or debt securities of my employer acquired through the TARP Capital Purchase Program.

This waiver includes all claims I may have under the laws of the United States or any state related to the requirements imposed by the aforementioned regulation, including without limitation a claim for any compensation or other payments I would otherwise receive, any challenge to the process by which this regulation was adopted and any tort or constitutional claim about the effect of these regulations on my employment relationship.

FORM OF OPINION

(a) The Company has been duly incorporated and is validly existing as a corporation in good standing under the laws of the state of its incorporation.

(b) The Preferred Shares have been duly and validly authorized, and, when issued and delivered pursuant to the Agreement, the Preferred Shares will be duly and validly issued and fully paid and non-assessable, will not be issued in violation of any preemptive rights, and will rank *pari passu* with or senior to all other series or classes of Preferred Stock issued on the Closing Date with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Company.

(c) The Warrant has been duly authorized and, when executed and delivered as contemplated by the Agreement, will constitute a valid and legally binding obligation of the Company enforceable against the Company in accordance with its terms, except as the same may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors' rights generally and general equitable principles, regardless of whether such enforceability is considered in a proceeding at law or in equity.

(d) The shares of Warrant Preferred Stock issuable upon exercise of the Warrant have been duly authorized and reserved for issuance upon exercise of the Warrant and when so issued in accordance with the terms of the Warrant will be validly issued, fully paid and non-assessable, and will rank *pari passu* with or senior to all other series or classes of Preferred Stock, whether or not issued or outstanding, with respect to the payment of dividends and the distribution of assets in the event of any dissolution, liquidation or winding up of the Company.

(e) The Company has the corporate power and authority to execute and deliver the Agreement and the Warrant and to carry out its obligations thereunder (which includes the issuance of the Preferred Shares, Warrant and Warrant Shares).

(f) The execution, delivery and performance by the Company of the Agreement and the Warrant and the consummation of the transactions contemplated thereby have been duly authorized by all necessary corporate action on the part of the Company and its stockholders, and no further approval or authorization is required on the part of the Company.

(g) The Agreement is a valid and binding obligation of the Company enforceable against the Company in accordance with its terms, except as the same may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors' rights generally and general equitable principles, regardless of whether such enforceability is considered in a proceeding at law or in equity; *provided, however*, such counsel need express no opinion with respect to Section 4.5(h) or the severability provisions of the Agreement insofar as Section 4.5(h) is concerned.

FORM OF WARRANT

[SEE ATTACHED]

FORM OF WARRANT TO PURCHASE PREFERRED STOCK

THE SECURITIES REPRESENTED BY THIS INSTRUMENT HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR THE SECURITIES LAWS OF ANY STATE AND MAY NOT BE TRANSFERRED, SOLD OR OTHERWISE DISPOSED OF EXCEPT WHILE A REGISTRATION STATEMENT RELATING THERETO IS IN EFFECT UNDER SUCH ACT AND APPLICABLE STATE SECURITIES LAWS OR PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT OR SUCH LAWS. THIS INSTRUMENT IS ISSUED SUBJECT TO THE RESTRICTIONS ON TRANSFER AND OTHER PROVISIONS OF A SECURITIES PURCHASE AGREEMENT BETWEEN THE ISSUER OF THESE SECURITIES AND THE INVESTOR REFERRED TO THEREIN, A COPY OF WHICH IS ON FILE WITH THE ISSUER. THE SECURITIES REPRESENTED BY THIS INSTRUMENT MAY NOT BE SOLD OR OTHERWISE TRANSFERRED EXCEPT IN COMPLIANCE WITH SAID AGREEMENT. ANY SALE OR OTHER TRANSFER NOT IN COMPLIANCE WITH SAID AGREEMENT WILL BE VOID.

**WARRANT
to purchase**

Shares of Preferred Stock

of _____

Issue Date: _____

1. **Definitions.** Unless the context otherwise requires, when used herein the following terms shall have the meanings indicated.

“*Board of Directors*” means the board of directors of the Company, including any duly authorized committee thereof.

“*business day*” means any day except Saturday, Sunday and any day on which banking institutions in the State of New York generally are authorized or required by law or other governmental actions to close.

“*Charter*” means, with respect to any Person, its certificate or articles of incorporation, articles of association, or similar organizational document.

“*Company*” means the Person whose name, corporate or other organizational form and jurisdiction of organization is set forth in Item 1 of Schedule A hereto.

“*Exchange Act*” means the Securities Exchange Act of 1934, as amended, or any successor statute, and the rules and regulations promulgated thereunder.

“*Exercise Price*” means the amount set forth in Item 2 of Schedule A hereto.

“*Expiration Time*” has the meaning set forth in Section 3.

“*Issue Date*” means the date set forth in Item 3 of Schedule A hereto.

“*Liquidation Amount*” means the amount set forth in Item 4 of Schedule A hereto.

“*Original Warrantholder*” means the United States Department of the Treasury. Any actions specified to be taken by the Original Warrantholder hereunder may only be taken by such Person and not by any other Warrantholder.

“*Person*” has the meaning given to it in Section 3(a)(9) of the Exchange Act and as used in Sections 13(d)(3) and 14(d)(2) of the Exchange Act.

“*Preferred Stock*” means the series of perpetual preferred stock set forth in Item 5 of Schedule A hereto.

“*Purchase Agreement*” means the Securities Purchase Agreement – Standard Terms incorporated into the Letter Agreement, dated as of the date set forth in Item 6 of Schedule A hereto, as amended from time to time, between the Company and the United States Department of the Treasury (the “*Letter Agreement*”), including all annexes and schedules thereto.

“*Regulatory Approvals*” with respect to the Warrantholder, means, to the extent applicable and required to permit the Warrantholder to exercise this Warrant for shares of Preferred Stock and to own such Preferred Stock without the Warrantholder being in violation of applicable law, rule or regulation, the receipt of any necessary approvals and authorizations of, filings and registrations with, notifications to, or expiration or termination of any applicable waiting period under, the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the rules and regulations thereunder.

“*SEC*” means the U.S. Securities and Exchange Commission.

“*Securities Act*” means the Securities Act of 1933, as amended, or any successor statute, and the rules and regulations promulgated thereunder.

“*Shares*” has the meaning set forth in Section 2.

“*Warrantholder*” has the meaning set forth in Section 2.

“*Warrant*” means this Warrant, issued pursuant to the Purchase Agreement.

2. Number of Shares; Exercise Price. This certifies that, for value received, the United States Department of the Treasury or its permitted assigns (the “*Warrantholder*”) is entitled, upon the terms and subject to the conditions hereinafter set forth, to acquire from the

Company, in whole or in part, after the receipt of all applicable Regulatory Approvals, if any, up to an aggregate of the number of fully paid and nonassessable shares of Preferred Stock set forth in Item 7 of Schedule A hereto (the “*Shares*”), at a purchase price per share of Preferred Stock equal to the Exercise Price.

3. Exercise of Warrant; Term. Subject to Section 2, to the extent permitted by applicable laws and regulations, the right to purchase the Shares represented by this Warrant is exercisable, in whole or in part by the Warrantholder, at any time or from time to time after the execution and delivery of this Warrant by the Company on the date hereof, but in no event later than 5:00 p.m., New York City time on the tenth anniversary of the Issue Date (the “*Expiration Time*”), by (A) the surrender of this Warrant and Notice of Exercise annexed hereto, duly completed and executed on behalf of the Warrantholder, at the principal executive office of the Company located at the address set forth in Item 8 of Schedule A hereto (or such other office or agency of the Company in the United States as it may designate by notice in writing to the Warrantholder at the address of the Warrantholder appearing on the books of the Company), and (B) payment of the Exercise Price for the Shares thereby purchased, by having the Company withhold, from the shares of Preferred Stock that would otherwise be delivered to the Warrantholder upon such exercise, shares of Preferred Stock issuable upon exercise of the Warrant with an aggregate Liquidation Amount equal in value to the aggregate Exercise Price as to which this Warrant is so exercised.

If the Warrantholder does not exercise this Warrant in its entirety, the Warrantholder will be entitled to receive from the Company within a reasonable time, and in any event not exceeding three business days, a new warrant in substantially identical form for the purchase of that number of Shares equal to the difference between the number of Shares subject to this Warrant and the number of Shares as to which this Warrant is so exercised. Notwithstanding anything in this Warrant to the contrary, the Warrantholder hereby acknowledges and agrees that its exercise of this Warrant for Shares is subject to the condition that the Warrantholder will have first received any applicable Regulatory Approvals.

4. Issuance of Shares; Authorization. Certificates for Shares issued upon exercise of this Warrant will be issued in such name or names as the Warrantholder may designate and will be delivered to such named Person or Persons within a reasonable time, not to exceed three business days after the date on which this Warrant has been duly exercised in accordance with the terms of this Warrant. The Company hereby represents and warrants that any Shares issued upon the exercise of this Warrant in accordance with the provisions of Section 3 will be duly and validly authorized and issued, fully paid and nonassessable and free from all taxes, liens and charges (other than liens or charges created by the Warrantholder, income and franchise taxes incurred in connection with the exercise of the Warrant or taxes in respect of any transfer occurring contemporaneously therewith). The Company agrees that the Shares so issued will be deemed to have been issued to the Warrantholder as of the close of business on the date on which this Warrant and payment of the Exercise Price are delivered to the Company in accordance with the terms of this Warrant, notwithstanding that the stock transfer books of the Company may then be closed or certificates representing such Shares may not be actually delivered on such date. The Company will at all times reserve and keep available, out of its authorized but unissued preferred stock, solely for the purpose of providing for the exercise of this Warrant, the aggregate number of shares of Preferred Stock then issuable upon exercise of this Warrant at any

time. The Company will use reasonable best efforts to ensure that the Shares may be issued without violation of any applicable law or regulation or of any requirement of any securities exchange on which the Shares are listed or traded.

5. No Rights as Stockholders; Transfer Books. This Warrant does not entitle the Warrantholder to any voting rights or other rights as a stockholder of the Company prior to the date of exercise hereof. The Company will at no time close its transfer books against transfer of this Warrant in any manner which interferes with the timely exercise of this Warrant.

6. Charges, Taxes and Expenses. Issuance of certificates for Shares to the Warrantholder upon the exercise of this Warrant shall be made without charge to the Warrantholder for any issue or transfer tax or other incidental expense in respect of the issuance of such certificates, all of which taxes and expenses shall be paid by the Company.

7. Transfer/Assignment.

(A) Subject to compliance with clause (B) of this Section 7, this Warrant and all rights hereunder are transferable, in whole or in part, upon the books of the Company by the registered holder hereof in person or by duly authorized attorney, and a new warrant shall be made and delivered by the Company, of the same tenor and date as this Warrant but registered in the name of one or more transferees, upon surrender of this Warrant, duly endorsed, to the office or agency of the Company described in Section 3. All expenses (other than stock transfer taxes) and other charges payable in connection with the preparation, execution and delivery of the new warrants pursuant to this Section 7 shall be paid by the Company.

(B) The transfer of the Warrant and the Shares issued upon exercise of the Warrant are subject to the restrictions set forth in Section 4.4 of the Purchase Agreement. If and for so long as required by the Purchase Agreement, this Warrant shall contain the legends as set forth in Section 4.2(a) of the Purchase Agreement.

8. Exchange and Registry of Warrant. This Warrant is exchangeable, upon the surrender hereof by the Warrantholder to the Company, for a new warrant or warrants of like tenor and representing the right to purchase the same aggregate number of Shares. The Company shall maintain a registry showing the name and address of the Warrantholder as the registered holder of this Warrant. This Warrant may be surrendered for exchange or exercise in accordance with its terms, at the office of the Company, and the Company shall be entitled to rely in all respects, prior to written notice to the contrary, upon such registry.

9. Loss, Theft, Destruction or Mutilation of Warrant. Upon receipt by the Company of evidence reasonably satisfactory to it of the loss, theft, destruction or mutilation of this Warrant, and in the case of any such loss, theft or destruction, upon receipt of a bond, indemnity or security reasonably satisfactory to the Company, or, in the case of any such mutilation, upon surrender and cancellation of this Warrant, the Company shall make and deliver, in lieu of such lost, stolen, destroyed or mutilated Warrant, a new Warrant of like tenor and representing the right to purchase the same aggregate number of Shares as provided for in such lost, stolen, destroyed or mutilated Warrant.

10. Saturdays, Sundays, Holidays, etc. If the last or appointed day for the taking of any action or the expiration of any right required or granted herein shall not be a business day, then such action may be taken or such right may be exercised on the next succeeding day that is a business day.

11. Rule 144 Information. The Company covenants that it will use its reasonable best efforts to timely file all reports and other documents required to be filed by it under the Securities Act and the Exchange Act and the rules and regulations promulgated by the SEC thereunder (or, if the Company is not required to file such reports, it will, upon the request of any Warrantholder, make publicly available such information as necessary to permit sales pursuant to Rule 144 under the Securities Act), and it will use reasonable best efforts to take such further action as any Warrantholder may reasonably request, in each case to the extent required from time to time to enable such holder to, if permitted by the terms of this Warrant and the Purchase Agreement, sell this Warrant without registration under the Securities Act within the limitation of the exemptions provided by (A) Rule 144 under the Securities Act, as such rule may be amended from time to time, or (B) any successor rule or regulation hereafter adopted by the SEC. Upon the written request of any Warrantholder, the Company will deliver to such Warrantholder a written statement that it has complied with such requirements.

12. Adjustments and Other Rights. For so long as the Original Warrantholder holds this Warrant or any portion thereof, if any event occurs that, in the good faith judgment of the Board of Directors of the Company, would require adjustment of the Exercise Price or number of Shares into which this Warrant is exercisable in order to fairly and adequately protect the purchase rights of the Warrants in accordance with the essential intent and principles of the Purchase Agreement and this Warrant, then the Board of Directors shall make such adjustments in the application of such provisions, in accordance with such essential intent and principles, as shall be reasonably necessary, in the good faith opinion of the Board of Directors, to protect such purchase rights as aforesaid.

Whenever the Exercise Price or the number of Shares into which this Warrant is exercisable shall be adjusted as provided in this Section 12, the Company shall forthwith file at the principal office of the Company a statement showing in reasonable detail the facts requiring such adjustment and the Exercise Price that shall be in effect and the number of Shares into which this Warrant shall be exercisable after such adjustment, and the Company shall also cause a copy of such statement to be sent by mail, first class postage prepaid, to each Warrantholder at the address appearing in the Company's records.

13. No Impairment. The Company will not, by amendment of its Charter or through any reorganization, transfer of assets, consolidation, merger, dissolution, issue or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed hereunder by the Company, but will at all times in good faith assist in the carrying out of all the provisions of this Warrant and in taking of all such action as may be necessary or appropriate in order to protect the rights of the Warrantholder.

14. Governing Law. This Warrant will be governed by and construed in accordance with the federal law of the United States if and to the extent such law is applicable, and otherwise in accordance with the laws of the State of New York applicable to contracts made and

to be performed entirely within such State. Each of the Company and the Warrantholder agrees (a) to submit to the exclusive jurisdiction and venue of the United States District Court for the District of Columbia for any civil action, suit or proceeding arising out of or relating to this Warrant or the transactions contemplated hereby, and (b) that notice may be served upon the Company at the address in Section 17 below and upon the Warrantholder at the address for the Warrantholder set forth in the registry maintained by the Company pursuant to Section 8 hereof. To the extent permitted by applicable law, each of the Company and the Warrantholder hereby unconditionally waives trial by jury in any civil legal action or proceeding relating to the Warrant or the transactions contemplated hereby or thereby.

15. Binding Effect. This Warrant shall be binding upon any successors or assigns of the Company.

16. Amendments. This Warrant may be amended and the observance of any term of this Warrant may be waived only with the written consent of the Company and the Warrantholder.

17. Notices. Any notice, request, instruction or other document to be given hereunder by any party to the other will be in writing and will be deemed to have been duly given (a) on the date of delivery if delivered personally, or by facsimile, upon confirmation of receipt, or (b) on the second business day following the date of dispatch if delivered by a recognized next day courier service. All notices hereunder shall be delivered as set forth in Item 9 of Schedule A hereto, or pursuant to such other instructions as may be designated in writing by the party to receive such notice.

18. Entire Agreement. This Warrant, the forms attached hereto and Schedule A hereto (the terms of which are incorporated by reference herein), and the Letter Agreement (including all documents incorporated therein), contain the entire agreement between the parties with respect to the subject matter hereof and supersede all prior and contemporaneous arrangements or undertakings with respect thereto.

[Remainder of page intentionally left blank]

[Form of Notice of Exercise]

Date: _____

TO: **[Company]**

RE: Election to Purchase Preferred Stock

The undersigned, pursuant to the provisions set forth in the attached Warrant, hereby agrees to subscribe for and purchase such number of shares of Preferred Stock covered by the Warrant such that after giving effect to an exercise pursuant to Section 3(B) of the Warrant, the undersigned will receive the net number of shares of Preferred Stock set forth below. The undersigned, in accordance with Section 3 of the Warrant, hereby agrees to pay the aggregate Exercise Price for such shares of Preferred Stock in the manner set forth in Section 3(B) of the Warrant.

Number of Shares of Preferred Stock:¹ _____

The undersigned agrees that it is exercising the attached Warrant in full and that, upon receipt by the undersigned of the number of shares of Preferred Stock set forth above, such Warrant shall be deemed to be cancelled and surrendered to the Company.

Holder: _____

By: _____

Name: _____

Title: _____

1. Number of shares to be received by the undersigned upon exercise of the attached Warrant pursuant to Section 3(B) thereof.

IN WITNESS WHEREOF, the Company has caused this Warrant to be duly executed by a duly authorized officer.

Dated: _____

COMPANY: _____

By: _____

Name:

Title:

Attest:

By: _____

Name:

Title:

[Signature Page to Warrant]

SCHEDULE A

Item 1

Name:

Corporate or other organizational form:

Jurisdiction of organization:

Item 2

Exercise Price:²

Item 3

Issue Date:

Item 4

Liquidation Amount:

Item 5

Series of Perpetual Preferred Stock:

Item 6

Date of Letter Agreement between the Company and the United States Department of the Treasury:

Item 7

Number of shares of Preferred Stock:³

Item 8

Company's address:

Item 9

Notice information:

² \$0.01 per share or such greater amount as the Charter may require as the par value of the Preferred Stock.

³ The initial number of shares of Preferred Stock for which this Warrant is exercisable shall include the number of shares required to effect the cashless exercise pursuant to Section 3(B) of this Warrant (e.g., such number of shares of Preferred Stock having an aggregate Liquidation Amount equal in value to the aggregate Exercise Price) such that, following exercise of this Warrant and payment of the Exercise Price in accordance with such Section 3(B), the net number of shares of Preferred Stock delivered to the Warranholder (and rounded to the nearest whole share) would have an aggregate Liquidation Amount equal to 5% of the aggregate amount invested by the United States Department of the Treasury on the investment date.

SCHEDULE A

ADDITIONAL TERMS AND CONDITIONS

Company Information:

Name of the Company: **Northway Financial, Inc.**

Corporate or other organizational form: **Corporation**

Jurisdiction of Organization: **New Hampshire**

Appropriate Federal Banking Agency: **Federal Reserve Bank of Boston**

Notice Information:

Northway Financial, Inc.
9 Main Street
Berlin, NH 03570
Attn: Richard P. Orsillo
Telephone: (603) 752-1171
Fax: (603) 733-1016

with a copy to:

Goodwin Procter LLP
Exchange Place
53 State Street
Boston, MA 02109
Attn: William P. Mayer
Paul W. Lee
Telephone: (617) 570-1000
Fax: (617) 523-1231

Terms of the Purchase:

Series of Preferred Stock Purchased: Fixed Rate Cumulative Perpetual Preferred Stock, Series A

Per Share Liquidation Preference of Preferred Stock: \$1,000

Number of Shares of Preferred Stock Purchased: 10,000

Dividend Payment Dates on the Preferred Stock: February 15, May 15, August 15, and November 15

Series of Warrant Preferred Stock: Fixed Rate Cumulative Perpetual Preferred Stock, Series B

Number of Warrant Shares: 500.50050

Number of Net Warrant Shares (after net settlement): 500

Exercise Price of the Warrant: \$1.00 per share

UST Sequence No. 581

Purchase Price: \$10,000,000

Closing:

Location of Closing: Telephonic.

Time of Closing: 9:00 a.m. Eastern Time

Date of Closing: January 30, 2009

Wire Information for Closing:

ABA Number: [REDACTED]
Bank: [REDACTED]
Account Name: [REDACTED]
Account Number: [REDACTED]
Beneficiary: [REDACTED]

Contact for Confirmation of Wire Information:

[REDACTED]

Contact for Dividend Information

[REDACTED]

SCHEDULE B

CAPITALIZATION

Capitalization Date: [REDACTED]

Common Stock

Par value: [REDACTED]

Total Authorized: [REDACTED]

Outstanding: [REDACTED]

Subject to warrants, options, convertible securities, etc.: [REDACTED]

Reserved for benefit plans and other issuances: [REDACTED]

Remaining authorized but unissued: [REDACTED]

Shares issued after Capitalization Date (other than pursuant to warrants, options, convertible securities, etc. as set forth above): [REDACTED]

Preferred Stock

Par value: [REDACTED]

Total Authorized: [REDACTED]

Outstanding (by series): [REDACTED]

Reserved for issuance: [REDACTED]

Remaining authorized but unissued: [REDACTED]

Holders of 5% or more of any class of capital stock

Primary Address

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

SCHEDULE C

LITIGATION

List any exceptions to the representation and warranty in Section 2.2(1) of the Securities Purchase Agreement - Standard Terms.

If none, please so indicate by checking the box: .

SCHEDULE D

COMPLIANCE WITH LAWS

List any exceptions to the representation and warranty in the second sentence of Section 2.2(m) of the Securities Purchase Agreement — Standard Terms.

If none, please so indicate by checking the box: .

List any exceptions to the representation and warranty in the last sentence of Section 2.2(m) of the Securities Purchase Agreement — Standard Terms.

If none, please so indicate by checking the box: .

SCHEDULE E

REGULATORY AGREEMENTS

List any exceptions to the representation and warranty in Section 2.2(s) of the Securities Purchase Agreement — Standard Terms.

If none, please so indicate by checking the box: .

SCHEDULE F

COMPANY FINANCIAL STATEMENTS

The December 31, 2008 financial statements are not yet completed and will be provided to the Investor promptly when available. The remaining Company Financial Statements that were Previously Disclosed pursuant to Section 2.2(h) of the Securities Purchase Agreement – Standard Terms are attached hereto.

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

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the fiscal year ended December 31, 2005

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

Commission File Number 000-23129

NORTHWAY FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

<u>New Hampshire</u> (State or other jurisdiction of incorporation or organization)	<u>04-3368579</u> (I.R.S. Employer Identification No.)
---	--

9 Main Street <u>Berlin, New Hampshire</u> Address of principal executive offices	<u>03570</u> (Zip Code)
---	----------------------------

(603) 752-1171

(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act: None

Securities Registered Pursuant to Section 12(g) of the Act:
Common Stock, Par Value \$1.00

Indicate by check mark if the registrant is a well-known seasoned issue, as defined in Rule 405 of the Securities Act.
YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES NO

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 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 days. YES NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.. Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES NO

The number of shares of voting and nonvoting common stock, par value \$1.00 per share, held by nonaffiliates of the registrant as of June 30, 2005 was 1,290,784 shares with an aggregate market value, computed by reference to the last reported sales price on the NASDAQ National Market on such date, of \$41,305,088. Although directors and executive officers of the registrant were assumed to be "affiliates" of the registrant for purposes of this calculation, this classification is not to be interpreted as an admission of such status.

At March 25, 2006, there were 1,491,174 shares of common stock outstanding, par value \$1.00 per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement for its 2006 Annual Meeting of Stockholders are incorporated by reference in Items 10, 11, 12, 13 and 14 of Part III.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CONSOLIDATED STATEMENTS OF INCOME

(\$000 Omitted, Except Per Share Data)

FOR THE YEAR ENDED DECEMBER 31,	2005	2004	2003
Interest and dividend income			
Interest and fees on loans	\$27,314	\$26,569	\$27,917
Interest on debt securities available-for-sale:			
Taxable	3,843	3,201	3,075
Tax-exempt	299	142	158
Dividends	323	239	237
Interest on federal funds sold	322	125	118
Interest on interest-bearing deposits	3	1	2
Total interest and dividend income	32,104	30,277	31,507
Interest expense			
Interest on deposits	4,092	3,150	4,422
Interest on short-term borrowings	257	110	126
Interest on long-term debt	4,579	4,171	3,909
Total interest expense	8,928	7,431	8,457
Net interest and dividend income	23,176	22,846	23,050
Provision for loan losses	75	495	805
Net interest and dividend income after provision for loan losses	23,101	22,351	22,245
Noninterest income			
Service charges and fees on deposit accounts	2,430	2,229	1,673
(Loss) gain on sales of securities available-for-sale, net	(551)	753	1,522
Gain on sales of loans, net	260	374	422
Other	1,857	1,741	1,758
Total noninterest income	3,996	5,097	5,375
Noninterest expense			
Salaries and employee benefits	11,592	11,981	11,426
Office occupancy and equipment	4,090	3,731	3,753
Amortization of core deposit intangibles	954	954	954
Write-down of equity securities	-	-	184
Other	6,946	5,728	5,819
Total noninterest expense	23,582	22,394	22,136
Income before income tax expense	3,515	5,054	5,484
Income tax expense	842	1,666	1,867
Net income	\$ 2,673	\$ 3,388	\$ 3,617
Basic earnings per common share	\$ 1.78	\$ 2.26	\$ 2.40
Earnings per common share assuming dilution	\$ 1.77	\$ 2.24	\$ 2.39

See Notes to Consolidated Financial Statements

CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31,	(\$000 Omitted)	
	2005	2004
Assets		
Cash and cash equivalents		
Cash and due from banks and interest-bearing deposits	\$ 14,587	\$ 13,794
Federal funds sold	14,775	10,975
Total cash and cash equivalents	29,362	24,769
Securities available-for-sale, at fair value	103,244	101,133
Federal Home Loan Bank stock	5,541	5,515
Federal Reserve Bank stock	-	365
Loans held-for-sale	453	311
Loans, net before allowance for loan losses	460,373	474,706
Less: allowance for loan losses	5,150	5,204
Net loans	455,223	469,502
Premises and equipment, net	11,735	13,701
Other real estate owned	196	-
Goodwill	10,152	10,152
Core deposit intangibles, net	1,995	2,949
Other assets	14,833	10,021
Total assets	\$632,734	\$638,418
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Demand	\$ 77,436	\$ 78,669
Regular savings, NOW and money market deposit accounts	238,689	263,685
Certificates of deposit (in denominations of \$100,000 or more)	28,297	18,935
Other time	120,034	114,070
Total deposits	464,456	475,359
Short-term borrowings	9,363	11,268
Long-term debt	105,620	98,620
Other liabilities	3,045	3,661
Total liabilities	582,484	588,908
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 shares issued and 1,491,174 shares outstanding in 2005 and 1,503,574 shares outstanding in 2004	1,732	1,732
Additional paid-in capital	2,064	2,075
Retained earnings	54,089	52,484
Treasury stock (240,795 shares at December 31, 2005 and 228,395 shares at December 31, 2004)	(6,531)	(6,090)
Accumulated other comprehensive loss, net of tax	(1,104)	(691)
Total stockholders' equity	50,250	49,510
Total liabilities and stockholders' equity	\$632,734	\$638,418

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(\$000 Omitted)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss) ¹	Total Stockholders' Equity
Balance at December 31, 2002	\$ 1,732	\$ 2,088	\$ 47,523	\$ (5,711)	\$ (1,366)	\$ 44,266
Net income – 2003	-	-	3,617	-	-	3,617
Net change in unrealized gain (loss) on securities available-for-sale, net of tax	-	-	-	-	1,110	1,110
Net change in unfunded pension accumulated benefit obligation, net of tax	-	-	-	-	405	405
Treasury stock purchased	-	-	-	(502)	-	(502)
Cash dividends declared (\$0.68 per share)	-	-	(1,024)	-	-	(1,024)
Balance at December 31, 2003	1,732	2,088	50,116	(6,213)	149	47,872
Net income – 2004	-	-	3,388	-	-	3,388
Net change in unrealized gain (loss) on securities available-for-sale, net of tax	-	-	-	-	(889)	(889)
Net change in unfunded pension accumulated benefit obligation, net of tax	-	-	-	-	49	49
Exercise of stock options, net of tax benefit	-	(13)	-	123	-	110
Cash dividends declared (\$0.68 per share)	-	-	(1,020)	-	-	(1,020)
Balance at December 31, 2004	1,732	2,075	52,484	(6,090)	(691)	49,510
Net income – 2005	-	-	2,673	-	-	2,673
Net change in unrealized gain (loss) on securities available-for-sale, net of tax	-	-	-	-	(1,085)	(1,085)
Net change in unfunded pension accumulated benefit obligation, net of tax	-	-	-	-	672	672
Exercise of stock options, net of tax benefit	-	(11)	-	122	-	111
Treasury stock purchased	-	-	-	(563)	-	(563)
Cash dividends declared (\$0.71 per share)	-	-	(1,068)	-	-	(1,068)
Balance at December 31, 2005	\$ 1,732	\$ 2,064	\$ 54,089	\$ (6,531)	\$ (1,104)	\$ 50,250

¹ Accumulated other comprehensive loss as of December 31, 2005 consists of net unrealized holding losses on available-for-sale securities of \$1,104, net of tax. Accumulated other comprehensive loss as of December 31, 2004 consists of net unrealized holding losses on available-for-sale securities of \$19, net of tax, and net unfunded pension accumulated benefit obligation of \$672, net of tax. Accumulated other comprehensive income as of December 31, 2003 consists of net unrealized holding gains on available-for-sale securities of \$870, net of tax, and net unfunded pension accumulated benefit obligation of \$721, net of tax.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(\$000 Omitted)

FOR THE YEAR ENDED DECEMBER 31,	2005	2004	2003
Net income	\$ 2,673	\$ 3,388	\$ 3,617
Other comprehensive (loss) income			
Net unrealized holding (losses) gains on securities available-for-sale	(2,347)	(720)	2,662
Reclassification adjustment for realized losses (gains) in net income	551	(753)	(1,338)
Net unrealized (losses) gains on securities	(1,796)	(1,473)	1,324
Minimum pension liability adjustment	1,018	74	615
Other comprehensive (loss) income	(778)	(1,399)	1,939
Income tax (benefit) expense	(365)	(559)	424
Other comprehensive (loss) income, net of tax	(413)	(840)	1,515
Comprehensive income	\$ 2,260	\$ 2,548	\$ 5,132

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

(\$000 Omitted)

FOR THE YEAR ENDED DECEMBER 31,	2005	2004	2003
Cash flows from operating activities:			
Net income	\$ 2,673	\$ 3,388	\$ 3,617
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	75	495	805
Depreciation and amortization	2,367	2,369	2,381
Deferred income tax (benefit) expense	(4)	43	(249)
Write-down of equity securities	-	-	184
Loss (gain) on sales of securities available-for-sale, net	551	(753)	(1,522)
Loss on sale, disposal and write-down of premises and equipment	57	9	28
Amortization of premiums and accretion of discounts on securities, net	54	90	408
Change in unearned income/unamortized cost, net	(190)	(141)	40
Accretion of discount on loans acquired	(140)	(160)	(106)
Loss (gain) on sales of other real estate owned and other personal property, net	-	9	(58)
Net (increase) decrease in loans held-for-sale	(142)	200	158
Net change in other assets and other liabilities	(999)	587	1,488
Net cash provided by operating activities	4,302	6,136	7,174
Cash flows from investing activities:			
Proceeds from sales of securities available-for-sale	16,002	16,964	24,520
Proceeds from maturities of securities available-for-sale	17,315	25,690	76,716
Purchases of securities available-for-sale	(40,829)	(76,515)	(80,314)
Purchases of Federal Home Loan Bank stock	(26)	(810)	(73)
Purchases of Federal Reserve Bank stock	-	-	(285)
Proceeds from sales of Federal Reserve Bank stock	365	-	-
Loan originations and principal collections, net	13,345	(7,142)	(28,494)
Recoveries of previously charged-off loans	286	338	181
Proceeds from sale of commercial loans	-	5,088	-
Proceeds from sales of and payments received on other real estate owned	25	-	285
Proceeds from sales of and payments received on other personal property	652	604	822
Disposal of (additions to) premises and equipment, net	496	(2,267)	(1,810)
Purchase of company owned life insurance policies	-	(400)	(800)
Net cash provided by (used by) investing activities	7,631	(38,450)	(9,252)
Cash flows from financing activities:			
Net (decrease) increase in deposits	(10,903)	12,052	(12,887)
Net (decrease) increase in short-term borrowings	(1,905)	3,867	(850)
Advances from Federal Home Loan Bank (FHLB)	13,000	20,000	28,000
Repayment of FHLB advances	(6,000)	(9,000)	(7,000)
Exercise of stock options	99	99	-
Purchases of treasury stock	(563)	-	(502)
Cash dividends paid	(1,068)	(1,020)	(1,024)
Net cash (used by) provided by financing activities	(7,340)	25,998	5,737
Net increase (decrease) in cash and cash equivalents	4,593	(6,316)	3,659
Cash and cash equivalents at beginning of year	24,769	31,085	27,426
Cash and cash equivalents at end of year	\$ 29,362	\$ 24,769	\$ 31,085

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

<u>FOR THE YEAR ENDED DECEMBER 31,</u>	<u>2005</u>	<u>((\$000 Omitted)</u> <u>2004</u>	<u>2003</u>
Supplemental disclosures of cash flows:			
Interest paid	\$ 8,662	\$ 7,519	\$ 8,617
Income taxes paid	1,106	2,090	1,610
Loans transferred to other real estate owned	221	-	46
Loans transferred to other personal property	682	603	824
Amount due from customer for pending municipal security maturity	3,000	-	-

See Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Northway is a bank holding company formed in 1997 under the laws of New Hampshire and is registered under the Bank Holding Company Act of 1956. Northway's only business activity has been to own all of the shares of, and provide management, capital and operational support to Northway Bank ("Bank"), formerly known as The Berlin City Bank, and its Delaware statutory business trusts Northway Capital Trust I and Northway Capital Trust II. October 1, 2005 The Berlin City Bank was renamed Northway Bank and The Pemigewasset National Bank of Plymouth, New Hampshire was merged into Northway Bank. The Company's headquarters are in Berlin, New Hampshire. The banking subsidiary is engaged principally in the business of attracting deposits from the general public and investing those deposits in securities, commercial loans, real estate loans, and consumer loans.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in the consolidation.

Northway Capital Trust I and Northway Capital Trust II, subsidiaries of the Company, were formed to sell capital securities to the public through a third party trust pool. In accordance with FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), these subsidiaries have not been included in the consolidated financial statements.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry.

In preparing the financial statements, management is required to make estimates and judgments that affect the reported amounts of assets and liabilities as of the dates of the consolidated balance sheets, and income and expense for the periods. Actual results could differ from those estimates. Material estimates that are particularly susceptible to change in the near-term relate to the determination of the allowance for loan losses.

Reclassifications

Certain amounts in the prior years' financial statements have been reclassified to conform with the current year's presentation.

Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits, and federal funds sold.

Securities

Debt securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost; if debt and equity securities are bought and held principally for the purpose of selling in the near term they would be classified as trading and reported at fair value, with unrealized gains and losses included in earnings; and debt and equity securities not classified as either held-to-maturity or trading are classified as available-for-sale and reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity, net of estimated income taxes. At this time, the Company has not established a trading account.

Premiums and discounts are amortized and accreted primarily on the level yield method over the contractual life of the securities adjusted for expected prepayments.

If a decline in the fair value below the adjusted cost basis of an investment is judged to be other than temporary, the cost basis of the investment is written down to fair value as the new cost basis and the amount of the write-down is included in noninterest expense.

Gains and losses on sales of securities available-for-sale are recognized at the time of the sale on a specific identification basis.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans Held-for-Sale

Loans held-for-sale are generally identified as such at origination and are stated at the lower of aggregate cost or market. Market value is based on outstanding investor commitments. When loans are sold, a gain or loss is recognized to the extent that the sale proceeds exceed or are less than the carrying value of the loans. Gains and losses are determined using the specific identification method. All loans sold are without recourse to the Company.

Loans

Loans are carried at the principal amounts outstanding, net of any unearned income or unamortized cost, premiums on originated loans and discounts on acquired loans. Unearned income and unamortized cost includes loan origination fees, net of direct loan origination costs. This income or expense is deferred and recognized as adjustments to loan income over the contractual life of the related notes using a method the result of which approximates that of the interest method.

Loans are placed on nonaccrual when payment of principal or interest is considered to be in doubt or is past due 90 days or more. The Company may choose to place a loan on nonaccrual status due to payment delinquency or uncertain collectibility, while not classifying the loan as impaired, if (i) it is probable that the Company will collect all amounts due in accordance with the contractual terms of the loan or (ii) the loan is not a commercial, commercial real estate or an individually significant mortgage or consumer loan. Previously accrued income on nonaccrual loans that has not been collected is reversed from current income, and subsequent cash receipts are recorded as income if principal on the loans is deemed collectible. Loans are returned to accrual status when collection of all contractual principal and interest is reasonably assured and there has been sustained repayment performance.

The Company's loans are primarily secured by real estate in New Hampshire. In addition, other real estate owned is located in this market. Accordingly, the ultimate collectibility of a substantial portion of the Company's loan portfolio and the recovery of other real estate owned are susceptible to changing conditions in this market.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level considered adequate by management on the basis of many factors including the risk characteristics of the portfolio, trends in loan delinquencies and an assessment of existing economic conditions. Additions to the allowance are charged to earnings; realized losses, net of recoveries, are charged directly to the allowance.

While management uses available information in establishing the allowance for loan losses, future additions to the allowance may be necessary if economic conditions differ substantially from the estimates used in making the evaluations. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on judgments different from those of management.

Commercial, commercial real estate and individually significant mortgage and consumer loans are considered impaired, and are placed on nonaccrual, when it is probable that the Company will not be able to collect all amounts due according to the contractual terms of the loan agreement. Mortgage and consumer loans, which are not individually significant, are measured for impairment collectively. Loans that experience insignificant payment delays and insignificant shortfalls in payment amounts generally are not classified as impaired. The amount of impairment for all impaired loans is determined by the difference between the present value of the expected cash flows related to the loan, using the original contractual interest rate, and its recorded value, or, as a practical expedient in the case of collateralized loans, the difference between the fair value of the collateral and the recorded amount of the loan.

When foreclosure is probable, impairment is measured based on the fair value of the collateral.

Servicing Assets

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the respective assets. Estimated lives are thirty-nine years for buildings, ten to fifteen years for building improvements and three to seven years for furniture and equipment.

Amortization of leasehold improvements is accumulated on a straight-line basis over the lesser of the term of the respective lease or the asset's useful life, not to exceed ten years.

Other Real Estate Owned

Other real estate owned is comprised of properties acquired either through foreclosure proceedings or acceptance of a deed in lieu of foreclosure, and for which the Company has taken physical possession. The Company classifies loans as repossessed or foreclosed if the Company receives physical possession of the debtor's assets, regardless of whether or not foreclosure proceedings take place.

Assets acquired through foreclosure or a similar conveyance of title are initially recorded at the lower of the carrying value of the loan or the fair value, less estimated costs to sell, of the property constructively or actually received. Gains and losses upon disposition are reflected in the statement of income as realized.

Advertising

The Company directly expenses costs associated with advertising as they are incurred.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and the respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Stock-Based Compensation

At December 31, 2005, the Company has a stock-based employee compensation plan which is described more fully in NOTE 15. The Company accounts for this plan under the recognition and measurement principles of 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 (revised 2004), "Share-Based Payment", to stock-based employee compensation.

		(\$000 Omitted, except per share data)		
		<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income	As reported	\$2,673	\$3,388	\$3,617
Deduct: Total stock-based employee compensation expense determined under fair value based methods awards, net of related tax effects	Pro forma	<u>-</u>	<u>-</u>	<u>39</u>
		<u>\$2,673</u>	<u>\$3,388</u>	<u>\$3,578</u>
Earnings per common share	As reported	\$ 1.78	\$ 2.26	\$ 2.40
	Pro forma	1.78	2.26	2.37
Earnings per common share (assuming dilution)	As reported	\$ 1.77	\$ 2.24	\$ 2.39
	Pro forma	1.77	2.24	2.36

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Earnings Per Share

Basic earnings per share ("EPS") excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS, if applicable, reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Earnings per common share have been computed based on the following:

	(\$000 Omitted)		
	Years Ended December 31,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income	\$2,673	\$3,388	\$3,617
Less: Preferred stock dividends	<u>-</u>	<u>-</u>	<u>-</u>
Net income applicable to common stock	<u>\$2,673</u>	<u>\$3,388</u>	<u>\$3,617</u>
Average number of common shares outstanding	1,502.1	1,500.1	1,504.4
Effect of dilutive options	<u>9.3</u>	<u>11.6</u>	<u>7.8</u>
Average number of common shares outstanding used to calculate diluted earnings per common share	<u>1,511.4</u>	<u>1,511.7</u>	<u>1,512.2</u>

Recent Accounting Pronouncements

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 adoption of SOP 03-3 did not have a material impact on the Company's financial position or results of operations.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"). This Statement revises FASB Statement No. 123, "Accounting for Stock Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS 123R requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. It establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair-value based measurement method in accounting for share-based payment transactions with employees except for equity instruments held by employee share ownership plans. This Statement is effective for the Company as of the beginning of the first interim reporting period that begins after December 15, 2005. The Company does not believe the adoption of this Statement will have a material impact on the Company's financial position or results of operations.

NOTE 2 CASH AND DUE FROM BANKS

There was no cash due from banks at December 31, 2005 subject to withdrawals and usage restrictions to satisfy the reserve requirements of the Federal Reserve Bank. At December 31, 2004, there was \$3,753,000, which was subject to withdrawals and usage restrictions to satisfy the reserve requirements of the Federal Reserve Bank.

NOTE 3 SECURITIES AVAILABLE-FOR-SALE

The amortized cost, gross unrealized gains, gross unrealized losses, and fair value of securities at December 31, 2005 and 2004 follows:

	(\$000 Omitted)			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>December 31, 2005</u>				
U.S. Treasury and other U.S. government agency securities	\$ 48,728	\$ -	\$ 977	\$ 47,751
Marketable equity securities	2,695	178	64	2,809
Mortgage-backed securities	24,704	1	774	23,931
Collateralized mortgage obligations	8	-	-	8
Corporate bonds	5,541	37	9	5,569
State and political subdivision bonds and notes	<u>23,396</u>	<u>45</u>	<u>265</u>	<u>23,176</u>
	<u>\$105,072</u>	<u>\$ 261</u>	<u>\$2,089</u>	<u>\$103,244</u>
 <u>December 31, 2004</u>				
U.S. Treasury and other U.S. government agency securities	\$ 54,914	\$ 1	\$ 352	\$ 54,563
Marketable equity securities	1,827	136	32	1,931
Mortgage-backed securities	29,447	92	248	29,291
Collateralized mortgage obligations	10	-	-	10
Corporate bonds	12,001	293	7	12,287
State and political subdivision bonds and notes	<u>2,966</u>	<u>85</u>	<u>-</u>	<u>3,051</u>
	<u>\$101,165</u>	<u>\$ 607</u>	<u>\$ 639</u>	<u>\$101,133</u>

The contractual maturity distribution of investments in debt obligations at December 31, 2005 follows:

	(\$000 Omitted)				
	Within One Year	One to Five Years	Five to Ten Years	Over Ten Years	Total Amortized Cost
U.S. Treasury and other U.S. government agency securities	\$5,998	\$37,730	\$5,000	\$ -	\$48,728
Mortgage-backed securities	-	29	-	24,675	24,704
Collateralized mortgage obligations	-	-	-	8	8
Corporate bonds	2,003	3,538	-	-	5,541
State and political subdivision bonds and notes	<u>1,101</u>	<u>425</u>	<u>562</u>	<u>21,308</u>	<u>23,396</u>
Total amortized cost	<u>\$9,102</u>	<u>\$41,722</u>	<u>\$5,562</u>	<u>\$45,991</u>	<u>\$102,377</u>
 Fair value	 <u>\$9,052</u>	 <u>\$40,916</u>	 <u>\$5,485</u>	 <u>\$44,982</u>	 <u>\$100,435</u>

Actual maturities of state and political subdivision bonds and notes, mortgage-backed securities and collateralized mortgage obligations will differ from the maturities presented because borrowers have the right to prepay obligations without prepayment penalties.

An analysis of gross realized gains and losses on sales of securities available-for-sale during the years ended December 31, follows:

	(\$000 Omitted)					
	2005		2004		2003	
	Realized Gains	Realized Losses	Realized Gains	Realized Losses	Realized Gains	Realized Losses
Marketable equity securities	\$ 221	\$ 104	\$ 402	\$ 149	\$ 97	\$ 244
U.S. Treasury and other U.S. government agency securities	-	200	5	-	15	-
Mortgage-backed securities	12	11	-	-	-	-
Corporate bonds	30	499	539	50	1,682	28
State and political subdivision bonds and notes	<u>-</u>	<u>-</u>	<u>6</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$ 263</u>	<u>\$ 814</u>	<u>\$ 952</u>	<u>\$ 199</u>	<u>\$ 1,794</u>	<u>\$ 272</u>

NOTE 3 SECURITIES AVAILABLE-FOR-SALE (CONTINUED)

The tax (benefit) provision applicable to these net realized (losses)/gains amounted to \$(218,000), \$298,000 and \$603,000 for 2005, 2004, and 2003, respectively.

Securities with a carrying amount totaling \$73,651,000 and \$72,106,000 were pledged to secure public deposits, securities sold under agreements to repurchase, FHLB advances and treasury, tax and loan accounts at December 31, 2005 and 2004, respectively.

The aggregate fair value and unrealized losses of securities that have been in a continuous unrealized loss position for less than twelve months and for twelve months or more, and are not other than temporarily impaired, are as follows as of December 31, 2005:

	(\$000 Omitted)					
	<u>Less than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
U.S. Treasury and other U.S. government agency securities	\$13,774	\$ 218	\$33,977	\$ 759	\$47,751	\$ 977
Marketable equity securities	881	53	64	11	945	64
Mortgage-backed securities	5,806	97	18,095	677	23,901	774
Corporate bonds	1,525	9	-	-	1,525	9
State and political subdivision bonds and notes	17,026	265	-	-	17,026	265
Total temporarily impaired securities	<u>\$39,012</u>	<u>\$ 642</u>	<u>\$52,136</u>	<u>\$ 1,447</u>	<u>\$91,148</u>	<u>\$ 2,089</u>

At December 31, 2005, securities with a total fair value of \$91,149,000 were in a loss position. These securities included twenty U.S. government agency securities with a fair value of \$47,751,000 and an unrealized loss of \$977,000. These securities had an unrealized loss due to the current interest rate environment. As these securities are guaranteed by U.S. government agencies such as FHLB, FHLMC or FNMA there is no credit risk associated with them. These securities are not other-than-temporarily impaired as the Company has the ability and the intent to hold these securities until recovery to cost basis.

Mortgage-backed securities with a fair value of \$23,901,000 had an unrealized loss of \$774,000 at December 31, 2005. As with the U.S. government agency securities, these securities have an unrealized loss due to the current interest rate environment. As all of these mortgage-backed securities are guaranteed by U.S. government agencies such as FHLMC, GNMA or FNMA there is no credit risk associated with them. These securities have not been classified as other-than-temporarily impaired as the Company has the ability and intent to hold these securities until recovery to cost basis.

Nineteen marketable equity securities with a fair value of \$945,000 had an unrealized loss of \$64,000 at December 31, 2005. Marketable equity securities are subject to internal testing on a quarterly basis to determine impairment. Testing includes review of industry analyst reports, credit ratings, sector analysis and earnings projections. Based upon the December 31, 2005 review, these securities were not determined to be other-than-temporarily impaired.

Two corporate bond securities with a fair value of \$1,525,000 had an unrealized loss of \$9,000 at December 31, 2005. Corporate bond securities are subject to internal testing on a quarterly basis to determine other-than-temporary impairment. Based upon the December 31, 2005 review, these securities were not determined to be other-than-temporarily impaired.

Thirty-six state and political subdivision securities with a fair value of \$17,026,000 had an unrealized loss of \$265,000 at December 31, 2005. As all of these state and political subdivision securities are guaranteed by municipalities there is minimal credit risk associated with them. These securities have not been classified as other-than-temporarily impaired as the Company had the ability to hold these securities until recovery to cost basis.

NOTE 4 LOANS

Loan balances were comprised of the following:

<u>December 31,</u>	(\$000 Omitted)	
	<u>2005</u>	<u>2004</u>
Real estate:		
Residential	\$158,729	\$147,333
Commercial	143,456	130,334
Construction	13,241	5,366
Commercial	27,349	27,013
Installment	35,786	29,345
Indirect installment	62,221	116,520
Other	<u>19,507</u>	<u>18,901</u>
Total loans	<u>460,289</u>	<u>474,812</u>
Less:		
(Unamortized cost) unearned income	(84)	106
Allowance for loan losses	<u>5,150</u>	<u>5,204</u>
Total (unamortized cost) unearned income and allowance for loan losses	<u>5,066</u>	<u>5,310</u>
Net loans	<u>\$455,223</u>	<u>\$469,502</u>

Total loans above are net of unearned discount on loans acquired in the amount of \$275,000 and \$415,000 at December 31, 2005 and 2004, respectively. In addition, total loans above are net of unamortized premium on indirect installment loans originated in the amount of \$789,000 and \$2,005,000 at December 31, 2005 and 2004, respectively.

Loans are made in the ordinary course of business to directors, executive officers, and their immediate families and to organizations in which such persons have more than a 10% ownership interest. These loans are made on substantially the same terms, including interest rate and collateral, as those prevailing at the same time for comparable transactions with unrelated persons and did not involve more than the normal risk of collectibility or present other unfavorable features. Total loans to such persons and their companies amounted to \$544,000 as of December 31, 2005. During 2005, principal payments were \$125,000 and principal advances amounted to \$156,000.

The Company's lending activities are conducted principally in New Hampshire. Although the loan portfolio is diversified, a portion of its debtors' ability to repay is dependent upon the economic conditions prevailing in New Hampshire. The Company maintains significant credit relationships with borrowers in the hotel and motel industry. The aggregate loan balances to these industries totaled \$67,152,000 at December 31, 2005 and \$59,730,000 at December 31, 2004.

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of these loans total \$39,219,000 and \$43,979,000 at December 31, 2005 and 2004, respectively. The Company sold \$15,705,000 of mortgage loans in 2005 and \$15,228,000 of mortgage loans and \$5,088,000 of SBA guaranteed commercial loans in 2004.

The Company capitalized \$79,000 and \$80,000 of servicing rights and amortized \$144,000 and \$168,000 of total servicing rights in 2005 and 2004, respectively. The impairment valuation allowance of mortgage servicing rights was reduced by \$3,000 and \$2,000 in 2005 and 2004, respectively. Impairment of mortgage servicing rights is assessed based on the fair value of those rights. Fair values are estimated using discounted cash flows based on a current market interest rate. The amount of the impairment recognized is the amount by which the capitalized mortgage servicing rights exceed their fair value. At December 31, 2005 and 2004, respectively, the carrying amount of servicing rights was \$236,000 and \$298,000, and is included in other assets. At December 31, 2005 and 2004, respectively, the fair value of servicing rights was \$389,000 and \$415,000.

Restructured, accruing loans entered into prior to the adoption of SFAS No. 114 and 118 are not required to be reported as impaired loans unless such loans are not performing in accordance with the restructured terms at adoption of SFAS No. 114. Restructured, accruing loans entered into subsequent to the adoption of these statements are reported as impaired loans. In the year subsequent to restructure these loans may be removed from the impaired loan disclosure provided that the loan bears a market rate of interest at the time of restructure and is performing under the restructured terms.

At December 31, 2005 and 2004, loans restructured in a troubled debt restructuring before January 1, 1995, the effective date of SFAS No. 114, that are not impaired based on the terms specified by the restructuring agreement totaled \$0 and \$838,000, respectively. The gross interest income that would have been recorded in the year ended December 31, 2004 if such restructured loans had been current in accordance with their original terms was \$60,000. The amount of interest income recognized on such restructured loans for the year ended December 31, 2004 was \$43,000.

NOTE 4 LOANS (CONTINUED)

At December 31, 2005 and 2004, nonperforming loans totaled \$3,013,000 and \$2,867,000, respectively. No nonperforming loans were past due 90 days or more and still accruing interest at December 31, 2005 and 2004. During January 2006, nonperforming loans totaling \$1,591,000 were paid in full.

The recorded investment in loans that are considered to be impaired under SFAS No. 114 was \$2,082,000 and \$1,914,000 at December 31, 2005 and 2004, respectively, for which the related allowance for loan losses is \$0 and \$307,000 as of December 31, 2005 and 2004, respectively. All of the Company's impaired loans are collateralized and therefore all impaired loans are measured by the difference between the fair value of the collateral and the recorded amount of the loan. The average recorded investment in impaired loans during the twelve months ended December 31, 2005 and 2004 was approximately \$2,147,000 and \$2,305,000, respectively. For the twelve months ended December 31, 2005 and 2004 the Company recognized interest income on impaired loans of \$97,000 and \$147,000, respectively, which included \$88,000 and \$128,000 of interest income recognized using the cash-basis method of income recognition, respectively.

NOTE 5 ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses for the years ended December 31, follows:

	(\$000 Omitted)		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Balance at beginning of year	\$5,204	\$5,036	\$4,920
Provision for loan losses	75	495	805
Recoveries on loans previously charged-off	286	338	181
Loans charged-off	<u>(415)</u>	<u>(665)</u>	<u>(870)</u>
Balance at end of year	<u>\$5,150</u>	<u>\$5,204</u>	<u>\$5,036</u>

NOTE 6 PREMISES AND EQUIPMENT

A summary of premises and equipment follows:

	(\$000 Omitted)	
	December 31,	
	<u>2005</u>	<u>2004</u>
Land	\$ 2,455	\$ 2,650
Buildings	9,718	11,509
Leasehold improvements	120	365
Construction in progress	129	36
Equipment	<u>9,359</u>	<u>8,906</u>
	21,781	23,466
Less accumulated depreciation and amortization	<u>10,046</u>	<u>9,765</u>
	<u>\$11,735</u>	<u>\$13,701</u>

Depreciation expense for the years ended December 31, 2005, 2004 and 2003 amounted to \$1,413,000, \$1,415,000 and \$1,427,000, respectively.

The Company leases five of its branch locations and an automobile under non-cancelable operating leases. In addition, the Company leases one storage facility under a non-cancelable lease and one storage facility as a tenant-at-will. Minimum lease payments in future periods under non-cancelable operating leases at December 31, 2005 are as follows:

	(\$000 Omitted)
2006	\$ 195
2007	151
2008	52
2009	22
2010	22
Thereafter	<u>112</u>
	<u>\$ 554</u>

NOTE 6 PREMISES AND EQUIPMENT (CONTINUED)

The terms of two of the leases provide that the Company can, at the end of the current five-year term, renew the lease under one five-year option. The terms of a third lease provide that the Company can, at the end of a ten-year term, renew the lease under two five-year options. All branch leases contain a provision that the Company shall pay its pro-rata share of operating costs. Additionally, two of the leases require that the Company pay all real estate taxes. The automobile lease contains a purchase option at the end of the lease term.

Rent expense for the years ended December 31, 2005, 2004, and 2003 amounted to \$359,000, \$404,000 and \$421,000, respectively.

NOTE 7 OTHER REAL ESTATE OWNED

Other real estate owned consists of real estate acquired by foreclosure or a similar conveyance of title. At December 31, 2005 other real estate owned was comprised of commercial real estate of \$196,000. At December 31, 2004, the Company had no other real estate owned.

Sales of other real estate owned by the Company resulted in no gains or losses for each of the years ended December 31, 2005, 2004, 2003, respectively.

There were no write-downs on other real estate owned for the years ended December 31, 2005, 2004, and 2003.

NOTE 8 DEPOSITS

The aggregate amount of maturities for time deposits as of December 31, 2005 for each of the following five years is as follows:

	(\$000 Omitted)
2006	\$134,786
2007	12,042
2008	1,078
2009	298
2010	127
	<u>\$148,331</u>

Deposits from related parties held by the Bank at December 31, 2005 and 2004 amounted to \$3,785,000 and \$2,953,000, respectively.

NOTE 9 SHORT-TERM BORROWINGS

Short-term borrowings consist of securities sold under agreements to repurchase. The securities sold under agreements to repurchase as of December 31, 2005 and 2004 are securities sold on a short term basis by the Company that have been accounted for not as sales but as borrowings. The underlying securities associated with securities sold under agreements to repurchase are under the control of the Company. The purchasers have agreed to sell to the Company substantially identical securities at the maturity of the agreements.

NOTE 10 LONG-TERM DEBT

Long-term debt at December 31, 2005 and 2004 consisted of FHLB advances of \$85,000,000 and \$78,000,000, respectively, as well as \$20,620,000 of junior subordinated debentures, for each year.

As of December 31, 2005, contractual principal payments due under long-term debt, which consists of FHLB advances and junior subordinated debentures, are as follows:

	(\$000 Omitted)
2006	\$ 31,000
2007	15,000
2008	7,000
2009	19,000
2010	7,000
2011 and years thereafter	<u>26,620</u>
	<u>\$105,620</u>

NOTE 10 LONG-TERM DEBT (CONTINUED)

The FHLB long-term debt consisted of twenty eight separate advances. Seven of these advances are callable with the following rates and terms:

(\$000 Omitted)

<u>Amount</u>	<u>Rate</u>	<u>Maturity Date</u>	Next <u>Call Date</u>
\$ 5,000	6.11%	03/28/07	03/28/06
7,000	5.54	11/02/09	02/01/06
7,000	5.57	11/09/09	02/09/06
5,000	5.91	12/17/09	03/17/06
2,000	4.80	12/27/10	03/26/06
3,000	4.50	01/24/11	01/22/06
<u>1,000</u>	4.58	02/07/11	02/06/06
<u>\$30,000</u>			

The remaining twenty one advances, totaling \$55,000,000, are at rates ranging from 1.96% to 4.46% with a weighted average rate of 2.81%.

The \$20,620,000 of junior subordinated debentures consists of the following two issues:

On April 10, 2002, the Company completed the private placement of \$7,217,000 aggregate liquidation amount of floating rate trust preferred securities (the "Trust I Capital Securities") issued by its Delaware statutory business trust, Northway Capital Trust I ("Capital Trust I"). The Trust I Capital Securities were sold to a pooled investment vehicle. The proceeds from the sale of the Trust I Capital Securities, which included the proceeds from the sale by Capital Trust I of its common securities to the Company, were invested in Floating Rate Junior Subordinated Debt Securities of the Company due 2032 (the "Trust I Junior Subordinated Debt"), which were issued pursuant to an Indenture, dated April 10, 2002, between the Company and Wilmington Trust Company, as Trustee. Both the Trust I Capital Securities and the Trust I Junior Subordinated Debt have a floating rate, which resets semi-annually, equal to six-month LIBOR plus 3.70%, with a ceiling of 11.00% for the first five years. Currently, the interest rate on these securities is 8.15%. Payments of distributions and other amounts due on the Trust I Capital Securities are irrevocably guaranteed by the Company, to the extent that Capital Trust I has funds available for the payments of such distributions, pursuant to a Guarantee Agreement, dated April 10, 2002, between the Company and Wilmington Trust Company, as Guarantee Trustee. The Trust I Junior Subordinated Debt and the Trust I Capital Securities may be redeemed at the option of the Company on fixed semi-annual dates beginning on April 22, 2007.

On July 11, 2002, the Company completed the private placement of \$13,403,000 aggregate liquidation amount of floating rate trust preferred securities (the "Trust II Capital Securities") issued by its Delaware statutory business trust, Northway Capital Trust II (the "Capital Trust II"). The Trust II Capital Securities were sold to a pooled investment vehicle. The proceeds from the sale of the Trust II Capital Securities, which include the proceeds from the sale by Capital Trust II of its common securities to the Company, were invested in Floating Rate Junior Subordinated Debt Securities of the Company due 2032 (the "Trust II Junior Subordinated Debt"), which were issued pursuant to an Indenture, dated July 11, 2002, between the Company and Wilmington Trust Company, as Trustee. Both the Trust II Capital Securities and the Trust II Junior Subordinated Debt have a floating rate, which resets quarterly, equal to three-month LIBOR plus 3.65%, with a ceiling of 12.50% for the first five years. Currently, the interest rate on these securities is 7.80%. Payments of distributions and other amounts due on the Trust II Capital Securities are irrevocably guaranteed by the Company, to the extent that Capital Trust II has funds available for the payments of such distributions, pursuant to a Guarantee Agreement, dated July 11, 2002, between the Company and Wilmington Trust Company, as Guarantee Trustee. The Trust II Junior Subordinated Debt and the Trust II Capital Securities may be redeemed at the option of the Company on fixed quarterly dates beginning on July 7, 2007.

NOTE 11 GOODWILL AND OTHER INTANGIBLE ASSETS

At December 31, 2005, the Company has goodwill and core deposit intangibles totaling \$12,147,000. Core deposit intangibles are being amortized over their useful lives and goodwill is tested for impairment at least annually.

The changes in the carrying amount of goodwill and core deposit intangibles for the years ended December 31, 2005 and 2004 are as follows:

	(\$000 Omitted)	
	<u>Goodwill</u>	<u>Core Deposit Intangibles</u>
Balance, December 31, 2003	\$10,152	\$3,903
Amortization expense	-	(954)
Balance, December 31, 2004	<u>10,152</u>	<u>2,949</u>
Amortization expense	-	(954)
Balance, December 31, 2005	<u>\$10,152</u>	<u>\$1,995</u>

Estimated annual amortization expense:

	(\$000 Omitted)	
	<u>Goodwill</u>	<u>Core Deposit Intangibles</u>
2006	-	\$927
2007	-	320
2008	-	320
2009	-	320
2010	-	108

The following table reflects the gross carrying amount and accumulated amortization of core deposit intangibles as of December 31, 2005:

	(\$000 Omitted)		
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net Carrying Amount</u>
Core deposit intangibles	<u>\$5,332</u>	<u>\$3,337</u>	<u>\$1,995</u>

Management reviews the carrying amount of intangible assets on an ongoing basis, taking into consideration any events and circumstances that might have diminished such amount. During 2005 and 2004, the Company reviewed the carrying amount of intangible assets and determined that no impairment was required.

NOTE 12 REGULATORY MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). As of December 31, 2005, the most recent notification from the FDIC categorized the Bank as "well-capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well-capitalized" the Bank must maintain total risk-based, Tier 1 risk-based and Tier 1 leverage ratios above regulatory prescribed minimum levels. There are no conditions or events since that notification that management believes have changed the Bank's category. Management believes, as of December 31, 2005 and 2004, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

NOTE 12 REGULATORY MATTERS (CONTINUED)

These minimum capital amounts and ratios, as well as the Company's and Bank's actual capital amounts and ratios, are presented in the following table:

	(\$000 Omitted)				
	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u> <u>Ratio</u>
<u>As of December 31, 2005</u>					
Tier 1 capital (to average assets)					
Consolidated	\$55,765	8.96%	\$24,888	≥4.00%	N/A
Northway Bank	50,450	8.19	24,644	≥4.00	\$30,806 ≥5.00%
Total capital (to risk weighted assets)					
Consolidated	65,025	15.24	34,138	≥8.00	N/A
Northway Bank	55,673	13.25	33,623	≥8.00	42,029 ≥10.00
Tier 1 capital (to risk weighted assets)					
Consolidated	55,765	13.07	17,069	≥4.00	N/A
Northway Bank	50,450	12.00	16,812	≥4.00	25,217 ≥6.00
<u>As of December 31, 2004</u>					
Tier 1 capital (to average assets)					
Consolidated	52,736	8.43	25,014	≥4.00	N/A
Northway Bank	48,150	7.72	24,940	≥4.00	31,176 ≥5.00
Total capital (to risk weighted assets)					
Consolidated	62,305	13.94	35,745	≥8.00	N/A
Northway Bank	53,437	12.14	35,206	≥8.00	44,007 ≥10.00
Tier 1 capital (to risk weighted assets)					
Consolidated	52,736	11.80	17,872	≥4.00	N/A
Northway Bank	48,150	10.94	17,603	≥4.00	26,404 ≥6.00

Federal regulations prohibit banking companies from paying dividends on their stock if the effect would cause stockholders' equity to be reduced below applicable regulatory capital requirements or if such declaration and payment would otherwise violate regulatory requirements.

As of December 31, 2005, the Bank is restricted from declaring dividends to the Company in an amount greater than approximately \$22,050,000, as such declaration would decrease capital below the Bank's required minimum level of regulatory capital.

NOTE 13 OTHER NONINTEREST EXPENSE

The major components of other noninterest expense for the years ended December 31, are as follows:

	(\$000 Omitted)		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Professional fees	\$1,523	\$1,234	\$1,166
Advertising	757	326	304
Stationery and supplies	647	429	556
Telecommunications	619	595	571
ATM expense	321	295	442
Postage and shipping	317	348	378
Other	<u>2,762</u>	<u>2,501</u>	<u>2,402</u>
	<u>\$6,946</u>	<u>\$5,728</u>	<u>\$5,819</u>

NOTE 14 FEDERAL AND STATE TAXES

The components of federal and state tax expense for the years ended December 31, are as follows:

	(\$000 Omitted)		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Current			
Federal	\$ 820	\$1,289	\$1,713
State	<u>26</u>	<u>334</u>	<u>403</u>
	<u>846</u>	<u>1,623</u>	<u>2,116</u>
Deferred			
Federal	2	44	(181)
State	<u>(6)</u>	<u>(1)</u>	<u>(37)</u>
	(4)	43	(218)
Change in valuation allowance	<u>-</u>	<u>-</u>	<u>(31)</u>
	<u>(4)</u>	<u>43</u>	<u>(249)</u>
Total	<u>\$ 842</u>	<u>\$1,666</u>	<u>\$1,867</u>

The temporary differences (the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases) that give rise to significant portions of the net deferred income tax asset at December 31, are as follows:

	(\$000 Omitted)	
	<u>2005</u>	<u>2004</u>
Deferred income tax assets		
Allowance for loan losses	\$2,072	\$1,988
Interest on nonaccrual loans	46	19
Loan origination costs, net	-	4
Unrealized holding loss on securities available-for-sale	724	13
Capital loss carryforward	24	70
Minimum pension liability adjustment	-	346
Amortization of goodwill and core deposit intangible	3	130
Supplemental pension	325	250
Other	<u>9</u>	<u>10</u>
	<u>3,203</u>	<u>2,830</u>
Deferred income tax liabilities		
Depreciation	(621)	(801)
Prepaid pension	(454)	(246)
Mortgage and consumer servicing rights	<u>(94)</u>	<u>(118)</u>
	<u>(1,169)</u>	<u>(1,165)</u>
Deferred income tax asset, net	<u>\$ 2,034</u>	<u>\$1,665</u>

The primary sources of recovery of the deferred income tax asset are taxes paid that are available for carryback and the expectation that the deductible temporary differences will reverse during periods in which the Company generates taxable income.

Total income tax expense for the years ended December 31, 2005, 2004 and 2003 differs from the "expected" federal income tax expense at the 34% statutory rate for the following reasons:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Expected federal income taxes	34.0%	34.0%	34.0%
Interest on municipal securities available-for-sale and municipal loans	(9.4)	(4.5)	(3.3)
State tax expense, net of federal benefit	0.4	4.3	4.4
Valuation allowance for securities	-	-	(0.6)
Other	<u>(1.0)</u>	<u>(0.8)</u>	<u>(0.4)</u>
Effective tax rates	<u>24.0%</u>	<u>33.0%</u>	<u>34.1%</u>

NOTE 15 EMPLOYEE BENEFITS

Pension Plan

The Company maintains a trustee non-contributory pension plan (the "Plan") covering substantially all full-time employees. Assuming retirement at age 65 after 30 years or more of service, the benefits are computed as the sum of one percent of final average earnings up to a covered compensation limit, plus 0.65 percent of final average earnings in excess of covered compensation, times years of service, up to 30. Final average earnings are defined as the five consecutive years out of the employee's last ten years of employment during which compensation is highest. The amounts contributed to the Plan are determined annually on the basis of (a) the maximum amount that can be deducted for federal income tax purposes or (b) the amount certified by a consulting actuary as necessary to avoid an accumulated funding deficiency as defined by the Employee Retirement Income Security Act of 1974. Contributions are intended to provide not only benefits attributed to service to date but also for those expected to be earned in the future.

The following table sets forth information about the Plan as of December 31, using a measurement date of December 31, and for the years then ended:

	(\$000 Omitted)		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
<u>Change in benefit obligation</u>			
Benefit obligation at beginning of year	\$ 5,805	\$ 4,901	\$ 4,356
Service cost	515	481	444
Interest cost	346	303	266
Actuarial loss (gain)	235	233	(46)
Benefits paid	<u>(311)</u>	<u>(113)</u>	<u>(119)</u>
Benefit obligation at end of year	<u>6,590</u>	<u>5,805</u>	<u>4,901</u>
<u>Change in plan assets</u>			
Fair value of plan assets at beginning of year	4,601	3,652	2,685
Actual return on plan assets	295	401	540
Employer contributions	1,145	661	546
Benefits paid	<u>(311)</u>	<u>(113)</u>	<u>(119)</u>
Fair value of plan assets at end of year	<u>5,730</u>	<u>4,601</u>	<u>3,652</u>
Funded status at end of year	(860)	(1,204)	(1,249)
Unrecognized transition asset	-	-	(1)
Unrecognized net actuarial loss	2,989	2,803	2,824
Unrecognized prior service cost	<u>(792)</u>	<u>(877)</u>	<u>(961)</u>
Net amount recognized	<u>\$ 1,337</u>	<u>\$ 722</u>	<u>\$ 613</u>
<u>Amounts recognized in the consolidated balance sheets consist of:</u>			
Accrued benefit liability	\$ -	\$(1,018)	\$(1,092)
Accumulated other comprehensive loss, before income tax benefit	-	1,018	1,092
Prepaid benefit cost	<u>1,337</u>	<u>722</u>	<u>613</u>
Net amount recognized	<u>\$ 1,337</u>	<u>\$ 722</u>	<u>\$ 613</u>

The accumulated benefit obligation for the plan was \$5,475,000 and \$4,896,000 at December 31, 2005 and 2004, respectively.

	(\$000 Omitted)		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
<u>Components of net periodic benefit cost</u>			
Service cost	\$ 515	\$ 481	\$ 444
Interest cost	346	303	266
Expected return on plan assets	(384)	(288)	(211)
Amortization of prior service cost	(85)	(84)	(84)
Amortization of net actuarial loss	138	141	172
Recognized transition amount	<u>-</u>	<u>(1)</u>	<u>(5)</u>
Net periodic benefit cost	<u>\$ 530</u>	<u>\$ 552</u>	<u>\$ 582</u>

NOTE 15 EMPLOYEE BENEFITS (CONTINUED)

Assumptions used to determine benefit obligations and benefit cost as of and for the years ending December 31,

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Discount rate:			
Benefit obligation	5.75%	6.00%	6.25%
Benefit cost	6.00	6.25	6.25
Long-term rate of return on plan assets	8.00	8.00	8.00
Rate of compensation increase	3.50	3.50	4.00

The expected long-term rate of return for the plan's total assets is based on the expected return of asset categories identified below, weighted based on the target allocations for each class. Equity funds are expected to return 8% to 10% over the long-term and bond funds and short-term money markets are expected to return between 4% and 6%.

At December 31, 2005 and 2004, the comprehensive loss for the unfunded pension accumulated benefit obligation was \$0 and \$672,000, net of taxes, respectively.

The Company's pension plan actual asset allocations by asset category are as follows:

<u>Asset Category</u>	<u>Plan Assets at December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Mutual funds:			
Bond funds	32.7%	32.6%	32.3%
Equity securities	42.5	43.6	43.9
Real estate funds	8.5	9.4	8.8
Short-term money market	<u>16.3</u>	<u>14.4</u>	<u>15.0</u>
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

The investment policy, as established by the Company, is to provide for a moderate growth of capital with a moderate level of volatility by investing assets per the target allocations as follows:

<u>Asset Category</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Mutual funds:			
Bond funds	40-60%	40-60%	40.0%
Equity securities	30-50	30-50	50.0
Real estate funds	0-15	0-15	10.0

The assets will be re-allocated quarterly to meet the above target allocations. The investment policy is reviewed on an annual basis, under the advisement of the Company's certified investment advisor, to determine if the policy should be changed.

The plan assets do not include any Company common stock at December 31, 2005 and 2004.

The Company does not expect to make a contribution to its pension plan in 2006.

Estimated future benefit payments, which reflect future service, as appropriate, are as follows for the years ended December 31:

	(\$000 Omitted)
2006	\$ 158
2007	166
2008	196
2009	228
2010	251
2011-2015	2,134

401(k) Plan

The Company offers a contributory 401(k) Plan. Under the Northway Financial, Inc. 401(k) and Profit Sharing Plan (the "401K Plan") employees must have attained age 21, completed six months of service and be credited with 1,000 hours of service in order to participate. Employees of the Company are eligible to participate. Under the 401K Plan, the Company matches 50 percent of the first 4 percent of employee contributions. Total 401(k) matching expense in 2005, 2004 and 2003 amounted to \$139,000, \$143,000 and \$130,000, respectively, and Profit Sharing contribution expense for 2005, 2004, and 2003 was \$0, \$38,000, and \$0, respectively.

NOTE 15 EMPLOYEE BENEFITS (CONTINUED)

Supplemental Executive Retirement Plan (SERP)

Effective May 29, 2003, the existing Executive Life program sponsored by the Company was terminated and replaced with a SERP. The existing Split Dollar Life Insurance policy designed to support the Executive Life program is now fully owned by Northway. This policy will be maintained by Northway and is used as the benchmark for the SERP.

The total retirement SERP benefit is as follows: Upon Mr. Woodward's termination of employment for reasons other than death or for cause, the account balance is paid out to him in ten (10) equal annual installments on the first day of the month following the month in which employment is terminated. Upon death after retirement, the unpaid account balance, if any, is paid out in a lump sum to the named beneficiary. During retirement, an additional retirement payment, based on the policy gains associated with the prior calendar year, will also be paid on an annual basis until the executive's death. In the event of Mr. Woodward's death while employed by the Company, the SERP permits a death benefit of \$2,000,000 be paid to his beneficiary.

Stock-Based Compensation

The Board of Directors (the "Committee") administers the 1999 Stock Option and Grant Plan (the "1999 Plan") which is described below.

Under the 1999 Plan, the Committee may select the individuals to whom awards may from time to time be granted; determine the time or times of grant; and determines the extent, if any, of incentive stock options, non-qualified stock options, restricted stock awards, unrestricted stock awards, performance share awards, or any combination of the foregoing.

The 1999 Plan expires in February 2009. The aggregate number of shares of the Company's common stock which may be issued upon the exercise of options granted under the 1999 Plan is 175,000. The option price is fixed by the Committee at the time of the grant and may not be less than 100 percent of the fair market value of the stock, as determined by the Committee, in good faith as of the grant date. Each option may be exercised at such times as shall be determined by the Committee at or after the grant date; provided, however, that no option may be exercised ten years after the date of grant. The fair value of each option granted is estimated on grant date using the Black-Scholes option pricing model.

A summary of the status of the Company's 1999 Plan as of December 31, 2005, 2004 and 2003 and changes during the years then ended is presented below:

	<u>2005</u>		<u>2004</u>		<u>2003</u>	
	Weighted		Weighted		Weighted	
	Average		Average		Average	
	Exercise		Exercise		Exercise	
	<u>Shares</u>	<u>Price</u>	<u>Shares</u>	<u>Price</u>	<u>Shares</u>	<u>Price</u>
Outstanding, beginning of year	38,000	\$24.96	42,000	\$24.93	42,000	\$24.93
Exercised	<u>(4,000)</u>	24.64	<u>(4,000)</u>	24.64	-	-
Outstanding, end of year	<u>34,000</u>	\$25.00	<u>38,000</u>	\$24.96	<u>42,000</u>	\$24.93
Options exercisable at year-end	34,000		38,000		42,000	

The following table summarizes information about fixed stock options outstanding as of December 31, 2005:

<u>Options Outstanding</u>			<u>Options Exercisable</u>	
Weighted	Number	Weighted	Number	Weighted
Average	Outstanding	Average	Exercisable	Average
Exercise	as of	Remaining	as of	Exercise
Price	12/31/05	Contractual	12/31/05	Price
		Life		
\$28.00	15,000	3.50 years	15,000	\$28.00
22.63	<u>19,000</u>	4.63 years	<u>19,000</u>	22.63
\$25.00	<u>34,000</u>	4.13 years	<u>34,000</u>	\$25.00

NOTE 15 EMPLOYEE BENEFITS (CONTINUED)

Change in Control

The Company and its subsidiaries have entered into Key Employee agreements with the specific Executive Officers as well as other Senior Officers of the Company. These agreements provide for payments, under certain circumstances, to the officer upon the officer's termination after a change in control. Payments will be made under these agreements upon the officer's termination or resignation in connection with certain specified actions adverse to the officer's employment status after a change in control. The amount of such payments ranges from 1.0 to 1.5 times such officer's annual compensation.

NOTE 16 FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to originate loans and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for loan commitments and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Financial instruments with off-balance sheet credit risk at December 31, are as follows:

	(\$000 Omitted)	
	<u>2005</u>	<u>2004</u>
Financial instrument whose contract amounts represent credit risk:		
Unadvanced portions of home equity loans	\$18,718	\$17,748
Unadvanced portions of lines of credit	7,897	9,216
Unadvanced portions of commercial real estate loans	2,467	1,888
Unadvanced portions of Bounce Protection™	11,294	12,091
Commitments to originate all other loans	19,971	15,952
Commitments to originate municipal notes	-	2,995
Standby letters of credit	71	400

Commitments to originate loans and municipal notes, unadvanced portions of home equity loans, lines of credit and commercial real estate loans are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without having been drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the borrower.

Unadvanced portions of Bounce Protection™ represent the unused portion of the Bank's overdraft privilege program.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers. As of December 31, 2005 and 2004, the maximum potential amount of the Company's obligation was \$71,000 and \$400,000, respectively, for financial and standby letters of credit. The Company's outstanding letters of credit generally have a term of less than one year. If a letter of credit is drawn upon, the Company may seek recourse through the customer's underlying line of credit. If the customer's line of credit is also in default, the Company may take possession of the collateral, if any, securing the line of credit.

At December 31, 2005, the Bank had commitments to purchase state and political subdivision bonds totaling \$2,206,000.

On December 13, 2005, the Bank entered into an agreement with Washington Mutual Bank to purchase two branch locations located in Belmont and Tilton, New Hampshire. The Bank expects to acquire approximately \$31,000,000 of deposits and \$10,000,000 of loans. This transaction is expected to close on or about April 7, 2006.

NOTE 17 FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents approximates the fair value of those assets.

Securities: Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

FHLB and Federal Reserve Bank ("FRB") Stock: The carrying amounts reported in the consolidated balance sheets for FHLB and FRB Stock approximates their fair value. If redeemed, the Company will receive an amount equal to the par value of the stocks.

Loans held-for-sale: Fair values for loans held-for-sale are estimated based on outstanding investor commitments, or in the absence of such commitments, are based on current investor yield requirements.

Loans: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The fair value of nonaccrual loans was estimated using discounted cash flow analysis or the estimated fair value of the underlying collateral where applicable.

Accrued interest receivable: The carrying value of accrued interest receivable approximates its fair value because of the short-term nature of this financial instrument.

Deposits: The fair value of demand deposits (e.g. NOW and super NOW checking, noninterest bearing checking, regular savings, money market accounts and mortgagors' escrow accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). Fair values for certificates of deposit are estimated using a discounted cash flow technique that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities of time deposits.

Short-term borrowings: The carrying value of short-term borrowings approximates its fair value because of the short-term nature of these financial instruments.

Long-term debt: The fair values of long-term debt are determined by discounting the anticipated future cash payments by using the rates currently available to the Company for debt with similar terms and remaining maturities.

Junior subordinated debentures: The fair values of junior subordinated debentures are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Off-balance sheet instruments: The fair value of commitments to originate loans is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments and the unadvanced portion of loans, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligation with the counterparties at the reporting date. See NOTE 16 for further information.

The estimated fair values of the Company's financial instruments are as follows:

	(\$000 Omitted)			
	December 31,			
	2005		2004	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	\$ 29,362	\$ 29,362	\$ 24,769	\$ 24,769
Securities available-for-sale	103,244	103,244	101,133	101,133
FHLB stock	5,541	5,541	5,515	5,515
FRB stock	-	-	365	365
Loans held-for-sale	453	461	311	314
Loans, net	455,223	445,529	469,502	466,679
Accrued interest receivable	2,614	2,614	2,405	2,405

NOTE 17 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

	(\$000 Omitted)			
	December 31,			
	2005		2004	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial liabilities:				
Deposits	\$464,456	\$463,159	\$475,359	\$475,952
Short-term borrowings	9,363	9,363	11,268	11,268
Long-term debt	85,000	84,296	78,000	78,494
Junior subordinated debentures	20,620	20,908	20,620	21,270

The carrying amounts of financial instruments shown in the above table are included in the consolidated balance sheets under the indicated captions except that accrued interest receivable is included with other assets and junior subordinated debentures is included with long-term debt.

At December 31, 2005 and 2004, all the Company's financial instruments were held for purposes other than trading.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for some of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, cash flows, current economic conditions, risk characteristics, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions and changes in the loan, debt and interest rate markets could significantly affect the estimates. Further, the income tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on the fair value estimates and have not been considered. The fair value amounts presented do not represent the underlying value of the Company because fair values of certain other financial instruments, assets and liabilities have not been determined.

NOTE 18 CONDENSED PARENT ONLY FINANCIAL STATEMENTS

Condensed financial statements of Northway Financial, Inc. (Parent Company only) as of December 31, 2005 and 2004 and for the three years ended December 31, 2005 follow:

Balance Sheets

	(\$000 Omitted)	
	2005	2004
Assets		
Cash and cash equivalents	\$ 3,780	\$ 3,843
Investment in subsidiary, Northway Bank	61,517	61,261
Investment in unconsolidated subsidiaries, Northway Capital Trust I & II	620	620
Equipment, net	1,571	2,058
Due from subsidiary	540	808
Other assets	4,751	4,117
Total assets	<u>\$72,779</u>	<u>\$72,707</u>
Liabilities and stockholders' equity		
Accrued expenses	\$ 540	\$ 571
Other liabilities	1,369	2,006
Junior subordinated debentures	20,620	20,620
Total liabilities	<u>22,529</u>	<u>23,197</u>
Stockholders' equity:		
Common stock	1,732	1,732
Additional paid-in capital	2,064	2,075
Retained earnings	54,089	52,484
Treasury stock	(6,531)	(6,090)
Accumulated other comprehensive loss	<u>(1,104)</u>	<u>(691)</u>
Total stockholders' equity	<u>50,250</u>	<u>49,510</u>
Total liabilities and stockholders' equity	<u>\$72,779</u>	<u>\$72,707</u>

NOTE 18 CONDENSED PARENT ONLY FINANCIAL STATEMENTS (CONTINUED)

Statements of Income

	(\$000 Omitted)		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Income:			
Dividends from subsidiary	\$ 2,036	\$ 2,030	\$1,820
Interest income	120	48	54
Management fee income from subsidiary	8,750	9,576	9,112
Other	<u>202</u>	<u>178</u>	<u>57</u>
	<u>11,108</u>	<u>11,832</u>	<u>11,043</u>
Expense:			
Interest expense	1,463	1,079	1,036
Salaries and employee benefits	5,495	5,639	5,130
Office occupancy and equipment expense	1,107	1,204	1,223
Professional fees	741	925	933
Other	<u>1,408</u>	<u>1,825</u>	<u>1,830</u>
	<u>10,214</u>	<u>10,672</u>	<u>10,152</u>
Income before income tax benefit and equity in undistributed net income of subsidiary	894	1,160	891
Income tax benefit	<u>(438)</u>	<u>(345)</u>	<u>(316)</u>
Income before equity in undistributed net income of subsidiary	1,332	1,505	1,207
Equity in undistributed net income of subsidiary	<u>1,341</u>	<u>1,883</u>	<u>2,410</u>
Net income	<u>\$ 2,673</u>	<u>\$ 3,388</u>	<u>\$ 3,617</u>

Statements of Cash Flows

	(\$000 Omitted)		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:			
Net income	\$ 2,673	\$ 3,388	\$ 3,617
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	630	603	467
Decrease (increase) in amount due from subsidiary	268	170	(463)
Increase in other assets	(622)	(305)	(1,271)
Increase in accrued expenses and other liabilities	4	535	662
Loss on disposal of assets	2	-	27
Undistributed net income of subsidiary	<u>(1,341)</u>	<u>(1,883)</u>	<u>(2,410)</u>
Net cash provided by operating activities	<u>1,614</u>	<u>2,508</u>	<u>629</u>
Cash flows from investing activities:			
Capital contributions to subsidiary	-	-	(1,000)
Additions to premises and equipment	(145)	(869)	(466)
Purchase of company owned life insurance	<u>-</u>	<u>(400)</u>	<u>(800)</u>
Net cash used by investing activities	<u>(145)</u>	<u>(1,269)</u>	<u>(2,266)</u>
Cash flows from financing activities:			
Exercise of stock options	99	99	-
Purchases of treasury stock	(563)	-	(502)
Cash dividends paid	<u>(1,068)</u>	<u>(1,020)</u>	<u>(1,024)</u>
Net cash used by financing activities	<u>(1,532)</u>	<u>(921)</u>	<u>(1,526)</u>
Net (decrease) increase in cash and cash equivalents	(63)	318	(3,163)
Cash and cash equivalents at beginning of year	<u>3,843</u>	<u>3,525</u>	<u>6,688</u>
Cash and cash equivalents at end of year	<u>\$ 3,780</u>	<u>\$ 3,843</u>	<u>\$ 3,525</u>

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

- Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the fiscal year ended December 31, 2006
- Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number 000-23129

NORTHWAY FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

New Hampshire
(State or other jurisdiction of
incorporation or organization)

04-3368579
(I.R.S. Employer
Identification No.)

9 Main Street
Berlin, New Hampshire
(Address of principal executive offices)

03570
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class
Common Stock

Name of Each Exchange on Which Registered
NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES NO

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 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 days. YES NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.. Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES NO

The number of shares of voting and nonvoting common stock, par value \$1.00 per share, held by nonaffiliates of the registrant as of June 30, 2006 was 1,270,163 shares with an aggregate market value, computed by reference to the last reported sales price on the NASDAQ Global Market on such date, of \$45,725,868. Although directors and executive officers of the registrant were assumed to be "affiliates" of the registrant for purposes of this calculation, this classification is not to be interpreted as an admission of such status.

At March 25, 2007, there were 1,491,174 shares of common stock outstanding, par value \$1.00 per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement for its 2007 Annual Meeting of Stockholders are incorporated by reference in Items 10, 11, 12, 13 and 14 of Part III.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEAR ENDED DECEMBER 31,	(\$000 Omitted, Except Per Share Data)		
	2006	2005	2004
Interest and dividend income			
Interest and fees on loans	\$30,327	\$27,314	\$26,569
Interest on debt securities available-for-sale:			
Taxable	3,946	3,843	3,201
Tax-exempt	1,149	299	142
Dividends	337	323	239
Interest on federal funds sold	200	322	125
Interest on interest-bearing deposits	8	3	1
Total interest and dividend income	35,967	32,104	30,277
Interest expense			
Interest on deposits	8,365	4,092	3,150
Interest on short-term borrowings	811	257	110
Interest on long-term debt	4,589	4,579	4,171
Total interest expense	13,765	8,928	7,431
Net interest and dividend income	22,202	23,176	22,846
Provision for loan losses	465	75	495
Net interest and dividend income after provision for loan losses	21,737	23,101	22,351
Noninterest income			
Service charges and fees on deposit accounts	2,837	2,430	2,229
Gain (loss) on sales of securities available-for-sale, net	394	(551)	753
Debit card fees	557	456	372
Gain on sales of loans, net	137	260	374
Other	1,946	1,401	1,369
Total noninterest income	5,871	3,996	5,097
Noninterest expense			
Salaries and employee benefits	12,252	11,633	12,058
Office occupancy and equipment	4,190	4,282	3,873
Amortization of core deposit intangibles	1,051	954	954
Other	6,248	6,713	5,509
Total noninterest expense	23,741	23,582	22,394
Income before income tax expense	3,867	3,515	5,054
Income tax expense	652	842	1,666
Net income	\$ 3,215	\$ 2,673	\$ 3,388
Basic earnings per common share	\$ 2.15	\$ 1.78	\$ 2.26
Earnings per common share assuming dilution	\$ 2.14	\$ 1.77	\$ 2.24

See Notes to Consolidated Financial Statements

CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31,	(\$000 Omitted)	
	2006	2005
Assets		
Cash and cash equivalents		
Cash and due from banks and interest-bearing deposits	\$ 16,053	\$ 14,587
Federal funds sold	8,755	14,775
Total cash and cash equivalents	24,808	29,362
Securities available-for-sale, at fair value	127,789	103,244
Federal Home Loan Bank stock	3,782	5,541
Loans held-for-sale	263	453
Loans, net before allowance for loan losses	462,230	460,373
Less: allowance for loan losses	5,581	5,150
Net loans	456,649	455,223
Premises and equipment, net	13,749	11,735
Other real estate owned	-	196
Goodwill	10,577	10,152
Core deposit intangibles, net	2,178	1,995
Other assets	11,082	14,833
Total assets	\$650,877	\$632,734
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Demand	\$ 72,054	\$ 77,436
Regular savings, NOW and money market deposit accounts	217,682	238,689
Certificates of deposit (in denominations of \$100,000 or more)	55,676	28,297
Other time	139,265	120,034
Total deposits	484,677	464,456
Short-term borrowings	36,497	9,363
Long-term debt	73,620	105,620
Other liabilities	3,934	3,045
Total liabilities	598,728	582,484
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 shares issued and 1,491,174 shares outstanding in 2006 and 2005	1,732	1,732
Surplus	2,064	2,064
Retained earnings	56,140	54,089
Treasury stock (240,795 shares at December 31, 2006 and 2005)	(6,531)	(6,531)
Accumulated other comprehensive loss, net of tax	(1,256)	(1,104)
Total stockholders' equity	52,149	50,250
Total liabilities and stockholders' equity	\$650,877	\$632,734

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(\$000 Omitted)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss) ¹	Total Stockholders' Equity
Balance at December 31, 2003	\$1,732	\$2,088	\$50,116	\$(6,213)	\$ 149	\$47,872
Net income – 2004	-	-	3,388	-	-	3,388
Net change in unrealized gain (loss) on securities available-for-sale, net of tax	-	-	-	-	(889)	(889)
Net change in unfunded pension accumulated benefit obligation, net of tax	-	-	-	-	49	49
Exercise of stock options, net of tax benefit	-	(13)	-	123	-	110
Cash dividends declared (\$0.68 per share)	-	-	(1,020)	-	-	(1,020)
Balance at December 31, 2004	1,732	2,075	52,484	(6,090)	(691)	49,510
Net income – 2005	-	-	2,673	-	-	2,673
Net change in unrealized loss on securities available-for-sale, net of tax	-	-	-	-	(1,085)	(1,085)
Net change in unfunded pension accumulated benefit obligation, net of tax	-	-	-	-	672	672
Exercise of stock options, net of tax benefit	-	(11)	-	122	-	111
Treasury stock purchased	-	-	-	(563)	-	(563)
Cash dividends declared (\$0.71 per share)	-	-	(1,068)	-	-	(1,068)
Balance at December 31, 2005	1,732	2,064	54,089	(6,531)	(1,104)	50,250
Net income – 2006	-	-	3,215	-	-	3,215
Net change in unrealized loss on securities available-for-sale, net of tax	-	-	-	-	803	803
Net change in unrecognized loss on pension valuation, net of tax	-	-	-	-	(1,382)	(1,382)
Net change in unrecognized pension prior service credit, net of tax	-	-	-	-	427	427
Cash dividends declared (\$0.78 per share)	-	-	(1,164)	-	-	(1,164)
Balance at December 31, 2006	\$1,732	\$2,064	\$56,140	\$(6,531)	\$ (1,256)	\$52,149

¹ Accumulated other comprehensive loss as of December 31, 2006 consists of net unrealized holding losses on available-for-sale securities of \$301, net of taxes, net unrealized loss on pension valuation of \$1,382, net of taxes, and a net credit for prior service on pension of \$427, net of tax benefit. Accumulated other comprehensive loss as of December 31, 2005 consists of net unrealized holding losses on available-for-sale securities of \$1,104, net of taxes. Accumulated other comprehensive loss at December 31, 2004 consists of net holding losses on available-for-sale securities of \$19, net of taxes, and net unrealized holding losses on unfunded pension accumulated obligation of \$672, net of taxes.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(\$000 Omitted)

FOR THE YEAR ENDED DECEMBER 31,	2006	2005	2004
Net income	\$ 3,215	\$ 2,673	\$ 3,388
Other comprehensive income (loss)			
Net unrealized holding gains (losses) on securities available-for-sale	1,723	(2,347)	(720)
Reclassification adjustment for realized (gains) losses in net income	(394)	551	(753)
Net unrealized gains (losses) on securities	1,329	(1,796)	(1,473)
Pension valuation adjustment	(2,289)	-	-
Pension prior service credit adjustment	708	-	-
Minimum pension liability adjustment	-	1,018	74
Other comprehensive income (loss)	(252)	(778)	(1,399)
Income tax benefit	(100)	(365)	(559)
Other comprehensive loss, net of tax	(152)	(413)	(840)
Comprehensive income	\$ 3,063	\$ 2,260	\$ 2,548

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31,	(\$'000 Omitted)		
	2006	2005	2004
Cash flows from operating activities:			
Net income	\$ 3,215	\$ 2,673	\$ 3,388
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	465	75	495
Depreciation and amortization	2,426	2,367	2,369
Deferred income tax (benefit) expense	(358)	(4)	43
(Gain) loss on sales of securities available-for-sale, net	(394)	551	(753)
Loss on sale, disposal and write-down of premises and equipment	52	57	9
Amortization of premiums and accretion of discounts on securities, net	21	54	90
Change in unearned income/unamortized cost, net	(195)	(190)	(141)
Accretion of discount on loans acquired	(149)	(140)	(160)
(Gains) losses on sales of other real estate owned and other personal property, net	(68)	-	9
Net decrease (increase) in loans held-for-sale	190	(142)	200
Net change in other assets and other liabilities	212	(999)	587
Net cash provided by operating activities	5,417	4,302	6,136
Cash flows from investing activities:			
Proceeds from sales of securities available-for-sale	11,459	16,002	16,964
Proceeds from maturities of securities available-for-sale	16,688	17,315	25,690
Purchases of securities available-for-sale	(47,990)	(40,829)	(76,515)
Purchases of Federal Home Loan Bank stock	-	(26)	(810)
Proceeds from sales of Federal Reserve Bank stock	-	365	-
Redemption of Federal Home Loan Bank stock	1,759	-	-
Capital distribution on investment in limited partnership	210	-	-
Loan originations and principal collections, net	6,112	13,345	(7,142)
Recoveries of previously charged-off loans	298	286	338
Loans acquired in branch transactions	(8,192)	-	-
Proceeds from sale of commercial loans	-	-	5,088
Proceeds from sales of and payments received on other real estate owned	264	25	-
Proceeds from sales of and payments received on other personal property	330	652	604
Premises and equipment acquired in branch transactions	(507)	-	-
Additions to premises and equipment, net of disposals	(2,934)	496	(2,267)
Purchase of company owned life insurance policies	-	-	(400)
Net cash (used by) provided by investing activities	(22,503)	7,631	(38,450)
Cash flows from financing activities:			
Net (decrease) increase in deposits	(9,217)	(10,903)	12,052
Deposits assumed in branch transactions, net of assumption premiums	27,779	-	-
Net increase (decrease) in short-term borrowings	27,134	(1,905)	3,867
Advances from Federal Home Loan Bank (FHLB)	24,000	13,000	20,000
Repayment of FHLB advances	(56,000)	(6,000)	(9,000)
Exercise of stock options	-	99	99
Purchases of treasury stock	-	(563)	-
Cash dividends paid	(1,164)	(1,068)	(1,020)
Net cash provided by (used in) financing activities	12,532	(7,340)	25,998
Net (decrease) increase in cash and cash equivalents	(4,554)	4,593	(6,316)
Cash and cash equivalents at beginning of year	29,362	24,769	31,085
Cash and cash equivalents at end of year	\$ 24,808	\$ 29,362	\$ 24,769

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

FOR THE YEAR ENDED DECEMBER 31,	(\$000 Omitted)		
	2006	2005	2004
Supplemental disclosures of cash flows:			
Interest paid	\$ 13,728	\$ 8,662	\$ 7,519
Income taxes paid	860	1,106	2,090
Loans transferred to other real estate owned	-	231	-
Loans transferred to other personal property	235	682	603
Amount due from customer for pending municipal security maturity	-	3,000	-

See Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Northway is a bank holding company formed in 1997 under the laws of New Hampshire and is registered under the Bank Holding Company Act of 1956. Northway's only business activity has been to own all of the shares of, and provide management, capital and operational support to Northway Bank ("Bank"), formerly known as The Berlin City Bank, and its Delaware statutory business trusts Northway Capital Trust I and Northway Capital Trust II. On October 1, 2005 The Berlin City Bank was renamed Northway Bank and The Pemigewasset National Bank of Plymouth, New Hampshire was merged into Northway Bank. The Company's headquarters are in Berlin, New Hampshire. The banking subsidiary is engaged principally in the business of attracting deposits from the general public and investing those deposits in securities, commercial loans, real estate loans, and consumer loans.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All significant intercompany accounts and transactions have been eliminated in the consolidation.

Northway Capital Trust I and Northway Capital Trust II, affiliates of the Company, were formed to sell capital securities to the public through a third party trust pool. In accordance with FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), these affiliates have not been included in the consolidated financial statements.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry.

In preparing the financial statements, management is required to make estimates and judgments that affect the reported amounts of assets and liabilities as of the dates of the consolidated balance sheets, and income and expense for the periods. Actual results could differ from those estimates. Material estimates that are particularly susceptible to change in the near-term relate to the determination of the allowance for loan losses.

Reclassifications

Certain amounts in the prior years' financial statements have been reclassified to conform with the current year's presentation.

Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits, and federal funds sold.

Securities

Debt securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost; if debt and equity securities are bought and held principally for the purpose of selling in the near term they would be classified as trading and reported at fair value, with unrealized gains and losses included in earnings; and debt and equity securities not classified as either held-to-maturity or trading are classified as available-for-sale and reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity, net of estimated income taxes. At this time, the Company has not established a trading account.

Premiums and discounts are amortized and accreted primarily on the level yield method over the contractual life of the securities adjusted for expected prepayments.

If a decline in the fair value below the adjusted cost basis of an investment is judged to be other than temporary, the cost basis of the investment is written down to fair value as the new cost basis and the amount of the write-down is included in noninterest expense.

Gains and losses on sales of securities available-for-sale are recognized at the time of the sale on a specific identification basis.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans Held-for-Sale

Loans held-for-sale are generally identified as such at origination and are stated at the lower of aggregate cost or market. Market value is based on outstanding investor commitments. When loans are sold, a gain or loss is recognized to the extent that the sale proceeds exceed or are less than the carrying value of the loans. Gains and losses are determined using the specific identification method. All loans sold are without recourse to the Company.

Loans

Loans are carried at the principal amounts outstanding, net of any unearned income or unamortized cost, premiums on originated loans and discounts on acquired loans. Unearned income and unamortized cost includes loan origination fees, net of direct loan origination costs. This income or expense is deferred and recognized as adjustments to loan income over the contractual life of the related notes using a method the result of which approximates that of the interest method.

Loans are placed on nonaccrual when payment of principal or interest is considered to be in doubt or is past due 90 days or more. The Company may choose to place a loan on nonaccrual status due to payment delinquency or uncertain collectibility, while not classifying the loan as impaired, if (i) it is probable that the Company will collect all amounts due in accordance with the contractual terms of the loan or (ii) the loan is not a commercial, commercial real estate or an individually significant mortgage or consumer loan. Previously accrued income on nonaccrual loans that has not been collected is reversed from current income, and subsequent cash receipts are recorded as income if principal on the loans is deemed collectible. Loans are returned to accrual status when collection of all contractual principal and interest is reasonably assured and there has been sustained repayment performance.

The Company's loans are primarily secured by real estate in New Hampshire. In addition, other real estate owned is located in this market. Accordingly, the ultimate collectibility of a substantial portion of the Company's loan portfolio and the recovery of other real estate owned are susceptible to changing conditions in this market.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level considered adequate by management on the basis of many factors including the risk characteristics of the portfolio, trends in loan delinquencies and an assessment of existing economic conditions. Additions to the allowance are charged to earnings; realized losses, net of recoveries, are charged directly to the allowance.

While management uses available information in establishing the allowance for loan losses, future additions to the allowance may be necessary if economic conditions differ substantially from the estimates used in making the evaluations. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on judgments different from those of management.

Commercial, commercial real estate and individually significant mortgage and consumer loans are considered impaired, and are placed on nonaccrual, when it is probable that the Company will not be able to collect all amounts due according to the contractual terms of the loan agreement. Mortgage and consumer loans, which are not individually significant, are measured for impairment collectively. Loans that experience insignificant payment delays and insignificant shortfalls in payment amounts generally are not classified as impaired. The amount of impairment for all impaired loans is determined by the difference between the present value of the expected cash flows related to the loan, using the original contractual interest rate, and its recorded value, or, as a practical expedient in the case of collateralized loans, the difference between the fair value of the collateral and the recorded amount of the loan.

When foreclosure is probable, impairment is measured based on the fair value of the collateral.

Servicing Assets

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the respective assets. Estimated lives are thirty-nine years for buildings, ten to fifteen years for building improvements and three to seven years for furniture and equipment.

Amortization of leasehold improvements is accumulated on a straight-line basis over the lesser of the term of the respective lease or the asset's useful life, not to exceed ten years.

Other Real Estate Owned

Other real estate owned is comprised of properties acquired either through foreclosure proceedings or acceptance of a deed in lieu of foreclosure, and for which the Company has taken physical possession. The Company classifies loans as repossessed or foreclosed if the Company receives physical possession of the debtor's assets, regardless of whether or not foreclosure proceedings take place.

Assets acquired through foreclosure or a similar conveyance of title are initially recorded at the lower of the carrying value of the loan or the fair value, less estimated costs to sell, of the property constructively or actually received. Gains and losses upon disposition are reflected in the statement of income as realized.

Advertising

The Company directly expenses costs associated with advertising as they are incurred.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and the respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Stock-Based Compensation

At December 31, 2006, the Company has a stock-based employee compensation plan which is described more fully in NOTE 16. Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004) "Share-Based Payment" ("SFAS 123R"). This Statement revised SFAS No. 123, "Accounting for Stock Based Compensation" and superceded Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS 123R requires that the cost resulting from all share-based payment transactions be recognized in the financial statements and establishes fair value as the measurement objective in accounting for share-based payment arrangements. No compensation expense was recognized for the twelve months ended December 31, 2006 related to SFAS 123R. Prior to January 1, 2006, the Company accounted for the plan under the recognition and measurement principles of APB Opinion No. 25. No stock-based employee compensation cost had been recognized during periods prior to January 1, 2006 for its fixed stock option plans.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123R to stock-based employee compensation during the years ended December 31, 2005 and 2004.

		(\$000 Omitted, Except Per Share Data)	
		2005	2004
Net income	As reported	\$2,673	\$3,388
Deduct: Total stock-based employee compensation expense determined under fair value based methods awards, net of related tax effects		-	-
	Pro forma	<u>\$2,673</u>	<u>\$3,388</u>
Earnings per common share	As reported	\$ 1.78	\$ 2.26
	Pro forma	1.78	2.26
Earnings per common share (assuming dilution)	As reported	\$ 1.77	\$ 2.24
	Pro forma	1.77	2.24

Earnings Per Share

Basic earnings per share ("EPS") excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS, if applicable, reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Earnings per common share have been computed based on the following:

	(\$000 Omitted, Shares Reported in Millions)		
	Years Ended December 31,		
	2006	2005	2004
Net income	\$3,215	\$2,673	\$3,388
Less: Preferred stock dividends	-	-	-
Net income applicable to common stock	<u>\$3,215</u>	<u>\$2,673</u>	<u>\$3,388</u>
Average number of common shares outstanding	1,492.3	1,502.1	1,500.1
Effect of dilutive options	9.1	9.3	11.6
Average number of common shares outstanding used to calculate diluted earnings per common share	<u>1,501.4</u>	<u>1,511.4</u>	<u>1,511.7</u>

Recent Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 155, "Accounting for Certain Hybrid Instruments" (SFAS 155), which permits, but does not require, fair value accounting for any hybrid financial instrument that contains an embedded derivative that would otherwise require bifurcation in accordance with SFAS 133. The statement also subjects beneficial interests issued by securitization vehicles to the requirements of SFAS 133. The statement is effective as of January 1, 2007. The adoption of SFAS 155 is not expected to have a material impact on the Company's financial condition, results of operations or cash flow.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets- an amendment of FASB Statement No. 140" (SFAS 156). SFAS 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in specific situations. Additionally, the servicing asset or servicing liability shall be initially measured at fair value; however, an entity may elect the "amortization method" or "fair value method" for subsequent balance sheet reporting periods. SFAS 156 is effective as of an entity's first fiscal year beginning after September 15, 2006. Early adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. The Company does not expect the adoption of this statement to have a material impact on its financial condition, results of operations or cash flows.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles (GAAP) and enhances disclosures about fair value measurements. SFAS 157 retains the exchange price notion and clarifies that the exchange price is the price that would be received for an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. SFAS 157 is effective for the Company's consolidated financial statements for the year beginning on January 1, 2008, with earlier adoption permitted. The Company does not expect the adoption of this statement to have a material impact on its financial condition, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS 158). SFAS 158 requires 1) the recognition of an asset or liability for the over-funded or under-funded status of a defined benefit plan, 2) the recognition of actuarial gains and losses and prior service costs and credits in other comprehensive income, 3) measurement of plan assets and benefit obligations as of the employer's balance sheet date, rather than at interim measurement dates as currently allowed, and 4) disclosure of additional information concerning actuarial gains and losses and prior service costs and credits recognized in other comprehensive income. This statement is effective for financial statements with fiscal years ending after December 15, 2006. The adoption of this Statement did not have a material impact on the Company's financial position, result of operations or cash flows.

NOTE 2 CASH AND DUE FROM BANKS

At December 31, 2006, there was \$64,000, which was subject to withdrawals and usage restrictions to satisfy the reserve requirements of the Federal Reserve Bank. There was no cash and due from bank balances at December 31, 2005 subject to withdrawals and usage restrictions to satisfy the reserve requirements of the Federal Reserve Bank.

NOTE 3 SECURITIES AVAILABLE-FOR-SALE

The amortized cost, gross unrealized gains, gross unrealized losses, and fair value of securities at December 31, 2006 and 2005 follows:

	(\$000 Omitted)			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>December 31, 2006</u>				
U.S. Treasury and other U.S. government agency securities	\$ 47,738	\$ 50	\$ 725	\$ 47,063
Marketable equity securities	3,364	311	58	3,617
Mortgage-backed securities	40,905	310	600	40,615
Collateralized mortgage obligations	6	-	-	6
Corporate bonds	3,517	10	5	3,522
Asset backed securities	4,974	-	6	4,968
State and political subdivision bonds and notes	27,784	221	7	27,998
	<u>\$ 128,288</u>	<u>\$ 902</u>	<u>\$ 1,401</u>	<u>\$ 127,789</u>
<u>December 31, 2005</u>				
U.S. Treasury and other U.S. government agency securities	\$ 48,728	\$ -	\$ 977	\$ 47,751
Marketable equity securities	2,695	178	64	2,809
Mortgage-backed securities	24,704	1	774	23,931
Collateralized mortgage obligations	8	-	-	8
Corporate bonds	5,541	37	9	5,569
State and political subdivision bonds and notes	23,396	45	265	23,176
	<u>\$ 105,072</u>	<u>\$ 261</u>	<u>\$ 2,089</u>	<u>\$ 103,244</u>

NOTE 3 SECURITIES AVAILABLE-FOR-SALE (CONTINUED)

The contractual maturity distribution of investments in debt obligations at December 31, 2006 follows:

	(\$000 Omitted)				
	Within One Year	Over One Through Five Years	After Five Through Ten Years	Over Ten Years	Total Amortized Cost
U.S. Treasury and other U.S. government agency securities	\$ 6,300	\$ 30,455	\$ 10,983	\$ -	\$ 47,738
Mortgage-backed securities	-	20	-	40,885	40,905
Collateralized mortgage obligations	-	-	-	6	6
Corporate bonds	1,508	2,009	-	-	3,517
Asset backed securities	-	-	-	4,974	4,974
State and political subdivision bonds and notes	1,506	996	-	25,282	27,784
Total amortized cost	\$ 9,314	\$ 33,480	\$ 10,983	\$ 71,147	\$ 124,924
 Fair value	 \$ 9,262	 \$ 32,935	 \$ 10,916	 \$ 71,059	 \$ 124,172

Actual maturities of state and political subdivision bonds and notes, mortgage-backed securities and collateralized mortgage obligations will differ from the maturities presented because borrowers have the right to prepay obligations without prepayment penalties.

For the years ended December 31, 2006, 2005 and 2004, proceeds from the sales of securities available-for-sale amounted to \$11,459,000, \$16,002,000 and \$16,964,000, respectively. An analysis of gross realized gains and losses on sales of securities available-for-sale during the years ended December 31, follows:

	(\$000 Omitted)					
	2006		2005		2004	
	Realized Gains	Realized Losses	Realized Gains	Realized Losses	Realized Gains	Realized Losses
Marketable equity securities	\$ 480	\$ 40	\$ 221	\$ 104	\$ 402	\$ 149
U.S. Treasury and other U.S. government agency securities	-	49	-	200	5	-
Mortgage-backed securities	-	-	12	11	-	-
Corporate bonds	3	-	30	499	539	50
State and political subdivision bonds and notes	-	-	-	-	6	-
Total	\$ 483	\$ 89	\$ 263	\$ 814	\$ 952	\$ 199

The tax provision (benefit) applicable to these net realized gains/(losses) amounted to \$156,000, (218,000) and \$298,000 for 2006, 2005, and 2004, respectively.

Securities with a carrying amount totaling \$91,155,000 and \$73,651,000 were pledged to secure public deposits, securities sold under agreements to repurchase, FHLB advances and treasury, tax and loan accounts at December 31, 2006 and 2005, respectively

The aggregate fair value and unrealized losses of securities that have been in a continuous unrealized loss position for less than twelve months and for twelve months or more, and are not other than temporarily impaired, are as follows as of December 31, 2006:

	(\$000 Omitted)					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and other U.S. government agency securities	\$ -	\$ -	\$ 38,030	\$ 725	\$ 38,030	\$ 725
Marketable equity securities	525	58	-	-	525	58
Mortgage-backed securities	-	-	25,048	600	25,048	600
Corporate bonds	-	-	1,503	5	1,503	5
Asset backed securities	4,968	6	-	-	4,968	6
State and political subdivision bonds and notes	3,497	7	-	-	3,497	7
Total temporarily impaired securities	\$ 8,990	\$ 71	\$ 64,581	\$ 1,330	\$ 73,571	\$ 1,401

NOTE 3 SECURITIES AVAILABLE-FOR-SALE (CONTINUED)

At December 31, 2006, securities with a total fair value of \$73,571,000 were in a loss position. These securities included twenty U.S. government agency securities with a fair value of \$38,030,000 and an unrealized loss of \$725,000. These securities had an unrealized loss due to the current interest rate environment. As these securities are guaranteed by U.S. government agencies such as FHLB, FHLMC or FNMA there is no credit risk associated with them. These securities are not other-than-temporarily impaired as the Company has the ability and the intent to hold these securities until recovery to cost basis.

Mortgage-backed securities with a fair value of \$25,048,000 had an unrealized loss of \$600,000 at December 31, 2006. As with the U.S. government agency securities, these securities have an unrealized loss due to the current interest rate environment. As all of these mortgage-backed securities are guaranteed by U.S. government agencies such as FHLMC, GNMA or FNMA there is no credit risk associated with them. These securities have not been classified as other-than-temporarily impaired as the Company has the ability and intent to hold these securities until recovery to cost basis.

Eight marketable equity securities with a fair value of \$525,000 had an unrealized loss of \$58,000 at December 31, 2006. Marketable equity securities are subject to internal testing on a quarterly basis to determine impairment. Testing includes review of industry analyst reports, credit ratings, sector analysis and earnings projections. Based upon the December 31, 2006 review, these securities were not determined to be other-than-temporarily impaired.

One corporate bond security with a fair value of \$1,503,000 had an unrealized loss of \$5,000 at December 31, 2006. Corporate bond securities are subject to internal testing on a quarterly basis to determine other-than-temporary impairment. Based upon the December 31, 2006 review, this security was not determined to be other-than-temporarily impaired.

One asset-backed security with a fair value of \$4,968,000 had an unrealized loss of \$6,000 at December 31, 2006. Asset-backed securities are subject to internal testing on a quarterly basis to determine other-than-temporary impairment. Based upon the December 31, 2006 review, this security was not determined to be other-than-temporarily impaired.

Eight state and political subdivision securities with a fair value of \$3,497,000 had an unrealized loss of \$7,000 at December 31, 2006. As all of these state and political subdivision securities are guaranteed by municipalities there is minimal credit risk associated with them. These securities have not been classified as other-than-temporarily impaired as the Company has the ability to hold these securities until recovery to cost basis.

NOTE 4 LOANS

Loan balances were comprised of the following:

	(\$000 Omitted)	
<u>December 31,</u>	<u>2006</u>	<u>2005</u>
Real estate:		
Residential	\$167,172	\$158,729
Commercial	158,464	143,456
Construction	10,700	13,241
Commercial	33,569	27,349
Installment	42,489	35,786
Indirect installment	28,714	62,221
Other	20,843	19,507
Total loans	<u>461,951</u>	<u>460,289</u>
Unamortized cost	279	84
Allowance for loan losses	<u>(5,581)</u>	<u>(5,150)</u>
Total unamortized cost and allowance for loan losses	<u>(5,302)</u>	<u>(5,066)</u>
Net loans	<u>\$456,649</u>	<u>\$455,223</u>

Total loans above are net of unearned discount on loans acquired in the amount of \$181,000 and \$275,000 at December 31, 2006 and 2005, respectively. In addition, total loans above are net of unamortized premium on indirect installment loans originated in the amount of \$234,000 and \$789,000 at December 31, 2006 and 2005, respectively.

NOTE 4 LOANS (CONTINUED)

Loans are made in the ordinary course of business to directors, executive officers, and their immediate families and to organizations in which such persons have more than a 10% ownership interest. These loans are made on substantially the same terms, including interest rate and collateral, as those prevailing at the same time for comparable transactions with unrelated persons and did not involve more than the normal risk of collectibility or present other unfavorable features. Total loans to such persons and their companies amounted to \$571,000 as of December 31, 2006. During 2006, principal payments were \$203,000 and principal advances amounted to \$230,000.

The Company's lending activities are conducted principally in New Hampshire. Although the loan portfolio is diversified, a portion of its debtors' ability to repay is dependent upon the economic conditions prevailing in New Hampshire. The Company maintains significant credit relationships with borrowers in the hotel and motel industry. The aggregate loan balances to these industries totaled \$71,874,000 at December 31, 2006 and \$67,152,000 at December 31, 2005.

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of these loans total \$36,225,000 and \$39,219,000 at December 31, 2006 and 2005, respectively. The Company sold \$5,965,000 of mortgage loans in 2006 and \$9,132,000 of mortgage loans in 2005.

The Company capitalized \$77,000 and \$79,000 of servicing rights and amortized \$115,000 and \$144,000 of total servicing rights in 2006 and 2005, respectively. The impairment valuation allowance of mortgage servicing rights was reduced by \$0 and \$3,000 in 2006 and 2005, respectively. Impairment of mortgage servicing rights is assessed based on the fair value of those rights. Fair values are estimated using discounted cash flows based on a current market interest rate. The amount of the impairment recognized is the amount by which the capitalized mortgage servicing rights exceed their fair value. At December 31, 2006 and 2005, respectively, the carrying amount of servicing rights was \$198,000 and \$236,000, and is included in other assets. At December 31, 2006 and 2005, respectively, the fair value of servicing rights was \$417,000 and \$389,000.

Restructured, accruing loans entered into prior to the adoption of SFAS No. 114 and 118 are not required to be reported as impaired loans unless such loans are not performing in accordance with the restructured terms at adoption of SFAS No. 114. Restructured, accruing loans entered into subsequent to the adoption of these statements are reported as impaired loans. In the year subsequent to restructure these loans may be removed from the impaired loan disclosure provided that the loan bears a market rate of interest at the time of restructure and is performing under the restructured terms.

At December 31, 2006 and 2005, the Company had no loans restructured in a troubled debt restructuring before January 1, 1995, the effective date of SFAS No. 114.

At December 31, 2006 and 2005, nonperforming loans totaled \$3,698,000 and \$3,013,000, respectively. No nonperforming loans were past due 90 days or more and still accruing interest at December 31, 2006 and 2005.

The recorded investment in loans that are considered to be impaired under SFAS No. 114 was \$2,666,000 and \$2,082,000 at December 31, 2006 and 2005, respectively, for which the related allowance for loan losses is \$0 for both years. All of the Company's impaired loans are collateralized and therefore all impaired loans are measured by the difference between the fair value of the collateral and the recorded amount of the loan. The average recorded investment in impaired loans during the twelve months ended December 31, 2006 and 2005 was approximately \$2,787,000 and \$2,147,000, respectively. For the twelve months ended December 31, 2006 and 2005 the Company recognized interest income on impaired loans of \$231,000 and \$88,000, respectively, which was recognized using the cash-basis method of income recognition.

NOTE 5 ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses for the years ended December 31, follows:

	(\$000 Omitted)		
	2006	2005	2004
Balance at beginning of year	\$5,150	\$5,204	\$5,036
Provision for loan losses	465	75	495
Recoveries on loans previously charged-off	298	286	338
Loans charged-off	(332)	(415)	(665)
Balance at end of year	<u>\$5,581</u>	<u>\$5,150</u>	<u>\$5,204</u>

NOTE 6 PREMISES AND EQUIPMENT

A summary of premises and equipment follows:

	(\$000 Omitted)	
	December 31,	
	2006	2005
Land	\$ 2,610	\$ 2,455
Buildings	11,033	9,718
Leasehold improvements	601	120
Construction in progress	381	129
Equipment	10,166	9,359
	<u>24,791</u>	<u>21,781</u>
Less accumulated depreciation and amortization	11,042	10,046
	<u>\$13,749</u>	<u>\$11,735</u>

Depreciation expense for the years ended December 31, 2006, 2005 and 2004 amounted to \$1,375,000, \$1,413,000 and \$1,415,000, respectively.

The Company leases six of its branch locations and an automobile under non-cancelable operating leases. In addition, the Company leases one storage facility under a non-cancelable lease. Minimum lease payments in future periods under non-cancelable operating leases at December 31, 2006 are as follows:

	(\$000 Omitted)
2007	\$ 220
2008	115
2009	85
2010	85
2011	91
Thereafter	<u>397</u>
	<u>\$993</u>

The terms of two of the leases provide that the Company can, at the end of the current five-year term, renew the lease under one five-year option. The terms of two additional leases provide that the Company can, at the end of a ten-year term, renew the lease under two five-year options. All branch leases contain a provision that the Company shall pay its pro-rata share of operating costs. Additionally, two of the leases require that the Company pay all real estate taxes. The automobile lease contains a purchase option at the end of the lease term.

Rent expense for the years ended December 31, 2006, 2005, and 2004 amounted to \$263,000, \$359,000 and \$404,000, respectively.

NOTE 7 OTHER REAL ESTATE OWNED

Other real estate owned consists of real estate acquired by foreclosure or a similar conveyance of title. At December 31, 2006, the Company had no other real estate owned. At December 31, 2005 other real estate owned was comprised of commercial real estate of \$196,000.

Sales of other real estate owned by the Company resulted in gains of \$68,000 for the year ended December 31, 2006.

There were no write-downs on other real estate owned for the years ended December 31, 2006, 2005, and 2004.

NOTE 8 DEPOSITS

The aggregate amount of maturities for time deposits as of December 31, 2006 for each of the following five years is as follows:

	(\$000 Omitted)
2007	\$186,296
2008	5,689
2009	1,469
2010	769
2011	718
	<u>\$194,941</u>

Deposits from related parties held by the Bank at December 31, 2006 and 2005 amounted to \$5,234,000 and \$3,785,000, respectively.

NOTE 9 SHORT-TERM BORROWINGS

Short-term borrowings consist of securities sold under agreements to repurchase. The securities sold under agreements to repurchase as of December 31, 2006 and 2005 are securities sold on a short term basis by the Company that have been accounted for not as sales but as borrowings. The underlying securities associated with securities sold under agreements to repurchase are under the control of the Company. The purchasers have agreed to sell to the Company substantially identical securities at the maturity of the agreements.

NOTE 10 LONG-TERM DEBT

Long-term debt at December 31, 2006 and 2005 consisted of FHLB advances of \$53,000,000 and \$85,000,000, respectively, as well as \$20,620,000 of junior subordinated debentures, for each year.

As of December 31, 2006, contractual principal payments due under long-term debt, which consists of FHLB advances and junior subordinated debentures, are as follows:

	(\$000 Omitted)
2007	\$13,000
2008	14,000
2009	5,000
2010	5,000
2012 and years thereafter	36,620
	<u>\$73,620</u>

The FHLB long-term debt consisted of fourteen separate advances. Two of these advances are callable with the following rates and terms (\$000 Omitted):

<u>Amount</u>	<u>Rate</u>	<u>Maturity Date</u>	<u>Next Call Date</u>
\$ 5,000	5.91 %	12/17/09	03/19/07 and quarterly thereafter
14,000	4.50	12/27/13	12/29/08 and quarterly thereafter
<u>\$19,000</u>			

One advance, totaling \$10,000,000 with a maturity date of May 9, 2008 and an interest rate of 5.31% reprices monthly to the 4-week weighted average money market yield, as published by the FHLB, plus 10 basis points.

The remaining eleven advances, totaling \$24,000,000, are at rates ranging from 2.35% to 6.11% with a weighted average rate of 3.79%.

NOTE 10 LONG-TERM DEBT (CONTINUED)

The \$20,620,000 of junior subordinated debentures consists of the following two issues:

On April 10, 2002, the Company completed the private placement of \$7,217,000 aggregate liquidation amount of floating rate trust preferred securities (the "Trust I Capital Securities") issued by its Delaware statutory business trust, Northway Capital Trust I ("Capital Trust I"). The Trust I Capital Securities were sold to a pooled investment vehicle. The proceeds from the sale of the Trust I Capital Securities, which included the proceeds from the sale by Capital Trust I of its common securities to the Company, were invested in Floating Rate Junior Subordinated Debt Securities of the Company due 2032 (the "Trust I Junior Subordinated Debt"), which were issued pursuant to an Indenture, dated April 10, 2002, between the Company and Wilmington Trust Company, as Trustee. Both the Trust I Capital Securities and the Trust I Junior Subordinated Debt have a floating rate, which resets semi-annually, equal to six-month LIBOR plus 3.70%, with a ceiling of 11.00% for the first five years. Currently, the interest rate on these securities is 9.089%. Payments of distributions and other amounts due on the Trust I Capital Securities are irrevocably guaranteed by the Company, to the extent that Capital Trust I has funds available for the payments of such distributions, pursuant to a Guarantee Agreement, dated April 10, 2002, between the Company and Wilmington Trust Company, as Guarantee Trustee. The Trust I Junior Subordinated Debt and the Trust I Capital Securities may be redeemed at the option of the Company on fixed semi-annual dates beginning on April 22, 2007.

On July 11, 2002, the Company completed the private placement of \$13,403,000 aggregate liquidation amount of floating rate trust preferred securities (the "Trust II Capital Securities") issued by its Delaware statutory business trust, Northway Capital Trust II (the "Capital Trust II"). The Trust II Capital Securities were sold to a pooled investment vehicle. The proceeds from the sale of the Trust II Capital Securities, which include the proceeds from the sale by Capital Trust II of its common securities to the Company, were invested in Floating Rate Junior Subordinated Debt Securities of the Company due 2032 (the "Trust II Junior Subordinated Debt"), which were issued pursuant to an Indenture, dated July 11, 2002, between the Company and Wilmington Trust Company, as Trustee. Both the Trust II Capital Securities and the Trust II Junior Subordinated Debt have a floating rate, which resets quarterly, equal to three-month LIBOR plus 3.65%, with a ceiling of 12.50% for the first five years. Currently, the interest rate on these securities is 9.01%. Payments of distributions and other amounts due on the Trust II Capital Securities are irrevocably guaranteed by the Company, to the extent that Capital Trust II has funds available for the payments of such distributions, pursuant to a Guarantee Agreement, dated July 11, 2002, between the Company and Wilmington Trust Company, as Guarantee Trustee. The Trust II Junior Subordinated Debt and the Trust II Capital Securities may be redeemed at the option of the Company on fixed quarterly dates beginning on July 7, 2007.

NOTE 11 ACQUISITIONS

On April 7, 2006, the Company acquired certain assets and assumed the deposits of two branch offices of Washington Mutual Bank located in Laconia and Belmont, New Hampshire. This acquisition has allowed the Company to expand its market area further in Belknap County. Deposits assumed totaled \$29,438,000 for which the Company paid a deposit purchase premium of 6.30%. In addition, the Company acquired certain loans associated with the branches totaling \$8,192,000. As a result of this purchase, the Company made the following entries to record this transaction:

	(\$000 Omitted)	
Cash	\$19,130	
Loans	8,192	
Goodwill	425	
Core deposit intangible	1,234	
Equipment	49	
Land and buildings	458	
Other assets	28	
Building and equipment expense	1	
Deposits		\$29,438
Other liabilities		74
Miscellaneous income		5
	<u>\$29,517</u>	<u>\$29,517</u>

This transaction was accounted for using the purchase method of accounting. The results of operations of the acquired branches are included in the 2006 consolidated statements of income of the Company from the date of the transaction.

The cost of the acquired branch offices exceeded the fair value of the assets acquired and liabilities assumed by \$1,659,000. Of this amount, \$1,234,000 was assigned to core deposit intangible and \$425,000 was recorded as goodwill. All of the goodwill was deductible for tax purposes. The core deposit intangible of \$1,234,000 is being amortized to noninterest expense over fourteen years using the sum-of-the-years'-digits method.

NOTE 12 GOODWILL AND OTHER INTANGIBLE ASSETS

At December 31, 2006, the Company has goodwill and core deposit intangibles totaling \$12,755,000. Core deposit intangibles are being amortized over their useful lives and both core deposit intangibles and goodwill are tested for impairment at least annually.

The changes in the carrying amount of goodwill and core deposit intangibles for the years ended December 31, 2006 and 2005 are as follows:

	(\$000 Omitted)	
	Goodwill	Core Deposit Intangibles
Balance, December 31, 2004	\$10,152	\$ 2,949
Amortization expense	-	(954)
Balance, December 31, 2005	10,152	1,995
Branch acquisition	425	1,234
Amortization expense	-	(1,051)
Balance, December 31, 2006	<u>\$10,577</u>	<u>\$ 2,178</u>

Estimated annual amortization expense:

	(\$000 Omitted)
	Core Deposit Intangibles
2007	\$476
2008	464
2009	453
2010	227
2011	109
2012 and thereafter	449

The following table reflects the gross carrying amount and accumulated amortization of core deposit intangibles as of December 31, 2006:

	(\$000 Omitted)		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Core deposit intangibles	<u>\$6,566</u>	<u>\$4,388</u>	<u>\$2,178</u>

Management reviews the carrying amount of intangible assets on an ongoing basis, taking into consideration any events and circumstances that might have diminished such amount. During 2006 and 2005, the Company reviewed the carrying amount of intangible assets and determined that no impairment write-down was required.

NOTE 13 REGULATORY MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). As of December 31, 2006, the most recent notification from the FDIC categorized the Bank as "well-capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well-capitalized" the Bank must maintain total risk-based, Tier 1 risk-based and Tier 1 leverage ratios above regulatory prescribed minimum levels. There are no conditions or events since that notification that management believes have changed the Bank's category. Management believes, as of December 31, 2006 and 2005, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

NOTE 13 REGULATORY MATTERS (CONTINUED)

These minimum capital amounts and ratios, as well as the Company's and Bank's actual capital amounts and ratios, are presented in the following table:

(\$000 Omitted)

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>As of December 31, 2006</u>						
Tier 1 capital (to average assets)						
Northway Financial, Inc.	\$58,432	9.31 %	\$25,102	≥4.00 %	N/A	
Northway Bank	51,653	8.30	24,887	≥4.00	\$31,109	≥5.00 %
Total capital (to risk weighted assets)						
Northway Financial, Inc.	66,464	15.95	33,339	≥8.00	N/A	
Northway Bank	56,796	13.82	32,885	≥8.00	41,107	≥10.00
Tier 1 capital (to risk weighted assets)						
Northway Financial, Inc.	58,432	14.02	16,669	≥4.00	N/A	
Northway Bank	51,653	12.57	16,443	≥4.00	24,664	≥6.00
<u>As of December 31, 2005</u>						
Tier 1 capital (to average assets)						
Northway Financial, Inc.	\$55,765	8.96	\$24,888	≥4.00	N/A	
Northway Bank	50,450	8.19	24,644	≥4.00	\$30,806	≥5.00
Total capital (to risk weighted assets)						
Northway Financial, Inc.	65,025	15.24	34,138	≥8.00	N/A	
Northway Bank	55,673	13.25	33,623	≥8.00	42,029	≥10.00
Tier 1 capital (to risk weighted assets)						
Northway Financial, Inc.	55,765	13.07	17,069	≥4.00	N/A	
Northway Bank	50,450	12.00	16,812	≥4.00	25,217	≥6.00

Federal regulations prohibit banking companies from paying dividends on their stock if the effect would cause stockholders' equity to be reduced below applicable regulatory capital requirements or if such declaration and payment would otherwise violate regulatory requirements.

As of December 31, 2006, the Bank is restricted from declaring dividends to the Company in an amount greater than approximately \$23,900,000, as such declaration would decrease capital below the Bank's required minimum level of regulatory capital.

NOTE 14 OTHER NONINTEREST EXPENSE

The following table sets for information relating to the Company's other noninterest expense for the years ended December 31:

(\$000 Omitted)

	2006	2005	2004
Professional fees	\$1,026	\$1,179	\$ 907
Marketing	726	757	326
Stationery and supplies	365	647	429
Telecommunications	455	619	595
Other	3,676	3,511	3,252
	<u>\$6,248</u>	<u>\$6,713</u>	<u>\$5,509</u>

NOTE 15 FEDERAL AND STATE TAXES

The components of federal and state tax expense for the years ended December 31, are as follows:

	(\$000 Omitted)		
	2006	2005	2004
Current			
Federal	\$1,010	\$ 820	\$1,289
State	-	26	334
	<u>1,010</u>	<u>846</u>	<u>1,623</u>
Deferred			
Federal	(363)	2	44
State	5	(6)	(1)
	<u>(358)</u>	<u>(4)</u>	<u>43</u>
Total	<u>\$ 652</u>	<u>\$ 842</u>	<u>\$1,666</u>

The temporary differences (the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases) that give rise to significant portions of the net deferred income tax asset at December 31, are as follows:

	(\$000 Omitted)	
	2006	2005
Deferred income tax assets		
Allowance for loan losses	\$2,234	\$2,072
Interest on nonaccrual loans	16	46
Unrealized holding loss on securities available-for-sale	198	724
Capital loss carryforward	-	24
Pension unfunded status valuation adjustment	626	-
Amortization of goodwill and core deposit intangible	-	3
Supplemental pension	416	325
Other	10	9
	<u>3,500</u>	<u>3,203</u>
Deferred income tax liabilities		
Depreciation	(557)	(621)
Amortization of goodwill and core deposit intangible	(86)	-
Prepaid pension	(286)	(454)
Mortgage and consumer servicing rights	(79)	(94)
	<u>(1,008)</u>	<u>(1,169)</u>
Deferred income tax asset, net	<u>\$ 2,492</u>	<u>\$ 2,034</u>

The primary sources of recovery of the deferred income tax asset are taxes paid that are available for carryback and the expectation that the deductible temporary differences will reverse during periods in which the Company generates taxable income.

Total income tax expense for the years ended December 31, 2006, 2005 and 2004 differs from the "expected" federal income tax expense at the 34% statutory rate for the following reasons:

	2006		2005		2004	
Expected federal income taxes	34.0	%	34.0	%	34.0	%
Interest on municipal securities available-for-sale and municipal loans	(16.8)		(9.4)		(4.5)	
State tax expense, net of federal benefit	0.1		0.4		4.3	
Other	(0.4)		(1.0)		(0.8)	
Effective tax rates	<u>16.9</u>	%	<u>24.0</u>	%	<u>33.0</u>	%

NOTE 16 EMPLOYEE BENEFITS

Pension Plan

The Company maintains a trustee non-contributory pension plan (the "Plan") covering substantially all full-time employees. Assuming retirement at age 65 after 30 years or more of service, the benefits are computed as the sum of one percent of final average earnings up to a covered compensation limit, plus 0.65 percent of final average earnings in excess of covered compensation, times years of service, up to 30. Final average earnings are defined as the five consecutive years out of the employee's last ten years of employment during which compensation is highest. The amounts contributed to the Plan are determined annually on the basis of (a) the maximum amount that can be deducted for federal income tax purposes or (b) the amount certified by a consulting actuary as necessary to avoid an accumulated funding deficiency as defined by the Employee Retirement Income Security Act of 1974. Contributions are intended to provide not only benefits attributed to service to date but also for those expected to be earned in the future.

The following table sets forth information about the Plan as of December 31, using a measurement date of December 31, and for the years then ended:

	(\$000 Omitted)		
	2006	2005	2004
Accumulated benefit obligation at the end of the year	<u>\$ 5,863</u>	<u>\$ 4,986</u>	<u>\$ 5,475</u>
<u>Change in projected benefit obligation</u>			
Projected benefit obligation at beginning of year	\$ 6,590	\$ 5,805	\$ 4,901
Service cost	519	515	481
Interest cost	371	346	303
Actuarial (gain) loss	(344)	235	233
Benefits paid	(169)	(311)	(113)
Projected benefit obligation at end of year	<u>6,967</u>	<u>6,590</u>	<u>5,805</u>
<u>Change in plan assets</u>			
Fair value of plan assets at beginning of year	5,730	4,601	3,652
Actual return on plan assets	680	295	401
Employer contributions	-	1,145	661
Administrative expense	(15)	-	-
Benefits paid	(169)	(311)	(113)
Fair value of plan assets at end of year	<u>6,226</u>	<u>5,730</u>	<u>4,601</u>
Funded status at end of year	<u>\$ (741)</u>	(860)	(1,204)
Unrecognized net actuarial loss		2,989	2,803
Unrecognized prior service credit		(792)	(877)
Net amount recognized		<u>\$ 1,337</u>	<u>\$ 722</u>
<u>Amounts recognized in the Statement of Financial Position</u>			
Prepaid benefit cost	\$ -	\$ 1,337	\$ 722
Accrued benefit liability	-	-	(1,018)
Unfunded pension liability	(741)	-	-
Total	<u>\$ (741)</u>	<u>\$ 1,337</u>	<u>\$ (296)</u>
<u>Amounts recognized in accumulated other comprehensive income</u>			
Pension liability adjustment	\$ -	\$ -	\$ 1,018
Prior service credit	(708)	-	-
Net loss	2,289	-	-
Total	<u>\$ 1,581</u>	<u>\$ -</u>	<u>\$ 1,018</u>

NOTE 16 EMPLOYEE BENEFITS (CONTINUED)

The following table illustrates the incremental effect of applying SFAS No. 158 on individual line items in the balance sheet as of December 31, 2006:

	(\$000 Omitted)		
	Before Application of SFAS No. 158	Adjustments	After Application of SFAS No. 158
Prepaid benefit cost	\$ 840	\$(840)	\$ -
Deferred income taxes	1,866	626	2,492
Total assets	651,091	(214)	650,877
Liability for pension benefits	-	741	741
Total liabilities	597,987	741	598,728
Accumulated other comprehensive loss	(301)	(955)	(1,256)
Total stockholders' equity	53,104	(955)	52,149

Components of net periodic benefit cost and other amounts recognized in other comprehensive loss

	2006	2005	2004
Service cost	\$ 519	\$ 515	\$ 481
Interest cost	371	346	303
Expected return on plan assets	(451)	(384)	(288)
Amortization of prior service cost	(85)	(85)	(84)
Amortization of net actuarial loss	143	138	141
Recognized transition amount	-	-	(1)
Net periodic benefit cost	<u>497</u>	<u>\$ 530</u>	<u>\$ 552</u>

Other changes in plan assets and benefit obligations recognized in other comprehensive loss*

Net gain for period	(558)
Amortization of prior service credit	85
Amortization of net loss	(143)
Total	<u>(616)</u>

Total recognized in net period pension cost and other comprehensive loss*

\$(119)

*This section illustrates the reconciliation items if FAS 158 were in effect at December 31, 2005

The estimated prior service credit and net loss that will be accreted and amortized from accumulated other comprehensive loss into net periodic benefit cost over the year ended December 31, 2007 are \$84,000 and \$100,000, respectively.

Assumptions used to determine benefit obligations and benefit cost as of and for the years ending December 31,

	2006		2005		2004
Discount rate:					
Benefit obligation	6.00	%	5.75	%	6.00
Benefit cost	5.75		6.00		6.25
Long-term rate of return on plan assets	8.00		8.00		8.00
Rate of compensation increase	3.50		3.50		3.50

The expected long-term rate of return for the plan's total assets is based on the expected return of asset categories identified below, weighted based on the target allocations for each class. Equity funds are expected to return 8% to 10% over the long-term and bond funds and short-term money markets are expected to return between 4% and 6%.

NOTE 16 EMPLOYEE BENEFITS (CONTINUED)

The Company's pension plan actual asset allocations by asset category are as follows:

<u>Asset Category</u>	Plan Assets at December 31,					
	2006		2005		2004	
Mutual funds:						
Bond funds	29.0	%	32.7	%	32.6	%
Equity securities	51.0		42.5		43.6	
Real estate funds	7.0		8.5		9.4	
Short-term money market	13.0		16.3		14.4	
Total	<u>100.0</u>	<u>%</u>	<u>100.0</u>	<u>%</u>	<u>100.0</u>	<u>%</u>

The investment policy, as established by the Company, is to provide for a moderate growth of capital with a moderate level of volatility by investing assets per the target allocations as follows:

<u>Asset Category</u>	2006	2005	2004
Mutual funds:			
Bond funds	25-45 %	40-60 %	40-60 %
Equity securities	45-65	30-50	30-50
Real estate funds	0-15	0-15	0-15
Other	0-25	-	-

The assets will be re-allocated quarterly to meet the above target allocations. The investment policy is reviewed on an annual basis, under the advisement of the Company's certified investment advisor, to determine if the policy should be changed.

The plan assets do not include any Company common stock at December 31, 2006 and 2005.

The Company expects to contribute \$435,000 to its pension plan in 2007.

Estimated future benefit payments, which reflect future service, as appropriate, are as follows for the years ended December 31:

	(\$000 Omitted)
2007	\$ 169
2008	194
2009	224
2010	235
2011	262
2012-2016	1,827

401(k) Plan

The Company offers a contributory 401(k) Plan. Under the Northway Financial, Inc. 401(k) and Profit Sharing Plan (the "401K Plan") employees must have attained age 21, completed six months of service and be credited with 1,000 hours of service in order to participate. Employees of the Company are eligible to participate. Under the 401K Plan, the Company matches 50 percent of the first 4 percent of employee contributions. Total 401(k) matching expense in 2006, 2005 and 2004 amounted to \$151,000, \$139,000 and \$143,000, respectively, and Profit Sharing contribution expense for 2006, 2005, and 2004 was \$0, \$0, and \$38,000, respectively.

Supplemental Executive Retirement Plan (SERP)

Effective May 29, 2003, the existing Executive Life program sponsored by the Company was terminated and replaced with a SERP in which Mr. Woodward participates. The existing Split Dollar Life Insurance policy designed to support the Executive Life program is now fully owned by Northway. This policy will be maintained by Northway and is used as the benchmark for the SERP.

NOTE 16 EMPLOYEE BENEFITS (CONTINUED)

The total retirement SERP benefit is as follows: Upon Mr. Woodward's termination of employment for reasons other than death or for cause, the account balance is paid out to him in ten (10) equal annual installments on the first day of the month following the month in which employment is terminated. Upon death after retirement, the unpaid account balance, if any, is paid out in a lump sum to the named beneficiary. During retirement, an additional retirement payment, based on the policy gains associated with the prior calendar year, will also be paid on an annual basis until the executive's death. In the event of Mr. Woodward's death while employed by the Company, the SERP permits a death benefit of \$2,000,000 be paid to his beneficiary.

Stock-Based Compensation

The Board of Directors (the "Committee") administers the 1999 Stock Option and Grant Plan (the "1999 Plan") which is described below.

Under the 1999 Plan, the Committee may select the individuals to whom awards may from time to time be granted; determine the time or times of grant; and determines the extent, if any, of incentive stock options, non-qualified stock options, restricted stock awards, unrestricted stock awards, performance share awards, or any combination of the foregoing.

The 1999 Plan expires in February 2009. The aggregate number of shares of the Company's common stock which may be issued upon the exercise of options granted under the 1999 Plan is 175,000. The option price is fixed by the Committee at the time of the grant and may not be less than 100 percent of the fair market value of the stock, as determined by the Committee, in good faith as of the grant date. Each option may be exercised at such times as shall be determined by the Committee at or after the grant date; provided, however, that no option may be exercised ten years after the date of grant. The fair value of each option granted is estimated on grant date using the Black-Scholes option pricing model.

A summary of the status of the Company's 1999 Plan as of December 31, 2006, 2005 and 2004 and changes during the years then ended is presented below:

	2006		2005		2004	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	34,000	\$25.00	38,000	\$24.96	42,000	\$24.93
Exercised	-		(4,000)	24.64	(4,000)	24.64
Forfeited	(3,500)	28.00	-		-	
Outstanding, end of year	<u>30,500</u>	24.65	<u>34,000</u>	25.00	<u>38,000</u>	24.96
Options exercisable at year-end	30,500		34,000		38,000	

The following table summarizes information about fixed stock options outstanding as of December 31, 2006:

	Options Outstanding			Options Exercisable	
	Weighted Average Exercise Price	Number Outstanding as of 12/31/06	Weighted Average Remaining Contractual Life	Number Exercisable as of 12/31/06	Weighted Average Exercise Price
	\$28.00	11,500	2.50 years	11,500	\$28.00
	22.63	19,000	3.63 years	19,000	22.63
	24.65	<u>30,500</u>	3.20 years	<u>30,500</u>	24.65

Change in Control

The Company and its subsidiary have entered into Key Employee agreements with specific Executive Officers as well as other Senior Officers of the Company. These agreements provide for payments, under certain circumstances, to the officer upon the officer's termination after a change in control. Payments will be made under these agreements upon the officer's termination or resignation in connection with certain specified actions adverse to the officer's employment status after a change in control. The amount of such payments ranges from 1.0 to 1.5 times such officer's annual compensation.

NOTE 17 FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to originate loans and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for loan commitments and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Financial instruments with off-balance sheet credit risk at December 31, are as follows:

	(\$000 Omitted)	
	2006	2005
Financial instrument whose contract amounts represent credit risk:		
Unadvanced portions of home equity loans	\$17,691	\$18,761
Unadvanced portions of lines of credit	21,424	14,485
Unadvanced portions of commercial real estate loans	17,421	17,381
Unadvanced portions of Bounce Protection™	13,667	11,294
Commitments to originate all other loans	20,742	19,971
Commitments to originate municipal notes	972	-
Standby letters of credit	303	78
Total	<u>\$92,220</u>	<u>\$81,970</u>

Commitments to originate loans and municipal notes, unadvanced portions of home equity loans, lines of credit and commercial real estate loans are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without having been drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the borrower.

Unadvanced portions of Bounce Protection™ represent the unused portion of the Bank's overdraft privilege program.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers. As of December 31, 2006 and 2005, the maximum potential amount of the Company's obligation was \$303,000 and \$78,000, respectively, for financial and standby letters of credit. The Company's outstanding letters of credit generally have a term of less than one year. If a letter of credit is drawn upon, the Company may seek recourse through the customer's underlying line of credit. If the customer's line of credit is also in default, the Company may take possession of the collateral, if any, securing the line of credit.

NOTE 18 FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents approximates the fair value of those assets.

Securities: Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

FHLB Stock: The carrying amount reported in the consolidated balance sheets for FHLB Stock approximates its fair value. If redeemed, the Company will receive an amount equal to the par value of the stock.

Loans held-for-sale: Fair values for loans held-for-sale are estimated based on outstanding investor commitments, or in the absence of such commitments, are based on current investor yield requirements.

Loans: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The fair values of nonaccrual loans was estimated using discounted cash flow analyses or the estimated fair value of the underlying collateral where applicable.

Accrued interest receivable: The carrying value of accrued interest receivable approximates its fair value because of the short-term nature of this financial instrument.

Deposits: The fair value of demand deposits (e.g. NOW and super NOW checking, noninterest bearing checking, regular savings, money market accounts and mortgagors' escrow accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). Fair values for certificates of deposit are estimated using a discounted cash flow technique that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities of time deposits.

Short-term borrowings: The carrying value of short-term borrowings approximates its fair value because of the short-term nature of these financial instruments.

Long-term debt: The fair values of long-term debt are determined by discounting the anticipated future cash payments by using the rates currently available to the Company for debt with similar terms and remaining maturities.

Junior subordinated debentures: The fair values of junior subordinated debentures are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Off-balance sheet instruments: The fair value of commitments to originate loans is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments and the unadvanced portion of loans, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligation with the counterparties at the reporting date. See NOTE 17 for further information.

The estimated fair values of the Company's financial instruments are as follows:

	(\$000 Omitted)			
	December 31,			
	2006		2005	
	<u>Carrying</u> <u>Amount</u>	<u>Estimated</u> <u>Fair Value</u>	<u>Carrying</u> <u>Amount</u>	<u>Estimated</u> <u>Fair Value</u>
Financial assets:				
Cash and cash equivalents	\$ 24,808	\$ 24,808	\$ 29,362	\$ 29,362
Securities available-for-sale	127,789	127,789	103,244	103,244
FHLB stock	3,782	3,782	5,541	5,541
Loans held-for-sale	263	268	453	461
Loans, net	456,649	445,550	455,223	445,529
Accrued interest receivable	2,941	2,941	2,614	2,614

NOTE 18 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

	(\$000 Omitted)			
	December 31,			
	2006		2005	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial liabilities:				
Deposits	\$484,677	\$484,266	\$464,456	\$463,159
Short-term borrowings	36,497	36,497	9,363	9,363
Long-term debt	53,000	51,900	85,000	84,296
Junior subordinated debentures	20,620	20,646	20,620	20,908

The carrying amounts of financial instruments shown in the above table are included in the consolidated balance sheets under the indicated captions except that accrued interest receivable is included with other assets and junior subordinated debentures are included with long-term debt.

At December 31, 2006 and 2005 all the Company's financial instruments were held for purposes other than trading.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for some of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, cash flows, current economic conditions, risk characteristics, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions and changes in the loan, debt and interest rate markets could significantly affect the estimates. Further, the income tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on the fair value estimates and have not been considered. The fair value amounts presented do not represent the underlying value of the Company because fair values of certain other financial instruments, assets and liabilities have not been determined.

NOTE 19 CONDENSED PARENT ONLY FINANCIAL STATEMENTS

Condensed financial statements of Northway Financial, Inc. (Parent Company only) as of December 31, 2006 and 2005 and for the three years ended December 31, 2006 follow:

Balance Sheets

	(\$000 Omitted)	
	2006	2005
Assets		
Cash and cash equivalents	\$ 5,182	\$ 3,780
Investment in subsidiary, Northway Bank	64,126	61,517
Investment in unconsolidated subsidiaries, Northway Capital Trust I & II	620	620
Equipment, net	960	1,571
Due from subsidiary	145	540
Other assets	4,126	4,751
Total assets	<u>\$75,159</u>	<u>\$72,779</u>
Liabilities and stockholders' equity		
Accrued expenses	\$ 541	\$ 540
Other liabilities	1,849	1,369
Junior subordinated debentures	20,620	20,620
Total liabilities	<u>23,010</u>	<u>22,529</u>
Stockholders' equity:		
Common stock	1,732	1,732
Additional paid-in capital	2,064	2,064
Retained earnings	56,140	54,089
Treasury stock	(6,531)	(6,531)
Accumulated other comprehensive loss	(1,256)	(1,104)
Total stockholders' equity	<u>52,149</u>	<u>50,250</u>
Total liabilities and stockholders' equity	<u>\$75,159</u>	<u>\$72,779</u>

NOTE 19 CONDENSED PARENT ONLY FINANCIAL STATEMENTS (CONTINUED)

Statements of Income

	(\$000 Omitted)		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Income:			
Dividends from subsidiary	\$ 2,210	\$ 2,036	\$ 2,030
Interest income	210	120	48
Management fee income from subsidiary	1,913	8,750	9,576
Other	<u>290</u>	<u>202</u>	<u>178</u>
	<u>4,623</u>	<u>11,108</u>	<u>11,832</u>
Expense:			
Interest expense	1,832	1,463	1,079
Salaries and employee benefits	940	5,536	5,715
Office occupancy and equipment expense	611	1,137	1,268
Professional fees	257	661	777
Other	<u>104</u>	<u>1,417</u>	<u>1,833</u>
	<u>3,744</u>	<u>10,214</u>	<u>10,672</u>
Income before income tax benefit and equity in undistributed net income of subsidiary	879	894	1,160
Income tax benefit	<u>(531)</u>	<u>(438)</u>	<u>(345)</u>
Income before equity in undistributed net income of subsidiary	1,410	1,332	1,505
Equity in undistributed net income of subsidiary	<u>1,805</u>	<u>1,341</u>	<u>1,883</u>
Net income	<u>\$ 3,215</u>	<u>\$ 2,673</u>	<u>\$ 3,388</u>

Statements of Cash Flows

	(\$000 Omitted)		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:			
Net income	\$ 3,215	\$ 2,673	\$ 3,388
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	597	630	603
Decrease in amount due from subsidiary	395	268	170
Increase in other assets	411	(622)	(305)
Increase in accrued expenses and other liabilities	(261)	4	535
Loss on disposal of assets	14	2	-
Undistributed net income of subsidiary	<u>(1,805)</u>	<u>(1,341)</u>	<u>(1,883)</u>
Net cash provided by operating activities	<u>2,566</u>	<u>1,614</u>	<u>2,508</u>
Cash flows from investing activities:			
Capital contributions to subsidiary	-	-	-
Additions to premises and equipment	-	(145)	(869)
Purchase of company owned life insurance	-	-	(400)
Net cash used by investing activities	<u>-</u>	<u>(145)</u>	<u>(1,269)</u>
Cash flows from financing activities:			
Exercise of stock options	-	99	99
Purchases of treasury stock	-	(563)	-
Cash dividends paid	<u>(1,164)</u>	<u>(1,068)</u>	<u>(1,020)</u>
Net cash used by financing activities	<u>(1,164)</u>	<u>(1,532)</u>	<u>(921)</u>
Net (decrease) increase in cash and cash equivalents	1,402	(63)	318
Cash and cash equivalents at beginning of year	<u>3,780</u>	<u>3,843</u>	<u>3,525</u>
Cash and cash equivalents at end of year	<u>\$ 5,182</u>	<u>\$ 3,780</u>	<u>\$ 3,843</u>



2007 Annual Report to Stockholders

NORTHWAY FINANCIAL, INC.
2007 ANNUAL REPORT

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Selected Financial Highlights

At or for the years ended December 31, (\$000 Omitted, except per share data)	2007	2006	2005	2004	2003
<i>Balance Sheet Data:</i>					
Total assets	\$688,773	\$650,877	\$632,734	\$638,418	\$609,216
Securities available-for-sale, at fair value	143,543	125,838	101,718	100,105	62,251
Loans, net of unearned income	489,969	464,181	461,899	475,734	479,450
Allowance for loan losses	6,240	5,581	5,150	5,204	5,036
Other real estate owned	666	-	196	-	175
Goodwill	10,577	10,577	10,152	10,152	10,152
Core deposit intangibles, net	1,702	2,178	1,995	2,949	3,903
Deposits	478,462	484,677	464,456	475,359	463,307
Short-term borrowings	63,865	36,497	9,363	11,268	7,401
Long-term debt	96,620	73,620	105,620	98,620	87,620
Stockholders' equity	44,645	52,149	50,250	49,510	47,872
<i>Income Statement Data:</i>					
Net interest and dividend income	\$ 21,805	\$ 22,211	\$ 23,186	\$ 22,846	\$ 23,050
Provision for loan losses	810	465	75	495	805
Noninterest income	5,807	5,862	3,986	5,097	5,375
Noninterest expense	23,053	23,741	23,582	22,394	22,136
Net income	3,279	3,215	2,673	3,388	3,617
<i>Per Common Share Data:</i>					
Net income – basic	\$ 1.16	\$ 1.08	\$ 0.89	\$ 1.13	\$ 1.20
Net income – assuming dilution	1.15	1.07	0.88	1.12	1.19
Cash dividends declared and paid	0.42	0.39	0.35	0.34	0.34
Book value	17.81	17.49	16.85	16.47	15.96
Tangible book value	12.84	13.14	12.70	12.01	11.15
<i>Selected Ratios:</i>					
Return on average assets	0.49%	0.51%	0.43%	0.54%	0.59%
Return on average equity	6.53	6.24	5.33	6.97	7.82
Dividend payout	36.47	36.21	39.96	30.10	28.28
Average equity to average assets	7.43	8.12	7.99	7.75	7.61

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The purpose of this discussion is to focus on significant changes in the financial condition and results of operations of Northway Financial, Inc. ("Northway") and its subsidiaries (collectively, the "Company"). It is intended to supplement and highlight information contained in the accompanying consolidated financial statements and the selected financial data presented elsewhere in this report. The discussion set forth below contains certain statements that may be considered "forward-looking statements." Forward-looking statements involve risks, uncertainties and other factors that may cause the Company's actual results to materially differ from those projected in the forwarding-looking statements. For further information regarding forward-looking statements, you should review the discussion under the caption "FORWARD-LOOKING STATEMENTS" below.

FORWARD-LOOKING STATEMENTS

Certain statements in this report 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, projections based on assumptions regarding market and liquidity risk, 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. 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 factors, overall economic and business conditions, economic and business conditions in the Company's market areas, interest rate fluctuations, a prolonged continuation of the current interest rate environment, 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: i) changes in interest rates over the past year and the relative relationship between the various interest rate indices that the Company uses; ii) a deterioration in the financial markets affecting the valuation of securities held in the Company's investment portfolio; (iii) a change in product mix attributable to changing interest rates, customer preferences or competition; iv) deterioration in the residential and other sectors of the real estate market generally; v) a significant portion of the Company's loan customers are in the hospitality business and therefore could be affected by a slower economy, adverse weather conditions and/or rising gasoline prices; and vi) the effectiveness of advertising, marketing and promotional programs.

The words "believe," "expect," "anticipate," "intend," "estimate," "project" or the negative of such terms and other similar 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 expressly disclaims any obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Though the Company has attempted to list comprehensively the factors which might affect forward-looking statements, the Company wishes to caution you 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.

OVERVIEW OF PERFORMANCE

The Company derives substantially all of its revenue and income from community bank-related activities. Northway Bank (the "Bank") operates as a typical community banking institution and does not engage in any specialized finance or capital markets activities. Northway functions primarily as the holder of stock of its subsidiary and assists in the management of the operations of its subsidiary as appropriate.

The principal components of the Company's income sources are net interest and dividend income. Net interest and dividend income is the difference between interest, dividends and fee income received on interest earning assets, such as loans and investments, and the interest expense paid on interest bearing liabilities, such as deposits and borrowed funds. Our other sources of income include revenues from sales of securities, deposit account service fees and fee-based services, such as cash management fees and alternative investment income.

OVERVIEW OF PERFORMANCE (CONTINUED)

Economic and industry factors that could cause the Company's financial performance to differ from expected results include changes in applicable federal and state regulations, changes in the hospitality industry on which the Company's business is largely dependent, interest rate volatility, significant changes in loan losses which may affect the Company's allowance for loan losses and the related provision for loan losses, and changes in the securities market that would affect the performance of the Company's investment portfolio. Management evaluates each of these factors on an ongoing basis to determine their impact and to effect any strategies necessary to mitigate these risks.

The Company reported net income of \$3,279,000, or \$1.16 basic earnings per common share, in 2007 compared to net income of \$3,215,000, or \$1.08 basic earnings per common share, in 2006 and \$2,673,000, or \$0.89 basic earnings per common share, in 2005. Return on average equity was 6.53% in 2007, compared to 6.24% in 2006 and 5.33% in 2005. Return on average assets was 0.49% in 2007, compared to 0.51% in 2006 and 0.43% in 2005.

On August 28, 2007 at the Annual Meeting of Stockholders, the stockholders of the Company approved a 1-400 reverse stock split. As a result of the reverse stock split, each stockholder owning fewer than 400 shares of common stock of Northway immediately before the reverse stock split received \$37.50 in cash, without interest, for each share of Northway common stock owned by such stockholder immediately prior to the reverse stock split and is no longer a stockholder of Northway. Further, the stockholders approved an 800-for-1 forward stock split of the remaining Northway common stock. Each holder of 400 or more shares of common stock immediately before the reverse stock split participated in the forward stock split, which resulted in such stockholder holding twice the number of shares of common stock he held prior to the reverse stock split. The record date for the reverse stock split and the forward stock split was Tuesday September 4, 2007. The effective date for the transaction was September 11, 2007. As a result of the transaction, the Company deregistered its common stock with the Securities and Exchange Commission ("SEC") and, therefore, terminated applicable reporting obligations under the federal securities laws.

On April 7, 2006, the Company acquired from Washington Mutual Bank the former Provident National Bank branches located in Tilton and Belmont, New Hampshire. This transaction included the purchase of approximately \$8,192,000 in loan balances, net of discount, and the acquisition of deposits, net of deposit assumption premium, totaling approximately \$27,779,000, for which the Company paid a deposit assumption premium of 6.30%. See NOTE 11 to the Consolidated Financial Statements.

During 2007, the Company recorded a decrease in net interest and dividend income of \$397,000, as an increase in the cost of interest bearing liabilities of 0.55% was only partially offset by an increase in the yield on earning assets of 0.26% and an increase in average earning assets of \$40,704,000. During 2007, interest and dividend income increased \$3,817,000 due primarily to an increase in the average balances on loans and investments of \$14,347,000 and \$25,466,000, respectively, as well as an increase in the yield on both loans and investments. Interest expense increased \$4,223,000 due to an increase in the rates paid for certificates of deposit and borrowed funds as well as an increase in interest bearing liabilities of \$41,780,000. The provision for loan losses increased \$345,000 as the total provision for 2007 was \$810,000 compared to \$465,000 for 2006. The increase in the provision for loan losses was the result of the ongoing review of the adequacy of the allowance for loan losses. Noninterest income, excluding securities gains, decreased \$181,000 from last year due to a decrease in the valuation of the Company's cash surrender value life insurance and a decrease in one-time items from 2006 relating to the resolution of a significant loan relationship workout as well as unwind fee income from a Federal Home Loan Bank ("FHLB") symmetrical advance. During 2007, the Company realized net securities gains of \$520,000 compared to \$394,000 in 2006. Noninterest expense decreased \$688,000 from last year due primarily to decreases in salaries and benefits expense, office occupancy and equipment expense, and the amortization of core deposit intangibles, which was partially offset by one-time expenses associated with the reverse and forward stock split transaction and the write down of unamortized deferred costs associated with the refinance of \$20,620,000 in junior subordinated debentures.

During 2006, the Company recorded a decrease in net interest and dividend income of \$974,000, as an increase in the cost of interest bearing liabilities of 0.92% was only partially offset by an increase in the yield on earning assets of 0.65% and an increase in average earning assets of \$9,026,000. During 2006, interest and dividend income increased \$3,862,000 due primarily to an improvement in the yield on loans as well as an increase in both the yield and average balances of investments. Interest expense increased \$4,837,000 due primarily to an increase in interest bearing liabilities of \$10,079,000 as well as a shift in liabilities from savings and NOW accounts, a less expensive source of funds, into certificates of deposits and securities sold under agreements to repurchase, more costly sources of funds. The provision for loan losses increased \$390,000 as the total provision for 2006 was \$465,000 compared to \$75,000 for 2005. The increase in the provision for loan losses was the result of the ongoing review of the adequacy of the allowance for loan losses. Noninterest income, excluding securities gains, increased \$931,000 from last year due primarily to an increase in overdraft income, debit card fees and one-time favorable items relating to the resolution of a significant loan relationship workout as well as unwind fee income from a FHLB symmetrical advance. During 2006, the Company realized net securities gains of \$394,000 compared to net securities losses of \$551,000 for the prior year. The 2005 net losses were the result of the restructuring of the investment portfolio as well as the sale of corporate bonds at a loss of \$499,000. Noninterest expense increased \$159,000 over the prior year.

NET INTEREST AND DIVIDEND INCOME ANALYSIS

Fluctuations in interest rates as well as changes in volume and mix of income earning assets and interest bearing liabilities can materially impact net interest and dividend income, the principal source of our income. The discussion of net interest and dividend income is presented on a taxable equivalent basis, unless otherwise noted, to facilitate performance comparisons among various taxable and tax-exempt assets.

The table below under the caption “Consolidated Average Balances, Interest and Dividend Income/Expense and Average Yields/Rates,” presents the average balances, income earned or interest paid, and average yields earned or rates paid on the Company’s assets and liabilities for the years ended December 31, 2007, 2006, and 2005.

Net interest and dividend income for 2007 remained relatively unchanged at \$23,203,000 compared to 2006. Interest and dividend income increased \$4,215,000, or 11%, in 2007 compared to 2006. This was the result of both an increase in the average balances on loans and investments of \$14,347,000 and \$25,466,000, respectively, as well as an improvement in the yield on investments and loans of 0.41% and 0.29%, respectively. The increase in investment securities was due primarily to an increase in US government-agency mortgage-backed securities and municipal bonds. The increase in loan portfolio occurred in residential mortgage loans, commercial real estate and commercial loans and municipal loans and was accompanied by a decrease in consumer loans, primarily indirect installment loans.

Interest expense increased \$4,223,000, or 31%, in 2007 compared to 2006. Interest expense increased due primarily to an increase in the average balance of interest bearing liabilities of \$41,780,000 as well as an increase in the rate paid on interest bearing liabilities of 0.55%. The increase in interest bearing liabilities occurred principally in certificates of deposit, securities sold under agreements to repurchase and FHLB advances, all of which are more expensive sources of funds.

Net interest and dividend income for 2006 decreased \$488,000, or 2%, compared to 2005. Interest and dividend income increased \$4,349,000, or 13%, in 2006 compared to 2005. Rising interest rates and a shift in the loan mix resulted in an improvement on the yield on loans of 0.65%. Further, the average balance on investments increased \$14,266,000 and the yield on investments increased 0.66% resulting in an improvement in investment income of \$1,419,000.

The increase in interest income was more than offset by an increase in interest expense of \$4,837,000, or 54%, in 2006 compared to 2005. Interest expense increased due primarily to an increase in the cost of interest bearing liabilities of 0.92%. This increase was the result of an increase in rates paid on money market accounts, certificates of deposit, securities sold under agreements to repurchase, FHLB advances and junior subordinated debentures. These rates increased as a result of the increase in interest rates during 2006. Further, the Company experienced a shift in liabilities from lower costing savings and NOW accounts into more expensive sources of funds, including money markets accounts, certificates of deposit and securities sold under agreements to repurchase.

The trend in net interest and dividend income is commonly evaluated in terms of average rates using net interest margin and interest rate spread. The net interest margin is computed by dividing fully taxable equivalent net interest and dividend income by average total earning assets. This ratio represents the difference between the average yield returned on average earning assets and the average rate paid for all funds used to support those earning assets, including both interest bearing and noninterest bearing sources of funds. The net interest margin decreased 0.25% to 3.67% in 2007 and decreased 0.15% to 3.92% in 2006. The decrease in the net interest margin for 2007 was a direct result of the increase in the cost of interest bearing liabilities, which increase was only partially offset by the increase in the yield on earning assets and the increase in average earning assets. The decrease in the net interest margin for 2006 was also a direct result of the increase in the cost of interest bearing liabilities, which increase was only partially offset by an increase in the yield on earning assets.

The interest rate spread measures the difference between the average yield on earning assets and the average rate paid on interest bearing liabilities. The interest rate spread eliminates the impact of noninterest bearing funds and gives a direct perspective on the effect of interest rate fluctuations. During 2007, the net interest rate spread decreased 0.29% to 3.24% as the cost of interest bearing liabilities increased 0.55% and was only partially offset by an increase in the yield on earning assets of 0.26%. During 2006, the net interest rate spread decreased 0.27% to 3.53% as the cost of interest bearing liabilities increased 0.92% and was only partially offset by an increase in the yield on earning assets of 0.65%.

See the tables below under the captions “Consolidated Average Balances, Interest and Dividend Income/Expense and Average Yields/Rates” and “Consolidated Rate/Volume Variance Analysis” for more information.

**CONSOLIDATED AVERAGE BALANCES, INTEREST AND DIVIDEND INCOME/EXPENSE
AND AVERAGE YIELDS/RATES**

(\$000 Omitted)

For the Year Ended December 31,

	2007			2006			2005		
	Average Balance	Interest Income/Expense	Average Yield/Rate	Average Balance	Interest Income/Expense	Average Yield/Rate	Average Balance	Interest Income/Expense	Average Yield/Rate
Assets									
Interest earning assets:									
Federal funds sold	\$ 4,754	\$ 239	5.03%	\$ 4,151	\$ 200	4.82%	\$ 9,383	\$ 322	3.43%
Interest bearing deposits	485	21	4.33	198	8	4.04	130	3	2.31
Securities (1) (2)	147,040	7,806	5.31	121,574	5,963	4.90	106,021	4,511	4.25
Loans, net (3) (4)	<u>480,338</u>	<u>33,125</u>	6.90	<u>465,990</u>	<u>30,805</u>	6.61	<u>467,353</u>	<u>27,791</u>	5.95
Total interest earning assets (5)	632,617	<u>41,191</u>	6.51	591,913	<u>36,976</u>	6.25	582,887	<u>32,627</u>	5.60
Cash and due from banks	12,866			13,008			14,942		
Allowance for loan losses	(5,850)			(5,341)			(5,254)		
Premises and equipment, net	13,239			12,934			13,453		
Other assets	<u>22,382</u>			<u>22,071</u>			<u>21,750</u>		
Total assets	<u>\$675,254</u>			<u>\$634,585</u>			<u>\$627,778</u>		
Liabilities									
Interest bearing liabilities:									
Regular savings	\$ 60,222	165	0.27	\$ 69,304	178	0.26	\$ 81,534	201	0.25
NOW and super NOW	79,927	298	0.37	85,785	279	0.33	96,713	356	0.37
Money market accounts	72,728	2,070	2.85	67,986	1,701	2.50	68,398	767	1.12
Certificates of deposit	201,244	9,043	4.49	173,706	6,207	3.57	135,751	2,769	2.04
Securities sold under agreements to repurchase	46,713	1,642	3.52	22,559	672	2.98	8,836	183	2.07
FHLB advances	66,104	2,966	4.49	66,408	2,896	4.36	84,437	3,189	3.78
Junior subordinated debentures	<u>22,854</u>	<u>1,804</u>	7.89	<u>20,620</u>	<u>1,832</u>	8.88	<u>20,620</u>	<u>1,463</u>	7.10
Total interest bearing liabilities	549,792	<u>17,988</u>	3.27	506,368	<u>13,765</u>	2.72	496,289	<u>8,928</u>	1.80
Noninterest bearing deposits	71,239			72,883			77,845		
Other liabilities	<u>4,003</u>			<u>3,775</u>			<u>3,466</u>		
Total liabilities	625,034			583,026			577,600		
Stockholders' equity	<u>50,220</u>			<u>51,559</u>			<u>50,178</u>		
Total liabilities and stockholders' equity	<u>\$675,254</u>			<u>\$634,585</u>			<u>\$627,778</u>		
Net interest and dividend income (6)		<u>\$ 23,203</u>			<u>\$ 23,211</u>			<u>\$ 23,699</u>	
Interest rate spread (7)			3.24%			3.53%			3.80%
Net interest margin (8)			3.67%			3.92%			4.07%

(1) Reported on a tax equivalent basis. Reported interest on securities of \$6,998,000, \$5,363,000 and \$4,374,000 was adjusted by \$808,000, \$600,000 and \$137,000, for 2007, 2006 and 2005, respectively, to reflect the tax equivalent adjustment.

(2) Average balances are calculated using the adjusted cost basis.

(3) Reported on a tax equivalent basis. Reported interest and fees on loans of \$32,535,000, \$30,405,000 and \$27,415,000 was adjusted by \$590,000, 400,000 and \$376,000 for 2007, 2006 and 2005, respectively, to reflect the tax equivalent adjustment.

(4) Net of unamortized cost/unearned income. Includes loans held for sale and nonperforming loans.

(5) Reported on a tax equivalent basis. Reported interest and dividend income of \$39,793,000, \$35,976,000 and \$32,114,000 was adjusted by \$1,398,000, \$1,000,000 and \$513,000 for 2007, 2006 and 2005, respectively, to reflect the tax equivalent adjustment.

(6) Reported on a tax equivalent basis. Reported net interest and dividend income of \$21,805,000, \$22,211,000 and \$23,186,000 was adjusted by \$1,398,000, \$1,000,000 and \$513,000 for 2007, 2006 and 2005, respectively, to reflect the tax equivalent adjustment.

(7) Interest rate spread equals the yield on interest earning assets minus the rate paid on interest bearing liabilities.

(8) The net interest margin equals net interest and dividend income divided by total average interest earning assets.

CONSOLIDATED RATE/VOLUME VARIANCE ANALYSIS⁽¹⁾

	(\$000 Omitted)							
	2007 Compared to 2006				2006 Compared to 2005			
	Increase (Decrease) Due to Change in				Increase (Decrease) Due to Change in			
	Volume	Rate	Mix	Total	Volume	Rate	Mix	Total
Interest and dividend income:								
Federal funds sold	\$ 29	\$ 9	\$ 1	\$ 39	\$ (180)	\$ 130	\$ (72)	\$ (122)
Interest bearing deposits	12	-	1	13	2	2	1	5
Securities	1,249	491	103	1,843	662	689	101	1,452
Loans, net	948	1,331	41	2,320	(81)	3,104	(9)	3,014
Total interest and dividend income	<u>2,238</u>	<u>1,831</u>	<u>146</u>	<u>4,215</u>	<u>403</u>	<u>3,925</u>	<u>21</u>	<u>4,349</u>
Interest expense:								
Regular savings	(23)	12	(2)	(13)	(30)	8	(1)	(23)
NOW and super NOW	(19)	41	(3)	19	(40)	(42)	5	(77)
Money market accounts	119	234	16	369	(5)	945	(6)	934
Certificates of deposit	984	1,599	253	2,836	774	2,082	582	3,438
Securities sold under agreements to repurchase	719	121	130	970	284	80	125	489
FHLB advances	(13)	83	-	70	(681)	493	(105)	(293)
Junior subordinated debentures	198	(204)	(22)	(28)	-	369	-	369
Total interest expense	<u>1,965</u>	<u>1,886</u>	<u>372</u>	<u>4,223</u>	<u>302</u>	<u>3,935</u>	<u>600</u>	<u>4,837</u>
Net interest and dividend income	<u>\$ 273</u>	<u>\$ (55)</u>	<u>\$ (226)</u>	<u>\$ (8)</u>	<u>\$ 101</u>	<u>\$ (10)</u>	<u>\$ (579)</u>	<u>\$ (488)</u>

(1) Reported on a tax equivalent basis.

PROVISION FOR LOAN LOSSES

The provision for loan losses represents the annual cost of providing an allowance for losses inherent in the loan portfolio. The size of the provision for each year is determined by management based upon many factors, including loan growth, net charge-offs, changes in the composition of the loan portfolio, delinquencies, management's assessment of loan portfolio quality, the value of collateral and general economic factors.

The provision for loan losses was \$810,000 in 2007, an increase of \$345,000 from the provision recorded in 2006. The provision for loan losses was \$465,000 in 2006, a increase of \$390,000 from the provision recorded in 2005. The provision for each of the three years was 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 Company's allowance for loan losses and such review may result in changes to the provision based on judgments different from those of management.

The increase in the 2007 provision was due in large part to an increase in commercial loans, especially large hospitality loans, which require a higher risk weighting in the allowance for loan loss calculation. Further, economic conditions in late 2007 impacted the loss calculation resulting in the need for a higher provision. The increase in the 2006 provision was due in large part to an increase in commercial loans, especially large hospitality loans, which require a higher risk weighting in the allowance for loan loss calculation.

Although management utilizes its best judgment in providing for losses, there can be no assurance that the Company will not have to change its provision for loan losses in subsequent periods. Management will continue to monitor the allowance for loan losses and modify the provision to the allowance for loan losses as appropriate.

NONINTEREST INCOME

Noninterest income consists of revenues generated from a broad range of financial services and activities, including fee-based services and income earned through securities sales.

The following table sets forth the components of the Company's noninterest income:

	(\$000 Omitted)		
	Years Ended December 31,		
	2007	2006	2005
Service charges and fees on deposit accounts	\$2,953	\$2,837	\$2,430
Gain (loss) on sales of securities available-for-sale, net	520	394	(551)
Debit card fees	662	557	456
Gain on sales of loans, net	185	137	260
Other	1,487	1,937	1,391
Total noninterest income	<u>\$5,807</u>	<u>\$5,862</u>	<u>\$3,986</u>

Fee income from service charges and fees on deposit accounts increased 4% in 2007, 17% in 2006 and 9% in 2005. The improvement in 2007 was due primarily to an increase in overdraft fee income. The improvement in 2006 was due primarily to an increase in overdraft fee income due to a 20% increase in the insufficient funds ("NSF") per item fees in May 2006 as well as the impact of the two branches acquired April 7, 2006. The improvement in 2005 was due primarily to an increase in overdraft fee income due to the full year impact of the introduction of Bounce Protection™, an overdraft privilege program, in April 2004.

During 2007, the Company recognized a net gain on sales of securities of \$520,000 compared to a net gain on sales of securities of \$394,000 in 2006 and a net loss on sales of securities of \$551,000 in 2005. Securities gains in 2007 and 2006 were primarily the result of the strong equity market. Securities losses in 2005 were primarily due to the restructuring of the investment portfolio, which resulted in the sale of U.S. Government Agency bonds at a loss, as well as the sale of corporate bonds at a loss of \$499,000. Securities gains, net, in 2007 included \$593,000 of net gains on sales of equity securities compared to \$440,000 and \$117,000 in 2006 and 2005, respectively. Net losses on the sales of debt securities totaled \$73,000 in 2007 compared to net losses of \$46,000 and \$668,000 in 2006 and 2005, respectively.

Debit card fees were \$662,000 in 2007 compared to \$557,000 in 2006 and \$456,000 in 2005. The \$105,000 increase in debit card fees in 2007 and \$101,000 in 2006 reflects the increase in debit card usage over the past several years. Further, during 2007 the Company instituted a program entitled Dime-A-Time, which allows customers to earn ten cents for each credit-based transaction using their debit card and has enhanced debit card usage.

Gains on sales of loans, net increased \$48,000 in 2007 compared to 2006 as gains on sales of mortgage loans increased \$32,000. Gains on sales of loans, net, decreased \$123,000 in 2006 compared to 2005 as gains on sales of mortgage loans declined \$52,000 to \$77,000 and the Company recorded no gain on the sale of commercial loans in 2006 compared to \$68,000 in 2005. Gains on sales of loans, net, decreased \$114,000 in 2005 compared to 2004.

Other noninterest income (sources of which include credit card merchant income, ATM fees, loan fees, safe deposit fees and commissions on alternative investment products) decreased \$450,000, or 23%, to \$1,487,000 in 2007 following an increase of \$546,000, or 39%, to \$1,937,000 in 2006 and an increase of \$22,000, or 2%, to \$1,391,000 in 2005. The decrease in 2007 was due primarily to a decrease in the valuation of the Company's cash surrender value life insurance and to 2006 one-time favorable items relating to the resolution of a significant loan relationship workout as well as unwind fee income from a FHLB symmetrical advance. The increase in 2006 was due primarily to an increase in income from alternative investment products, an increase in the valuation of the cash surrender value of a company-owned life insurance and several one-time favorable items relating to the recapture of prior years' interest and expenses on the payoff of a large commercial loan workout totaling \$100,000, gains on sale of OREO property of \$86,000 as well as an unwind fee of \$84,000 from the redemption of a FHLB symmetrical advance. The increase in 2005 was due primarily to an increase in income from alternative investments products as well as an increase in debit card income.

NONINTEREST EXPENSE

Total noninterest expense decreased \$688,000, or 3%, during 2007 following an increase of \$159,000, or 1%, during 2006 and an increase \$1,188,000, or 5%, during 2005. In 2007, noninterest expense decreased due primarily to decreases in salaries and benefits expense, office occupancy and equipment expense, and the amortization of core deposit intangibles, which was partially offset by one-time expenses of \$918,000 associated with the reverse and forward stock split transaction and the write down of unamortized deferred costs associated with the refinance of \$20,620,000 in junior subordinated debentures. During 2006, noninterest expense was impacted by expenses totaling approximately \$125,000 associated with the acquisition of the two branches in April 2006 and \$357,000 associated with a FHLB unwind penalty due to the early prepayment of FHLB advances. The increase in expenses during 2005 is due primarily to one-time expenses of \$1,161,000 resulting from the merger of the Company's two subsidiary banks.

The following table sets forth information relating to the Company's noninterest expense during the periods indicated:

	(\$000 Omitted) Years Ended December 31,		
	2007	2006	2005
Salaries and employee benefits	\$12,164	\$12,252	\$11,633
Office occupancy and equipment	3,941	4,190	4,282
Amortization of core deposit intangibles	476	1,051	954
Professional fees	1,425	1,026	1,179
Marketing	824	726	757
Amortization of deferred costs debentures	576	23	23
Stationery and supplies	263	365	647
Telecommunications	354	455	619
Other	3,030	3,653	3,488
Total noninterest expense	<u>\$23,053</u>	<u>\$23,741</u>	<u>\$23,582</u>

One-time expenses of \$918,000 for 2007 consisted of \$353,000 in costs related to the reverse and forward stock split transaction completed September 11, 2007 and \$565,000 associated with the write down of unamortized deferred costs associated with the refinance of \$20,620,000 in junior subordinated debentures.

During 2006, noninterest expense included approximately \$126,000 in one-time costs associated with the acquisition of the two former Providian Bank deposits of \$29.5 million. These expenses were related primarily to system conversion costs, marketing, postage and shipping and the expense of providing checks to our new deposit customers.

The merger related expenses, which totaled \$1,161,000 for 2005, consisted primarily of advertising expense of \$386,000, stationery and supplies of \$337,000, equipment expense of \$141,000, professional fees of \$83,000, legal fees of \$81,000 and state transfer tax of \$71,000. These one-time costs related to marketing the Northway brand, replacing all existing forms, replacing all existing signage, transfer of real estate, and all necessary legal and computer systems issues related to the merger. These expenses are included in the table above in the appropriate expense categories.

Salaries and employee benefits decreased \$88,000, or 1%, from 2006 to 2007 and increased \$619,000, or 5%, from 2005 to 2006. The decrease in 2007 was due primarily to a decrease in salary expense partially offset by an increase in incentive compensation expense and Supplemental Employee Retirement Plan ("SERP") expense. The increase in 2006 was attributable primarily to increases in health and dental insurance, pension expense and the SERP expense as well as one-time separation expenses from the centralization of consumer lending. The decrease in 2005 was due primarily to a focus on staffing levels, an increase in SFAS No. 91 credits associated with deferred loan origination costs, and a decrease in the expense related to the SERP.

Office occupancy and equipment expense decreased \$249,000 in 2007 compared to 2006 due primarily to a decrease in equipment expense and maintenance expense. Office occupancy and equipment expense decreased \$92,000 in 2006 compared to 2005. Further, 2005 included one-time merger related expenses of \$141,000. The primary reason for the decrease of \$233,000, net of merger related expenses, was the decrease in occupancy depreciation expense, leases and property maintenance partially offset by an increase in equipment depreciation and maintenance expense. Office occupancy and equipment expenses increased \$268,000, net of merger related expenses of \$141,000, during 2005 compared to 2004. The increase in 2005 was due primarily to increases in building maintenance costs as well as one-time expenses associated with the write-down of leasehold improvements associated with the closure of two supermarket branch facilities.

During 2007, the amortization of core deposit intangibles expense decreased \$575,000 as amortization of the branches acquired in 2002 ended in December 2006. The amortization of core deposit intangibles increased \$97,000 from 2005 to 2006 due to the core deposit intangibles amortization associated with the two branches acquired in April 2006. There was no change from 2004 to 2005. Management reviews the carrying amount of intangible assets on an ongoing basis, taking into consideration any events and circumstances that might have diminished such amount. During 2007 and 2006, the Company reviewed the carrying amount of intangible assets and determined that no impairment write-down was required.

INCOME TAX EXPENSE

The Company recognized \$470,000, \$652,000 and \$842,000 in income tax expense for the years ended December 31, 2007, 2006 and 2005, respectively. The effective tax rate was 12.5% for 2007, 16.9% for 2006 and 24.0% for 2005. For additional information relating to income taxes, see NOTE 15 to the Consolidated Financial Statements.

ASSETS

Total assets increased \$37,896,000, or 6%, to \$688,773,000 at December 31, 2007 compared to \$650,877,000 at December 31, 2006. The following is a summary of significant balance sheet changes.

	(\$000 Omitted)			
	December 31			
	2007	2006	\$ Change	% Change
Total assets	\$688,773	\$650,877	\$ 37,896	5.8
Earning assets	639,570	603,318	36,252	6.0
Federal funds sold	-	8,755	(8,755)	(100.0)
Securities available-for-sale, at fair value	143,543	125,838	17,705	14.1
Loans, net of unamortized cost/unearned income	489,969	464,181	25,788	5.6
Deposits	478,462	484,677	(6,215)	(1.3)
Borrowings	160,485	110,117	50,368	45.7
Stockholders' equity	44,645	52,149	(7,504)	(14.4)

The increase in earning assets of \$36,252,000 was due primarily to an increase in loans and securities available-for-sale partially offset by a decrease in federal funds sold. The increase in earning assets was accompanied by an increase in borrowings which was partially offset by a decrease in deposits. The decrease in stockholders' equity was due primarily to the payment of \$9,029,000 to complete the reverse stock split transaction.

SECURITIES AVAILABLE-FOR-SALE

The Company's securities are classified into one of two categories based on management's intent to hold the securities: (i) "held-to-maturity" securities, or (ii) securities "available-for-sale." Securities designated to be held-to-maturity are reported at amortized cost. Securities classified as available-for-sale are required to be reported at fair value with unrealized gains and losses, net of taxes, excluded from earnings and shown separately as a component of stockholders' equity. At December 31, 2007 and 2006 the Company had no securities designated as held-to-maturity.

The following table summarizes the Company's securities portfolio at December 31, 2007 and 2006 showing amortized cost and fair value for each category:

	(\$000 Omitted)			
	December 31,			
	2007		2006	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities available-for-sale:				
U.S. Treasury and U.S. government agency securities	\$ 43,381	\$ 43,493	\$ 47,738	\$ 47,063
U.S. government agency mortgage-backed securities	47,289	47,399	40,905	40,615
Collateralized mortgage obligations	4	4	6	6
Marketable equity securities	6,225	5,910	3,364	3,617
Corporate bonds	6,921	6,747	3,517	3,522
Asset backed securities	4,975	4,795	4,974	4,968
State and political subdivision bonds and notes	35,623	35,195	25,833	26,047
Total securities available-for-sale	<u>\$144,418</u>	<u>\$143,543</u>	<u>\$126,337</u>	<u>\$125,838</u>

SECURITIES AVAILABLE-FOR-SALE (CONTINUED)

The fair value of total securities available-for-sale increased \$17,705,000 during 2007 to \$143,543,000 as a result of the growth in funding sources. The Company purchased U.S. government agency mortgage-backed securities, marketable equity securities and state and political subdivision bonds and notes.

The net unrealized loss on securities available-for-sale was \$875,000 at December 31, 2007 compared to a net unrealized loss of \$499,000 at December 31, 2006 due primarily to the continued level of low interest rates, which decreases the value of our security holdings. At December 31, 2007, the net unrealized loss on debt securities was \$560,000 and the net unrealized loss on marketable equity securities was \$315,000. At December 31, 2006, the net unrealized loss on debt securities was \$752,000 and the net unrealized gain on marketable equity securities was \$253,000.

At December 31, 2007, the Company's investment in equity securities totaled \$5,910,000. This amount is net of a market value adjustment of (\$315,000), of which the full amount was reflected as an increase in accumulated other comprehensive loss in stockholders' equity.

The Company has a general policy of purchasing investment grade securities and U.S. government securities to minimize credit risk. All securities, however, carry interest rate risk, which affect their market values such that as market yields increase, the value of the Company's debt securities decline and vice versa. Additionally, mortgage-backed securities carry prepayment risk whereby expected yields may not be achieved due to the inability to reinvest proceeds from prepayment at comparable yields. Moreover, such mortgage-backed securities may not benefit from price appreciation in periods of declining rates to the same extent as the remainder of the portfolio.

A portion of the securities portfolio is pledged to secure public deposits, securities sold under agreements to repurchase, FHLB advances and treasury, tax and loan accounts. Refer to NOTE 3 to the Consolidated Financial Statements for a further discussion of pledging of securities.

LOANS

Gross loans increased \$25,640,000, or 5.5%, to \$489,542,000 at December 31, 2007 compared to December 31, 2006. This increase was due primarily to an increase in commercial real estate, residential real estate, commercial and municipal loans, which was partially offset by a decrease in indirect installment loans of \$18,648,000. Gross loans increased \$2,087,000, or 0.5%, to \$463,902,000 at December 31, 2006 compared to December 31, 2005. This increase was due primarily to an increase in commercial real estate, residential real estate, commercial and installment loans, which was partially offset by a decrease in indirect installment loans of \$33,507,000. The following table presents the composition of the loan portfolio as of December 31, 2007 and 2006:

	(\$000 Omitted)			
	2007	Percent of Total	2006	Percent of Total
Real estate:				
Residential	\$177,931	36.3	\$167,172	36.0
Commercial	169,744	34.7	158,464	34.2
Construction	14,368	2.9	10,700	2.3
Commercial	39,924	8.2	33,569	7.2
Installment	41,867	8.6	42,489	9.2
Indirect installment	10,066	2.0	28,714	6.2
Other (including municipal)	35,642	7.3	22,794	4.9
	<u>\$489,542</u>	<u>100.0</u>	<u>\$463,902</u>	<u>100.0</u>

During 2007, the loan portfolio mix continued to shift as runoff from the indirect installment loan portfolio was redeployed into residential real estate, commercial real estate, commercial and municipal loans. Residential real estate loans increased modestly to account for 36.3% of the portfolio from 36.0% at December 31, 2006 due in part to the decision to continue the retention of high credit quality fixed-rate mortgages in the portfolio rather than sell in the secondary market. Commercial real estate and construction loans now comprise 34.7% and 2.9%, respectively of total loans compared to 34.2% and 2.3%, respectively at December 31, 2006 due to the continued efforts of our seasoned commercial lenders. Indirect installment loans, which originations were discontinued in August 2004, now comprise 2.0% of total loans compared to 6.2% at December 31, 2006. Other loans, which consist primarily of municipal loans, now comprise 7.3% to total loans compared to 4.9% at December 31, 2006.

LOANS (CONTINUED)

Commercial real estate loans consist of loans secured by income producing and owner-occupied commercial real estate and commercial loans consist of loans that are either unsecured or are secured by inventories, receivables or other corporate assets, and some are additionally secured by a guarantee of the federal Small Business Administration. Commercial real estate and commercial loans increased by \$17,635,000 in 2007 as compared to 2006. The Company continues to emphasize commercial real estate and commercial loans in order to enhance earnings and maintain the balance of its portfolio.

Residential real estate loans increased by \$10,759,000, a 6% increase from 2006, compared to an increase of \$8,443,000, or 5%, in 2006 compared to 2005. The Company originates both fixed-rate and adjustable-rate residential loans for its portfolio. Some fixed-rate residential loans are originated for sale to investors in the secondary market. The increase in residential real estate loans in 2007 resulted primarily from the Company's decision to retain a greater percentage of fixed-rate residential mortgage loans.

During 2007, other loan balances, consisting primarily of municipal loans, increased \$12,848,000, or 56%, from 2006. Indirect installment loans decreased by \$18,648,000, or 65%, in 2007 compared to a decrease of \$33,507,000, or 54%, in 2006.

NONPERFORMING ASSETS

Nonperforming assets were \$4,962,000, or 0.72%, of total assets, at December 31, 2007 compared to \$3,714,000, or 0.57% of total assets, at December 31, 2006, an increase of \$1,248,000, or 34%. Nonperforming assets are comprised primarily of nonaccrual loans, other chattels owned and real estate acquired by foreclosure or a similar conveyance of title. The accrual of interest on a loan is discontinued when there is reasonable doubt as to its collectability or whenever the payment of principal or interest is more than 90 days past due. However, there are loans within this nonaccrual classification that provide periodic payments, but which have a weakness with respect to the collateral securing the loan.

At December 31, 2007, nonaccrual loans totaled \$4,268,000, or 0.87% of total loans, compared to \$3,698,000, or 0.80% of total loans, in 2006. At December 31, 2007 the Company had \$666,000 in other real estate owned. At December 31, 2006, the company had no other real estate owned. Other chattels owned increased \$12,000 to \$28,000 at December 31, 2007 compared to \$16,000 at December 31, 2006.

ALLOWANCE FOR LOAN LOSSES

The Company maintains an allowance for loan losses to absorb losses inherent in the existing loan portfolio. When a loan, or portion thereof, is considered uncollectible, it is charged against the allowance. Recoveries of amounts previously charged-off are added to the allowance when collected. The adequacy of the allowance for loan losses is evaluated on a regular basis by management. Factors considered in evaluating the adequacy of the allowance include previous loss experience, current economic conditions and their effect on borrowers and the market area in general, and the performance of individual credits in relation to the contract terms. In addition various federal and state regulatory agencies, as an integral part of their examination process, periodically review the adequacy of the Company's allowance for loan losses.

The Company's allowance for loan losses increased \$659,000 from December 31, 2006 to \$6,240,000, or 1.27% of total loans, at December 31, 2007.

The following table sets forth the activity of the allowance for loan losses for the periods indicated:

	(\$000 Omitted)		
	Years Ended December 31,		
	2007	2006	2005
Beginning allowance	\$5,581	\$5,150	\$5,204
Provision for loan losses	810	465	75
Loans charged-off	(356)	(332)	(415)
Recoveries on loans previously charged-off	205	298	286
Net charge-offs	(151)	(34)	(129)
Ending allowance	<u>\$6,240</u>	<u>\$5,581</u>	<u>\$5,150</u>
Allowance as a percentage of loans outstanding	1.27%	1.20%	1.12%
Allowance as a percentage of nonperforming loans	146.20	150.92	170.93
Net charge-offs as a percentage of average loans	0.03	0.01	0.03

DEPOSITS

Total deposits at December 31, 2007 were \$478,462,000, a decrease of \$6,215,000, or 1%, compared to \$484,677,000 at December 31, 2006. The decrease in deposits was due to a decrease in demand deposit accounts, NOW and money market accounts partially offset by an increase in time deposits.

The following table sets forth the components of deposits for the periods indicated:

	(\$000 Omitted)	
	December 31,	
	2007	2006
Demand	\$ 67,777	\$ 72,054
Regular savings, NOW and money market	209,492	217,682
Time	201,193	194,941
Total deposits	\$478,462	\$484,677

At December 31, 2007, time deposits of \$100,000 or more are scheduled to mature as follows:

	(\$000 Omitted)
3 months or less	\$29,563
Over 3 to 6 months	7,818
Over 6 to 12 months	22,407
Over 12 months	1,395
	\$61,183

BORROWINGS

At December 31, 2007 short-term borrowings consisted of a FHLB advance totaling \$9,435,000 and securities sold under agreements to repurchase of \$54,430,000 compared to securities sold under agreements to repurchase of \$36,497,000 at December 31, 2006.

Long-term debt in 2007 consisted of FHLB term advances of \$76,000,000 as well as \$20,620,000 of junior subordinated debentures, compared to \$53,000,000 of FHLB term advances and \$20,620,000 of junior subordinated debentures in 2006. Thirteen long-term term FHLB advances are callable quarterly with their next call dates ranging from January 2008 through May 2010. The increase in FHLB advances is the result of new advances totaling \$41,000,000 partially offset by the maturity and redemption of \$18,000,000 in advances.

Junior subordinated debentures consist of two issues of floating rate trust preferred securities acquired during April and July 2007 in the amount of \$10,310,000 each, due in 2032. These junior subordinated debentures were offered for the purpose of refinancing junior subordinated debentures issued in 2002. The refinance was completed in order for the Company to reduce its interest expense relating to these securities. The original junior subordinated debentures were offered for the purpose of providing capital to the subsidiary bank to ensure adequate capital following branch acquisitions and for general corporate purposes. As of December 31, 2007, of the \$20,620,000 principal amount outstanding, \$15,354,000 qualified as Tier 1 capital and \$5,266,000 was allocated to Tier 2 capital.

See NOTES 9 and 10 to the Consolidated Financial Statements for additional information regarding the Company's borrowings.

The following table sets forth certain information concerning the Company's borrowings at the dates indicated:

	(\$000 Omitted)	
	December 31,	
	2007	2006
Short-term borrowings	\$ 63,865	\$ 36,497
Long-term debt	96,620	73,620
	\$160,485	\$110,117

At December 31, 2007, long-term debt is scheduled to mature as follows:

	(\$000 Omitted)
Less than one year	\$ 4,000
After one year through three years	12,000
After three year through five years	8,000
Over five years	72,620
	\$96,620

OFF-BALANCE SHEET ARRANGEMENTS

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to originate loans and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for loan commitments and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for balance sheet instruments.

Financial instruments with off-balance sheet credit risk at December 31, 2007 and 2006 totaled \$94,531,000 and \$92,220,000, respectively.

See NOTE 17 to the Consolidated Financial Statements for additional information regarding off-balance sheet arrangements.

CAPITAL

The Company's stockholders' equity serves to support growth and provide depositors and other creditors protection against loss. Equity capital represents the stockholders' investment in the Company. Management strives to maintain an optimal level of capital on which an attractive return to the stockholders will be realized over both the short-term and long-term, while serving depositors' and creditors' needs.

The Company must also observe the minimum requirements enforced by the federal banking regulators. There are three capital requirements that banks and bank holding companies must meet: Tier 1 capital, total capital (combination of Tier 1 capital and Tier 2 capital), and leverage (Tier 1 capital to average assets) ratios. Tier 1 capital consists of stockholders' equity, net of intangible assets as well as a portion of junior subordinated debentures. Tier 2 capital consists of a limited amount of allowance for loan losses and the portion of junior subordinated debentures not allocated to Tier 1 capital. Tier 1 capital, total capital and leverage ratios do not include any adjustments for unrealized gains and losses relating to securities available-for-sale except net unrealized losses relating to marketable equity securities. The minimum requirements for the leverage ratio, risk-based Tier 1 capital and risk-based total capital are 4%, 4% and 8%, respectively. As of December 31, 2007 and 2006, the Bank was "well capitalized" as defined under FDIC regulations.

The following table sets forth the Company's risk-based capital and leverage ratios:

	(\$000 Omitted)	
	<u>December 31,</u>	
	<u>2007</u>	<u>2006</u>
Risk-adjusted assets	\$434,753	\$416,735
Tier 1 capital (to average assets)	7.34%	9.31%
Tier 1 capital (to risk weighted assets)	11.36	14.02
Total capital (to risk weighted assets)	13.82	15.95

Total stockholders' equity includes a \$1,881,000 negative adjustment for accumulated other comprehensive loss, net of tax, at December 31, 2007 and a \$1,256,000 negative adjustment for accumulated other comprehensive loss, net of tax, at December 31, 2006. At December 31, 2007 this adjustment was comprised of a net unrealized loss on securities available-for-sale, net of taxes, of \$528,000, a \$1,729,000 unrealized loss on pension valuation, net of tax and a \$376,000 unrealized credit on prior pension service cost. At December 31, 2006 this adjustment was comprised of a net unrealized loss on securities available-for-sale, net of taxes, of \$301,000, a \$1,382,000 unrealized loss on pension valuation, net of tax and a \$427,000 unrealized credit on prior pension service cost.

The Company intends to continue to pay dividends on a quarterly basis subject to the financial condition and earnings of the Company, capital requirements, and other factors, including applicable governmental regulations. No dividends will be payable unless declared by the Board of Directors and then only to the extent funds are legally available for the payment of such dividends.

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31,	(\$000 Omitted, Except Per Share Data)		
	2007	2006	2005
Interest and dividend income			
Interest and fees on loans	\$32,535	\$30,405	\$27,415
Interest on debt securities available-for-sale			
Taxable	5,198	3,946	3,843
Tax-exempt	1,440	1,080	208
Dividends	360	337	323
Interest on federal funds sold	239	200	322
Interest on interest-bearing deposits	21	8	3
Total interest and dividend income	39,793	35,976	32,114
Interest expense			
Interest on deposits	11,576	8,365	4,092
Interest on short-term borrowings	1,750	811	257
Interest on long-term debt	4,662	4,589	4,579
Total interest expense	17,988	13,765	8,928
Net interest and dividend income	21,805	22,211	23,186
Provision for loan losses	810	465	75
Net interest and dividend income after provision for loan losses	20,995	21,746	23,111
Noninterest income			
Service charges and fees on deposit accounts	2,953	2,837	2,430
Gain (loss) on sales of securities available-for-sale, net	520	394	(551)
Debit card fees	662	557	456
Gain on sales of loans, net	185	137	260
Other	1,487	1,937	1,391
Total noninterest income	5,807	5,862	3,986
Noninterest expense			
Salaries and employee benefits	12,164	12,252	11,633
Office occupancy and equipment	3,941	4,190	4,282
Amortization of core deposit intangibles	476	1,051	954
Other	6,472	6,248	6,713
Total noninterest expense	23,053	23,741	23,582
Income before income tax expense	3,749	3,867	3,515
Income tax expense	470	652	842
Net income	\$ 3,279	\$ 3,215	\$ 2,673
Basic earnings per common share	\$ 1.16	\$ 1.08	\$ 0.89
Earnings per common share assuming dilution	\$ 1.15	\$ 1.07	\$ 0.88

See Notes to Consolidated Financial Statements

CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31,	(\$000 Omitted)	
	2007	2006
Assets		
Cash and cash equivalents		
Cash and due from banks and interest-bearing deposits	\$ 19,784	\$ 16,053
Federal funds sold	-	8,755
Total cash and cash equivalents	19,784	24,808
Securities available-for-sale, at fair value	143,543	125,838
Federal Home Loan Bank stock	4,779	3,782
Loans held-for-sale	403	263
Loans, net before allowance for loan losses	489,969	464,181
Less: allowance for loan losses	6,240	5,581
Net loans	483,729	458,600
Premises and equipment, net	12,753	13,749
Other real estate owned	666	-
Goodwill	10,577	10,577
Core deposit intangibles, net	1,702	2,178
Other assets	10,837	11,082
Total assets	\$688,773	\$650,877
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Demand	\$ 67,777	\$ 72,054
Regular savings, NOW and money market deposit accounts	209,492	217,682
Certificates of deposit (in denominations of \$100,000 or more)	61,183	55,676
Other time	140,010	139,265
Total deposits	478,462	484,677
Short-term borrowings	63,865	36,497
Long-term debt	96,620	73,620
Other liabilities	5,181	3,934
Total liabilities	644,128	598,728
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; 3,462,018 shares issued at December 31, 2007 and 1,731,969 at December 31, 2006, and 2,506,804 outstanding at December 31, 2007 and 1,491,174 outstanding at December 31, 2006	3,462	1,732
Surplus	311	2,064
Retained earnings	58,223	56,140
Treasury stock (955,214 shares at December 31, 2007 and 240,795 shares at December 31, 2006)	(15,470)	(6,531)
Accumulated other comprehensive loss, net of tax	(1,881)	(1,256)
Total stockholders' equity	44,645	52,149
Total liabilities and stockholders' equity	\$688,773	\$650,877
See Notes to Consolidated Financial Statements		

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	(\$000 Omitted)					
	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss) ¹	Total Stockholders' Equity
Balance at December 31, 2004	\$1,732	\$2,075	\$52,484	\$ (6,090)	\$ (691)	\$49,510
Net income – 2005	-	-	2,673	-	-	2,673
Net change in unrealized loss on securities available-for-sale, net of tax	-	-	-	-	(1,085)	(1,085)
Net change in unfunded pension accumulated benefit obligation, net of tax	-	-	-	-	672	672
Exercise of stock options, net of tax benefit	-	(11)	-	122	-	111
Treasury stock purchased	-	-	-	(563)	-	(563)
Cash dividends declared and paid (\$0.35 per share)	-	-	(1,068)	-	-	(1,068)
Balance at December 31, 2005	1,732	2,064	54,089	(6,531)	(1,104)	50,250
Net income – 2006	-	-	3,215	-	-	3,215
Net change in unrealized loss on securities available-for-sale, net of tax	-	-	-	-	803	803
Net change in unrecognized loss on pension valuation, net of tax	-	-	-	-	(1,382)	(1,382)
Net change in unrecognized pension prior service credit, net of tax	-	-	-	-	427	427
Cash dividends declared and paid (\$0.39 per share)	-	-	(1,164)	-	-	(1,164)
Balance at December 31, 2006	1,732	2,064	56,140	(6,531)	(1,256)	52,149
Net income – 2007	-	-	3,279	-	-	3,279
Transfer to reflect impact of reverse/forward split transaction	1,730	(1,730)	-	-	-	-
Net change in unrealized loss on securities available-for-sale, net of tax	-	-	-	-	(227)	(227)
Net change in unrecognized loss on pension valuation, net of tax	-	-	-	-	(347)	(347)
Net change in unrecognized pension prior service credit, net of tax	-	-	-	-	(51)	(51)
Exercise of stock options, net of tax benefit	-	(23)	-	90	-	67
Treasury stock purchased	-	-	-	(9,029)	-	(9,029)
Cash dividends declared and paid (\$0.42 per share)	-	-	(1,196)	-	-	(1,196)
Balance at December 31, 2007	\$3,462	\$ 311	\$58,223	\$(15,470)	\$(1,881)	\$44,645

See Notes to Consolidated Financial Statements

¹ Accumulated other comprehensive loss as of December 31, 2007 consists of net unrealized holding losses on available-for-sale securities of \$528, net of taxes, net unrealized loss on pension valuation of \$1,729, net of taxes, and a net credit for prior service on pension of \$376, net of tax benefit. Accumulated other comprehensive loss as of December 31, 2006 consists of net unrealized holding losses on available-for-sale securities of \$301, net of taxes, net unrealized loss on pension valuation of \$1,382, net of taxes, and a net credit for prior service on pension of \$427, net of tax benefit. Accumulated other comprehensive loss as of December 31, 2005 consists of net unrealized holding losses on available-for-sale securities of \$1,104, net of taxes.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED DECEMBER 31,	(\$000 Omitted)		
	2007	2006	2005
Net income	\$ 3,279	\$ 3,215	\$ 2,673
Other comprehensive (loss) income			
Net unrealized holding gains (losses) on securities available-for-sale	144	1,723	(2,347)
Reclassification adjustment for realized (gains) losses in net income	(520)	(394)	551
Net unrealized (losses) gains on securities	(376)	1,329	(1,796)
Pension valuation adjustment	(574)	-	-
Pension prior service credit adjustment	(85)	-	-
Minimum pension liability adjustment	-	-	1,018
Other comprehensive (loss) income	(1,035)	1,329	(778)
Income tax (benefit) expense	(410)	526	(365)
Other comprehensive (loss) income, net of tax	(625)	803	(413)
Comprehensive income	\$ 2,654	\$ 4,018	\$ 2,260

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31,	(\$'000 Omitted)		
	2007	2006	2005
Cash flows from operating activities			
Net income	\$ 3,279	\$ 3,215	\$ 2,673
Adjustments to reconcile net income to net cash provided by operating activities			
Provision for loan losses	810	465	75
Depreciation and amortization	1,925	2,426	2,367
Deferred income tax benefit	(245)	(358)	(4)
(Gain) loss on sales of securities available-for-sale, net	(520)	(394)	551
Loss on sale, disposal and write-down of premises and equipment	2	52	57
(Accretion) amortization of premiums and accretion of discounts on securities, net	(54)	21	54
Change in unearned income/unamortized cost, net	(148)	(195)	(190)
Accretion of discount on loans acquired	(150)	(149)	(140)
Losses (gains) on sales of other real estate owned and other personal property, net	2	(68)	-
Net (increase) decrease in loans held-for-sale	(140)	190	(142)
Net change in other assets and other liabilities	1,569	212	(999)
Net cash provided by operating activities	6,330	5,417	4,302
Cash flows from investing activities			
Proceeds from sales of securities available-for-sale	19,835	11,459	16,002
Proceeds from maturities of securities available-for-sale	14,772	11,160	8,756
Purchases of securities available-for-sale	(52,114)	(42,038)	(31,111)
Purchases of Federal Home Loan Bank stock	(1,120)	-	(26)
Proceeds from sales of Federal Reserve Bank stock	-	-	365
Redemption of Federal Home Loan Bank stock	123	1,759	-
Capital distribution on investment in limited partnership	-	210	-
Capital investment on investment in limited partnership	(70)	-	-
Investment in affiliate	(620)	-	-
Redemption of investment in affiliate	620	-	-
Loan originations and principal collections, net	(26,728)	5,688	12,186
Recoveries of previously charged-off loans	205	298	286
Loans acquired in branch transactions	-	(8,192)	-
Proceeds from sales of and payments received on other real estate owned	-	264	25
Proceeds from sales of and payments received on other personal property	203	330	652
Premises and equipment acquired in branch transactions	-	(507)	-
Additions to premises and equipment, net of disposals	(455)	(2,934)	496
Net cash (used by) provided by investing activities	(45,349)	(22,503)	7,631
Cash flows from financing activities			
Net decrease in deposits	(6,215)	(9,217)	(10,903)
Deposits assumed in branch transactions, net of assumption premiums	-	27,779	-
Net increase (decrease) in short-term borrowings	27,368	27,134	(1,905)
Advances from Federal Home Loan Bank (FHLB)	41,000	24,000	13,000
Repayment of FHLB advances	(18,000)	(56,000)	(6,000)
Redemption of junior subordinated debentures	(20,620)	-	-
Issuance of junior subordinated debentures	20,620	-	-
Exercise of stock options	67	-	99
Purchases of treasury stock	(9,029)	-	(563)
Cash dividends paid	(1,196)	(1,164)	(1,068)
Net cash provided by (used in) financing activities	33,995	12,532	(7,340)
Net (decrease) increase in cash and cash equivalents	(5,024)	(4,554)	4,593
Cash and cash equivalents at beginning of year	24,808	29,362	24,769
Cash and cash equivalents at end of year	\$ 19,784	\$ 24,808	\$ 29,362

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

<u>FOR THE YEAR ENDED DECEMBER 31,</u>	(\$000 Omitted)		
	2007	2006	2005
Supplemental disclosures of cash flows			
Interest paid	\$ 18,170	\$ 13,728	\$ 8,662
Income taxes paid	320	860	1,106
Loans transferred to other real estate owned	666	-	231
Loans transferred to other personal property	216	235	682
Amount due from customer for pending municipal security maturity	-	-	3,000

See Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Northway Financial, Inc. (“Northway”) is a bank holding company formed in 1997 under the laws of New Hampshire and is registered under the Bank Holding Company Act of 1956. Northway’s only business activity has been to own all of the shares of, and provide management, capital and operational support to Northway Bank (“Bank”), its subsidiary, and its Delaware statutory business trusts Northway Capital Trust III and Northway Capital Trust IV, affiliates of Northway. Northway and its subsidiary (the “Company”) are headquartered in Berlin, New Hampshire. The Bank is engaged principally in the business of attracting deposits from the general public and investing those deposits in securities, commercial loans, real estate loans, and consumer loans.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All significant intercompany accounts and transactions have been eliminated in the consolidation.

Northway Capital Trust III and Northway Capital Trust IV, affiliates of the Company, were formed to sell capital securities to the public through a third party trust pool. In accordance with FASB Interpretation No. 46, “Consolidation of Variable Interest Entities” (“FIN 46”), these affiliates have not been included in the consolidated financial statements.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry.

Earnings per share and dividends per share have been adjusted to reflect the impact of the reverse and forward stock split transaction completed September 11, 2007.

In preparing the financial statements, management is required to make estimates and judgments that affect the reported amounts of assets and liabilities as of the dates of the consolidated balance sheets, and income and expense for the periods. Actual results could differ from those estimates. Material estimates that are particularly susceptible to change in the near-term relate to the determination of the allowance for loan losses.

Reclassifications

Certain amounts in the prior years’ financial statements have been reclassified to conform with the current year’s presentation.

Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits, and federal funds sold.

Securities

Debt securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost; if debt and equity securities are bought and held principally for the purpose of selling in the near term they would be classified as trading and reported at fair value, with unrealized gains and losses included in earnings; and debt and equity securities not classified as either held-to-maturity or trading are classified as available-for-sale and reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders’ equity, net of estimated income taxes. At this time, the Company has not established a trading account.

Premiums and discounts are amortized and accreted primarily on the level yield method over the contractual life of the securities adjusted for expected prepayments.

If a decline in the fair value below the adjusted cost basis of an investment is judged to be other than temporary, the cost basis of the investment is written down to fair value as the new cost basis and the amount of the write-down is included in noninterest expense.

Gains and losses on sales of securities available-for-sale are recognized at the time of the sale on a specific identification basis.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans Held-for-Sale

Loans held-for-sale are generally identified as such at origination and are stated at the lower of aggregate cost or market. Market value is based on outstanding investor commitments. When loans are sold, a gain or loss is recognized to the extent that the sale proceeds exceed or are less than the carrying value of the loans. Gains and losses are determined using the specific identification method. All loans sold are without recourse to the Company.

Loans

Loans are carried at the principal amounts outstanding, net of any unearned income or unamortized cost, premiums on originated loans and discounts on acquired loans. Unearned income and unamortized cost includes loan origination fees, net of direct loan origination costs. This income or expense is deferred and recognized as adjustments to loan income over the contractual life of the related notes using a method the result of which approximates that of the interest method.

Loans are placed on nonaccrual when payment of principal or interest is considered to be in doubt or is past due 90 days or more. The Company may choose to place a loan on nonaccrual status due to payment delinquency or uncertain collectability, while not classifying the loan as impaired, if (i) it is probable that the Company will collect all amounts due in accordance with the contractual terms of the loan or (ii) the loan is not a commercial, commercial real estate or an individually significant mortgage or consumer loan. Previously accrued income on nonaccrual loans that has not been collected is reversed from current income, and subsequent cash receipts are recorded as income if principal on the loans is deemed collectible. Loans are returned to accrual status when collection of all contractual principal and interest is reasonably assured and there has been sustained repayment performance.

The Company's loans are primarily secured by real estate in New Hampshire. In addition, other real estate owned is located in this market. Accordingly, the ultimate collectability of a substantial portion of the Company's loan portfolio and the recovery of other real estate owned are susceptible to changing conditions in this market.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level considered adequate by management on the basis of many factors including the risk characteristics of the portfolio, trends in loan delinquencies and an assessment of existing economic conditions. Additions to the allowance are charged to earnings; realized losses, net of recoveries, are charged directly to the allowance.

While management uses available information in establishing the allowance for loan losses, future additions to the allowance may be necessary if economic conditions differ substantially from the estimates used in making the evaluations. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on judgments different from those of management.

Commercial, commercial real estate and individually significant mortgage and consumer loans are considered impaired, and are placed on nonaccrual, when it is probable that the Company will not be able to collect all amounts due according to the contractual terms of the loan agreement. Mortgage and consumer loans, which are not individually significant, are measured for impairment collectively. Loans that experience insignificant payment delays and insignificant shortfalls in payment amounts generally are not classified as impaired. The amount of impairment for all impaired loans is determined by the difference between the present value of the expected cash flows related to the loan, using the original contractual interest rate, and its recorded value, or, as a practical expedient in the case of collateralized loans, the difference between the fair value of the collateral and the recorded amount of the loan.

When foreclosure is probable, impairment is measured based on the fair value of the collateral less estimated costs to sell.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Servicing Assets

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the respective assets. Estimated lives are thirty-nine years for buildings, ten to fifteen years for building improvements and three to seven years for furniture and equipment.

Amortization of leasehold improvements is accumulated on a straight-line basis over the lesser of the term of the respective lease or the asset's useful life, not to exceed ten years.

Other Real Estate Owned

Other real estate owned is comprised of properties acquired either through foreclosure proceedings or acceptance of a deed in lieu of foreclosure, and for which the Company has taken physical possession. The Company classifies loans as repossessed or foreclosed if the Company receives physical possession of the debtor's assets, regardless of whether or not foreclosure proceedings take place.

Assets acquired through foreclosure or a similar conveyance of title are initially recorded at the lower of the carrying value of the loan or the fair value, less estimated costs to sell, of the property constructively or actually received. Gains and losses upon disposition are reflected in the statement of income as realized.

Advertising

The Company directly expenses costs associated with advertising as they are incurred.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and the respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Stock-Based Compensation

At December 31, 2007, the Company has a stock-based employee compensation plan which is described more fully in NOTE 16. Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004) "Share-Based Payment" ("SFAS 123R"). This Statement revised SFAS No. 123, "Accounting for Stock Based Compensation" and superceded Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS 123R requires that the cost resulting from all share-based payment transactions be recognized in the financial statements and establishes fair value as the measurement objective in accounting for share-based payment arrangements. No compensation expense was recognized for the twelve months ended December 31, 2007 and 2006 related to SFAS 123R. Prior to January 1, 2006, the Company accounted for the plan under the recognition and measurement principles of APB Opinion No. 25. No stock-based employee compensation cost had been recognized during periods prior to January 1, 2006 for its fixed stock option plans.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123R to stock-based employee compensation during the year ended December 31, 2005.

(\$000 Omitted, Except Per Share Data)

		2005
Net income	As reported	\$2,673
Deduct: Total stock-based employee compensation expense determined under fair value based methods awards, net of related tax effects		-
	Pro forma	<u>\$2,673</u>
Earnings per common share	As reported	\$ 0.89
	Pro forma	0.89
Earnings per common share (assuming dilution)	As reported	\$ 0.88
	Pro forma	0.88

Earnings Per Share

Basic earnings per share ("EPS") excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS, if applicable, reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Earnings per common share have been computed based on the following:

	(\$000 Omitted, Shares Reported in Thousands)		
	Years Ended December 31,		
	2007	2006	2005
Net income	\$3,279	\$3,215	\$2,673
Less: Preferred stock dividends	-	-	-
Net income applicable to common stock	<u>\$3,279</u>	<u>\$3,215</u>	<u>\$2,673</u>
Average number of common shares outstanding	2,839.2	2,982.3	3,004.2
Effect of dilutive options	15.6	18.3	18.0
Average number of common shares outstanding used to calculate diluted earnings per common share	<u>2,854.8</u>	<u>3,000.6</u>	<u>3,022.2</u>

Recent Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 155, "Accounting for Certain Hybrid Instruments" (SFAS 155), which permits, but does not require, fair value accounting for any hybrid financial instrument that contains an embedded derivative that would otherwise require bifurcation in accordance with SFAS 133. The statement also subjects beneficial interests issued by securitization vehicles to the requirements of SFAS 133. The statement is effective as of January 1, 2007. The adoption of SFAS 155 did not have a material impact on the Company's financial condition, results of operations or cash flow.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140" (SFAS 156). SFAS 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in specific situations. Additionally, the servicing asset or servicing liability shall be initially measured at fair value; however, an entity may elect the "amortization method" or "fair value method" for subsequent balance sheet reporting periods. SFAS 156 is effective as of an entity's first fiscal year beginning after September 15, 2006. Early adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. The adoption of this statement did not have a material impact on the Company's financial condition, results of operations or cash flows.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In June 2006 the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement 109" ("FIN 48"). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken, or expected to be taken, in a tax return and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 did not have a material impact on the Company's financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles (GAAP) and enhances disclosures about fair value measurements. SFAS 157 retains the exchange price notion and clarifies that the exchange price is the price that would be received for an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. SFAS 157 is effective for the Company's consolidated financial statements for the year beginning on January 1, 2008, with earlier adoption permitted. The Company does not expect the adoption of this statement to have a material impact on its financial condition, results of operations or cash flows.

In September 2006, the FASB ratified the consensus reached by the Emerging Issues Task Force ("EITF") on Issue No. 06-4 "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements," (EITF 06-4). EITF 06-4 requires companies with an endorsement split-dollar life insurance arrangement to recognize a liability for future postretirement benefits. The effective date is for fiscal years beginning after December 15, 2007, with earlier application permitted. Companies should recognize the effects of applying this issue through either (a) a change in accounting principle through a cumulative effect adjustment to retained earnings or (b) a change in accounting principle through retrospective application to all periods. The Company's adoption of this issue is not expected to have a material impact on its financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115" (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The new standard is effective at the beginning of the Company's fiscal year beginning January 1, 2008, and early application may be elected in certain circumstances. The Company's adoption of this statement is not expected to have a material impact on its financial position, results of operations or cash flows.

NOTE 2 CASH AND DUE FROM BANKS

At December 31, 2007 and 2006, there was \$699,000 and \$64,000, respectively, which was subject to withdrawals and usage restrictions to satisfy the reserve requirements of the Federal Reserve Bank.

NOTE 3 SECURITIES AVAILABLE-FOR-SALE

The amortized cost, gross unrealized gains, gross unrealized losses, and fair value of securities at December 31, 2007 and 2006 follows:

	(\$000 Omitted)			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>December 31, 2007</u>				
U.S. Treasury and other U.S. government agency securities	\$ 43,381	\$ 281	\$ 169	\$ 43,493
Marketable equity securities	6,225	180	495	5,910
U. S. government agency mortgage-backed securities	47,289	526	416	47,399
Collateralized mortgage obligations	4	-	-	4
Corporate bonds	6,921	30	204	6,747
Asset backed securities	4,975	-	180	4,795
State and political subdivision bonds	35,623	72	500	35,195
	<u>\$ 144,418</u>	<u>\$ 1,089</u>	<u>\$ 1,964</u>	<u>\$ 143,543</u>

<u>December 31, 2006</u>				
U.S. Treasury and other U.S. government agency securities	\$ 47,738	\$ 50	\$ 725	\$ 47,063
Marketable equity securities	3,364	311	58	3,617
U.S. government agency mortgage-backed securities	40,905	310	600	40,615
Collateralized mortgage obligations	6	-	-	6
Corporate bonds	3,517	10	5	3,522
Asset backed securities	4,974	-	6	4,968
State and political subdivision bonds	25,833	221	7	26,047
	<u>\$ 126,337</u>	<u>\$ 902</u>	<u>\$ 1,401</u>	<u>\$ 125,838</u>

The contractual maturity distribution of investments in debt obligations at December 31, 2007 follows:

	(\$000 Omitted)				
	Within One Year	Over One Through Five Years	After Five Through Ten Years	Over Ten Years	Total Amortized Cost
U.S. Treasury and other U.S. government agency securities	\$ -	\$ 21,480	\$ 15,971	\$ 5,930	\$ 43,381
U.S. government agency mortgage-backed securities	-	9	-	47,280	47,289
Collateralized mortgage obligations	-	-	4	-	4
Corporate bonds	-	2,991	3,930	-	6,921
Asset backed securities	-	-	-	4,975	4,975
State and political subdivision bonds	-	335	-	35,288	35,623
Total amortized cost	<u>\$ -</u>	<u>\$ 24,815</u>	<u>\$ 19,905</u>	<u>\$ 93,473</u>	<u>\$ 138,193</u>
Fair value	<u>\$ -</u>	<u>\$ 24,688</u>	<u>\$ 19,846</u>	<u>\$ 93,099</u>	<u>\$ 137,633</u>

Actual maturities of state and political subdivision bonds, U.S. government agency mortgage-backed securities and collateralized mortgage obligations will differ from the maturities presented because borrowers have the right to prepay obligations with or without prepayment penalties.

NOTE 3 SECURITIES AVAILABLE-FOR-SALE (CONTINUED)

For the years ended December 31, 2007, 2006 and 2005, proceeds from the sales of securities available-for-sale amounted to \$19,835,000, \$11,459,000 and \$16,002,000, respectively. An analysis of gross realized gains and losses on sales of securities available-for-sale during the years ended December 31, follows:

	(\$000 Omitted)					
	2007		2006		2005	
	Realized Gains	Realized Losses	Realized Gains	Realized Losses	Realized Gains	Realized Losses
Marketable equity securities	\$ 744	\$ 151	\$ 480	\$ 40	\$ 221	\$ 104
U.S. Treasury and other U.S. government agency securities	1	74	-	49	-	200
U.S. government agency mortgage-backed securities	-	-	-	-	12	11
Corporate bonds	-	-	3	-	30	499
State and political subdivision bonds	-	-	-	-	-	-
	<u>\$ 745</u>	<u>\$ 225</u>	<u>\$ 483</u>	<u>\$ 89</u>	<u>\$ 263</u>	<u>\$ 814</u>

The tax provision (benefit) applicable to these net realized gains/(losses) amounted to \$206,000, \$156,000 and (\$218,000) for 2007, 2006, and 2005, respectively.

Securities with a carrying amount totaling \$96,222,000 and \$91,155,000 were pledged to secure public deposits, securities sold under agreements to repurchase, FHLB advances and treasury, tax and loan accounts at December 31, 2007 and 2006, respectively

The aggregate fair value and unrealized losses of securities that have been in a continuous unrealized loss position for less than twelve months and for twelve months or more, and are not other than temporarily impaired, are as follows as of December 31:

	December 31, 2007					
	(\$000 Omitted)					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and other U.S. government agency securities	\$ 6,979	\$ 21	\$ 16,333	\$ 148	\$ 23,312	\$ 169
Marketable equity securities	3,927	495	-	-	3,927	495
U.S. government agency mortgage-backed securities	1,848	7	18,229	409	20,077	416
Corporate bonds	4,711	204	-	-	4,711	204
Asset backed securities	-	-	4,795	180	4,795	180
State and political subdivision bonds	23,056	492	461	8	23,517	500
Total temporarily impaired securities	<u>\$ 40,521</u>	<u>\$ 1,219</u>	<u>\$ 39,818</u>	<u>\$ 745</u>	<u>\$ 80,339</u>	<u>\$ 1,964</u>

	December 31, 2006					
	(\$000 Omitted)					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and other U.S. government agency securities	\$ -	\$ -	\$ 38,030	\$ 725	\$ 38,030	\$ 725
Marketable equity securities	525	58	-	-	525	58
Mortgage-backed securities	-	-	25,048	600	25,048	600
Corporate bonds	-	-	1,503	5	1,503	5
Asset backed securities	4,968	6	-	-	4,968	6
State and political subdivision bonds and notes	3,497	7	-	-	3,497	7
Total temporarily impaired securities	<u>\$ 8,990</u>	<u>\$ 71</u>	<u>\$ 64,581</u>	<u>\$ 1,330</u>	<u>\$ 73,571</u>	<u>\$ 1,401</u>

NOTE 3 SECURITIES AVAILABLE-FOR-SALE (CONTINUED)

At December 31, 2007, securities with a total fair value of \$80,339,000 were in a loss position. These securities included seven U.S. government agency securities with a fair value of \$23,312,000 and an unrealized loss of \$169,000. These securities had an unrealized loss due to the current interest rate environment. As these securities are guaranteed or issued by U.S. government agencies or government sponsored enterprises such as FHLB, FHLMC or FNMA there is little or no credit risk associated with them. These securities are not other-than-temporarily impaired as the Company has the ability and the intent to hold these securities until recovery to cost basis.

Mortgage-backed securities with a fair value of \$20,077,000 had an unrealized loss of \$416,000 at December 31, 2007. As with the U.S. government agency securities, these securities have an unrealized loss due to the current interest rate environment. As all of these mortgage-backed securities are guaranteed or issued by U.S. government agencies or government sponsored enterprises such as FHLMC, GNMA or FNMA there is little or no credit risk associated with them. These securities have not been classified as other-than-temporarily impaired as the Company has the ability and intent to hold these securities until recovery to cost basis.

Twenty-one marketable equity securities with a fair value of \$3,927,000 had an unrealized loss of \$495,000 at December 31, 2007. Marketable equity securities are subject to internal testing on a quarterly basis to determine impairment. Testing includes review of industry analyst reports, credit ratings, sector analysis and earnings projections. Based upon the December 31, 2007 review, these securities were not determined to be other-than-temporarily impaired.

Three corporate bond securities with a fair value of \$4,711,000 had an unrealized loss of \$204,000 at December 31, 2007. Corporate bond securities are subject to internal testing on a quarterly basis to determine other-than-temporary impairment. Based upon the December 31, 2007 review, these securities were not determined to be other-than-temporarily impaired.

One asset-backed security with a fair value of \$4,795,000 had an unrealized loss of \$180,000 at December 31, 2007. Asset-backed securities are subject to internal testing on a quarterly basis to determine other-than-temporary impairment. Based upon the December 31, 2007 review, this security was not determined to be other-than-temporarily impaired.

Forty-four state and political subdivision securities with a fair value of \$23,517,000 had an unrealized loss of \$500,000 at December 31, 2007. As all of these state and political subdivision securities are guaranteed by municipalities there is minimal credit risk associated with them. These securities have not been classified as other-than-temporarily impaired as the Company has the ability to hold these securities until recovery to cost basis.

NOTE 4 LOANS

Loan balances were comprised of the following:

<u>December 31,</u>	<u>(\$000 Omitted)</u>	
	<u>2007</u>	<u>2006</u>
Real estate		
Residential	\$177,931	\$167,172
Commercial	169,744	158,464
Construction	14,368	10,700
Commercial	39,924	33,569
Installment	41,867	42,489
Indirect installment	10,066	28,714
Other	35,642	22,794
Total loans	<u>489,542</u>	<u>463,902</u>
Unamortized cost	427	279
Allowance for loan losses	(6,240)	(5,581)
Total unamortized cost and allowance for loan losses	<u>(5,813)</u>	<u>(5,302)</u>
Net loans	<u>\$483,729</u>	<u>\$458,600</u>

Total loans above are net of unearned discount on loans acquired in the amount of \$31,000 and \$181,000 at December 31, 2007 and 2006, respectively. In addition, total loans above are net of unamortized premium on indirect installment loans originated in the amount of \$79,000 and \$234,000 at December 31, 2007 and 2006, respectively.

NOTE 4 LOANS (CONTINUED)

Loans are made in the ordinary course of business to directors, executive officers, and their immediate families and to organizations in which such persons have more than a 10% ownership interest. These loans are made on substantially the same terms, including interest rate and collateral, as those prevailing at the same time for comparable transactions with unrelated persons and did not involve more than the normal risk of collectibility or present other unfavorable features. The total of such loans amounted to \$864,000 as of December 31, 2007. During 2007, principal payments were \$220,000 and principal advances amounted to \$513,000.

The Company's lending activities are conducted principally in New Hampshire. Although the loan portfolio is diversified, a portion of its debtors' ability to repay is dependent upon the economic conditions prevailing in New Hampshire. The Company maintains significant credit relationships with borrowers in the hotel and motel industry. The aggregate loan balances to these industries totaled \$87,648,000 at December 31, 2007 and \$71,874,000 at December 31, 2006.

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of these loans total \$34,858,000 and \$36,225,000 at December 31, 2007 and 2006, respectively. The Company sold \$8,607,000 of mortgage loans in 2007 and \$5,965,000 of mortgage loans in 2006.

The Company capitalized \$94,000 and \$77,000 of servicing rights and amortized \$106,000 and \$115,000 of total servicing rights in 2007 and 2006, respectively. The impairment valuation allowance of mortgage servicing rights remained unchanged in both 2007 and 2006. Impairment of mortgage servicing rights is assessed based on the fair value of those rights. Fair values are estimated using discounted cash flows based on a current market interest rate. The amount of the impairment recognized is the amount by which the capitalized mortgage servicing rights exceed their fair value. At December 31, 2007 and 2006, respectively, the carrying amount of servicing rights was \$186,000 and \$198,000, and is included in other assets. At December 31, 2007 and 2006, respectively, the fair value of servicing rights was \$371,000 and \$417,000.

At December 31, 2007 and 2006, nonperforming loans totaled \$4,268,000 and \$3,698,000, respectively, and represent 0.87% and 0.80% of total loans, respectively. No nonperforming loans were past due 90 days or more and still accruing interest at December 31, 2007 and 2006.

The recorded investment in loans that are considered to be impaired under SFAS No. 114 was \$3,678,000 and \$2,666,000 at December 31, 2007 and 2006, respectively, for which the related allowance for loan losses is \$255,000 and \$0 at December 31, 2007 and 2006, respectively. All of the Company's impaired loans are collateralized and therefore all impaired loans are measured by the difference between the fair value of the collateral and the recorded amount of the loan. The average recorded investment in impaired loans during the twelve months ended December 31, 2007 and 2006 was approximately \$4,090,000 and \$2,787,000, respectively. For the twelve months ended December 31, 2007 and 2006 the Company recognized interest income on impaired loans of \$136,000 and \$231,000, respectively, which was recognized using the cash-basis method of income recognition. Further, for the twelve months ended December 31, 2007 and 2006 the Company applied \$161,000 and \$0, respectively, of interest payments received on impaired loans with a determined collateral shortfall as a reduction in the Bank's carrying balance.

NOTE 5 ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses for the years ended December 31, follows:

	(\$000 Omitted)		
	2007	2006	2005
Balance at beginning of year	\$5,581	\$5,150	\$5,204
Provision for loan losses	810	465	75
Recoveries on loans previously charged-off	205	298	286
Loans charged-off	(356)	(332)	(415)
Balance at end of year	<u>\$6,240</u>	<u>\$5,581</u>	<u>\$5,150</u>

NOTE 6 PREMISES AND EQUIPMENT

A summary of premises and equipment follows:

	(\$000 Omitted)	
	December 31,	
	2007	2006
Land	\$ 2,623	\$ 2,610
Buildings	11,351	11,033
Leasehold improvements	601	601
Equipment	9,321	10,206
Premises and equipment in process	6	381
	23,902	24,831
Less accumulated depreciation and amortization	11,149	11,082
	<u>\$12,753</u>	<u>\$13,749</u>

Depreciation expense for the years ended December 31, 2007, 2006 and 2005 amounted to \$1,449,000, \$1,375,000 and \$1,413,000, respectively.

The Company leases four of its branch locations and an automobile under non-cancellable operating leases. In addition, the Company leases one branch location under a cancellable operating lease and one storage facility as a tenant-at-will. Minimum lease payments in future periods under non-cancelable operating leases at December 31, 2007 are as follows:

	(\$000 Omitted)
2008	\$ 246
2009	169
2010	169
2011	175
2012	172
Thereafter	352
	<u>\$1,283</u>

The terms of two of the leases provide that the Company can, at the end of the current ten-year term, renew the lease under two five-year options. All branch leases contain a provision that the Company shall pay its pro-rata share of operating costs, which may include real estate taxes. The terms of one of the leases provides that the Company can, with no less than one year's written notice of intention to do so, cancel or opt out of the lease. One branch lease contains a purchase option at the end of the lease term. The automobile lease contains a purchase option at the end of the lease term.

Rent expense for the years ended December 31, 2007, 2006, and 2005 amounted to \$281,000, \$263,000 and \$359,000, respectively.

NOTE 7 OTHER REAL ESTATE OWNED

Other real estate owned consists of real estate acquired by foreclosure or a similar conveyance of title. At December 31, 2007, other real estate owned was comprised of commercial real estate of \$666,000. At December 31, 2006, there was no other real estate owned.

Sales of other real estate owned by the Company resulted in gains of \$68,000 for the year ended December 31, 2006.

There were no write-downs on other real estate owned for the years ended December 31, 2007, 2006, and 2005.

NOTE 8 DEPOSITS

The aggregate amount of maturities for time deposits as of December 31, 2007 for each of the following five years, and thereafter, is as follows:

	(\$000 Omitted)
2008	\$194,868
2009	4,969
2010	1,014
2011	258
2012	81
Thereafter	3
	<u>\$201,193</u>

Deposits from related parties held by the Bank at December 31, 2007 and 2006 amounted to \$3,964,000 and \$5,234,000, respectively.

NOTE 9 SHORT-TERM BORROWINGS

Short-term borrowings at December 31, 2007 consisted of a FHLB overnight advance of \$9,435,000 and securities sold under agreements to repurchase of \$54,430,000. Short-term borrowings at December 31, 2006 consisted of securities sold under agreements to repurchase of \$36,497,000. The FHLB overnight advance was at a rate of 3.56%. Securities sold under agreements to repurchase were at an average rate of 2.75% at December 31, 2007. The securities sold under agreements to repurchase as of December 31, 2007 and 2006 are securities sold on a short term basis by the Company that have been accounted for not as sales but as borrowings. The underlying securities associated with securities sold under agreements to repurchase are under the control of the Company. The purchasers have agreed to sell to the Company substantially identical securities at the maturity of the agreements.

NOTE 10 LONG-TERM DEBT

Long-term debt at December 31, 2007 and 2006 consisted of FHLB advances of \$76,000,000 and \$53,000,000, respectively, as well as \$20,620,000 of junior subordinated debentures, for each year.

As of December 31, 2007, contractual principal payments due under long-term debt, which consists of FHLB advances and junior subordinated debentures, are as follows:

	(\$000 Omitted)
2008	\$ 4,000
2009	5,000
2010	7,000
2011	-
2012	8,000
2013 and years thereafter	72,620
	<u>\$96,620</u>

NOTE 10 LONG-TERM DEBT (CONTINUED)

The FHLB long-term debt consisted of twenty separate advances. Thirteen of these advances, totaling \$65,000,000, are callable with the following rates and terms:

Amount	Rate	(\$000 Omitted) Maturity Date	Next Call Date
\$ 3,000	4.29 %	07/20/17	01/22/08 and quarterly thereafter
2,000	3.99	08/16/17	02/19/08 and quarterly thereafter
10,000	4.09	03/16/17	03/17/08 and quarterly thereafter
5,000	5.91	12/17/09	03/17/08 and quarterly thereafter
3,000	4.69	07/13/12	07/14/08 and quarterly thereafter
5,000	4.25	07/27/17	07/28/08 and quarterly thereafter
5,000	4.05	08/02/17	08/04/08 and quarterly thereafter
14,000	4.50	12/27/13	12/29/08 and quarterly thereafter
5,000	4.29	03/23/17	03/23/09 and quarterly thereafter
3,000	4.59	08/13/12	08/13/09 and quarterly thereafter
2,000	4.59	08/20/10	08/20/09 and quarterly thereafter
3,000	4.25	08/20/14	08/20/09 and annually thereafter
5,000	4.59	05/02/14	05/03/10 and quarterly thereafter

The remaining seven advances, totaling \$11,000,000, are at rates ranging from 2.84% to 4.46% with a weighted average rate of 3.72%.

The \$20,620,000 of junior subordinated debentures consists of the following two issues:

On March 22, 2007, the Company completed the private placement of \$10,310,000 aggregate liquidation amount of floating rate trust preferred securities (the "Trust III Capital Securities") issued by its Delaware statutory business trust, Northway Capital Trust III ("Capital Trust III"). The Trust III Capital Securities were sold to a pooled investment vehicle. The proceeds from the sale of the Trust III Capital Securities, which included the proceeds from the sale by Capital Trust III of its common securities to the Company, were invested in Floating Rate Junior Subordinated Debt Securities of the Company due June 15, 2037 (the "Trust III Junior Subordinated Debt"), which were issued pursuant to an Indenture, dated March 22, 2007 between the Company and Wilmington Trust Company as Trustee. Both the Trust III Capital Securities and the Trust III Junior Subordinated Debt have a floating rate, which resets quarterly, equal to the three-month LIBOR plus 1.60%. Currently, the interest on these securities is 6.59%. Payments of distributions and other amounts due on the Trust III Capital Securities are irrevocably guaranteed by the Company, to the extent that the Capital Trust III has funds available for the payments of such distributions, pursuant to a Guarantee Agreement, dated March 22, 2007, between the Company and Wilmington Trust Company, as Guarantee Trustee. The Trust III Junior Subordinated Debt and the Trust III Capital Securities may be redeemed at the option of the Company on fixed quarterly dates starting on March 15, 2012.

On June 15, 2007, the Company completed the private placement of \$10,310,000 aggregate liquidation amount of floating rate trust preferred securities (the "Trust IV Capital Securities") issued by its Delaware statutory business trust, Northway Capital IV ("Capital Trust IV"). The Trust IV Capital Securities were sold to a pooled investment vehicle. The proceeds from the sale of the Trust IV Capital Securities, which included the proceeds from the sale by the Capital Trust IV of its common securities to the Company, were invested in Floating Rate Junior Subordinated Debt Securities of the Company due June 15, 2037 (the "Trust IV Junior Subordinated Debt"), which were issued pursuant to an Indenture, dated June 15, 2007 between the Company and Wells Fargo Bank, National Association as Trustee. Both the Trust IV Capital Securities and the Trust IV Junior Subordinated Debt have a floating rate, which resets quarterly, equal to the three-month LIBOR plus 1.49%. Currently, the interest rate on these securities is 6.48%. Payments of distributions and other amounts due on the Trust IV Capital Securities are irrevocably guaranteed by the Company, to the extent that the Capital Trust IV has funds available from the payments of such distributions, pursuant to a Guarantee Agreement, dated June 15, 2007, between the Company and Wells Fargo Bank, National Association, as Guarantee Trustee. The Trust IV Junior Subordinated Debt and the Trust IV Capital Securities may be redeemed at the option of the Company on fixed quarterly dates starting on June 15, 2012.

NOTE 11 ACQUISITIONS

On April 7, 2006, the Company acquired certain assets and assumed the deposits of two branch offices of Washington Mutual Bank located in Laconia and Belmont, New Hampshire. This acquisition has allowed the Company to expand its market presence in Belknap County. Deposits assumed totaled \$29,438,000 for which the Company paid a deposit purchase premium of 6.30%. In addition, the Company acquired certain loans associated with the branches totaling \$8,192,000. As a result of this purchase, the Company made the following entries to record this transaction:

	(\$000 Omitted)	
Cash	\$19,130	
Loans	8,192	
Goodwill	425	
Core deposit intangible	1,234	
Equipment	49	
Land and buildings	458	
Other assets	28	
Building and equipment expense	1	
Deposits		\$29,438
Other liabilities		74
Miscellaneous income		5
	<u>\$29,517</u>	<u>\$29,517</u>

This transaction was accounted for using the purchase method of accounting. The results of operations of the acquired branches are included in the 2006 consolidated statements of income of the Company from the date of the transaction.

The cost of the acquired branch offices exceeded the fair value of the assets acquired and liabilities assumed by \$1,659,000. Of this amount, \$1,234,000 was assigned to core deposit intangible and \$425,000 was recorded as goodwill. All of the goodwill was deductible for tax purposes. The core deposit intangible of \$1,234,000 is being amortized to noninterest expense over fourteen years using the sum-of-the-years'-digits method.

NOTE 12 GOODWILL AND OTHER INTANGIBLE ASSETS

At December 31, 2007, the Company has goodwill and core deposit intangibles totaling \$12,279,000. Core deposit intangibles are being amortized over their useful lives and both core deposit intangibles and goodwill are tested for impairment at least annually.

The changes in the carrying amount of goodwill and core deposit intangibles for the years ended December 31, 2007 and 2006 are as follows:

	(\$000 Omitted)	
	Goodwill	Core Deposit Intangibles
Balance, December 31, 2005	\$10,152	\$ 1,995
Branch acquisition	425	1,234
Amortization expense	-	(1,051)
Balance, December 31, 2006	10,577	2,178
Amortization expense	-	(476)
Balance, December 31, 2007	<u>\$10,577</u>	<u>\$ 1,702</u>

Estimated annual amortization expense:

	(\$000 Omitted)
	Core Deposit Intangibles
2008	\$464
2009	453
2010	227
2011	109
2012	97
2013 and thereafter	352

NOTE 12 GOODWILL AND OTHER INTANGIBLE ASSETS (CONTINUED)

The following table reflects the gross carrying amount and accumulated amortization of core deposit intangibles as of December 31, 2007:

	(\$000 Omitted)		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Core deposit intangibles	\$3,927	\$2,225	\$1,702

Management reviews the carrying amount of intangible assets on an ongoing basis, taking into consideration any events and circumstances that might have diminished such amount. During 2007 and 2006, the Company reviewed the carrying amount of intangible assets and determined that no impairment write-down was required.

NOTE 13 REGULATORY MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). As of December 31, 2007, the most recent notification from the FDIC categorized the Bank as "well-capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well-capitalized" the Bank must maintain total risk-based, Tier 1 risk-based and Tier 1 leverage ratios above regulatory prescribed minimum levels. There are no conditions or events since that notification that management believes have changed the Bank's category. Management believes, as of December 31, 2007 and 2006, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

These minimum capital amounts and ratios, as well as the Company's and Bank's actual capital amounts and ratios, are presented in the following table:

	(\$000 Omitted)					
	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>As of December 31, 2007</u>						
Tier 1 capital (to average assets)						
Northway Financial, Inc.	\$49,393	7.34%	\$26,924	≥4.00%	N/A	
Northway Bank	49,703	7.43	26,754	≥4.00	\$33,443	≥5.00%
Total capital (to risk weighted assets)						
Northway Financial, Inc.	60,104	13.82	34,780	≥8.00	N/A	
Northway Bank	55,090	12.81	34,405	≥8.00	43,006	≥10.00
Tier 1 capital (to risk weighted assets)						
Northway Financial, Inc.	49,393	11.36	17,390	≥4.00	N/A	
Northway Bank	49,703	11.56	17,203	≥4.00	25,804	≥6.00

NOTE 13 REGULATORY MATTERS (CONTINUED)

(\$000 Omitted)

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2006						
Tier 1 capital (to average assets)						
Northway Financial, Inc.	\$58,432	9.31%	\$25,102	≥4.00%	N/A	
Northway Bank	51,653	8.30	24,887	≥4.00	\$31,109	≥5.00%
Total capital (to risk weighted assets)						
Northway Financial, Inc.	66,464	15.95	33,339	≥8.00	N/A	
Northway Bank	56,796	13.82	32,885	≥8.00	41,107	≥10.00
Tier 1 capital (to risk weighted assets)						
Northway Financial, Inc.	58,432	14.02	16,669	≥4.00	N/A	
Northway Bank	51,653	12.57	16,443	≥4.00	24,664	≥6.00

Federal regulations prohibit banking companies from paying dividends on their stock if the effect would cause stockholders' equity to be reduced below applicable regulatory capital requirements or if such declaration and payment would otherwise violate regulatory requirements.

As of December 31, 2007, the Bank is restricted from declaring dividends to the Company in an amount greater than approximately \$20,685,000, as such declaration would decrease capital below the Bank's required minimum level of regulatory capital.

NOTE 14 OTHER NONINTEREST EXPENSE

The following table sets for information relating to the Company's other noninterest expense for the years ended December 31:

(\$000 Omitted)

	2007	2006	2005
Professional fees	\$1,425	\$1,026	\$1,179
Marketing	824	726	757
Amortization and write-off of deferred costs debentures	576	23	23
Telecommunications	354	455	619
Stationery and supplies	263	365	647
Other	3,030	3,653	3,488
	<u>\$6,472</u>	<u>\$6,248</u>	<u>\$6,713</u>

One-time costs associated with the reverse and forward stock split transaction totaled \$353,000 during 2007 and consisted of \$337,000 in professional fees and \$16,000 in other expenses. In addition, the amortization of deferred cost on debentures included a \$565,000 write down of unamortized deferred costs associated with the refinance of \$20,620,000 in junior subordinated debentures.

During 2006, other noninterest expense included approximately \$60,000 in one-time costs associated with the acquisition of the two former Providian Bank deposits of \$29.4 million. These expenses were related primarily to marketing, postage and shipping and the expense of providing checks to our new deposit customers. In addition, 2006 included a one-time expense of \$357,000 related to an unwind penalty from the FHLB for early prepayment of FHLB advances.

During 2005, other noninterest expenses related to the merger of the two banks totaled \$1,008,000 and included marketing expense of \$386,000, stationery and office supplies of \$337,000, professional fees of \$83,000, legal fees of \$81,000 and state transfer tax of \$71,000.

NOTE 15 FEDERAL AND STATE TAXES

The components of federal and state tax expense for the years ended December 31, are as follows:

	2007	(\$000 Omitted) 2006	2005
Current			
Federal	\$ 715	\$1,010	\$ 820
State	-	-	26
	<u>715</u>	<u>1,010</u>	<u>846</u>
Deferred			
Federal	(253)	(363)	2
State	8	5	(6)
	<u>(245)</u>	<u>(358)</u>	<u>(4)</u>
Total	<u>\$ 470</u>	<u>\$ 652</u>	<u>\$ 842</u>

The temporary differences (the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases) that give rise to significant portions of the net deferred income tax asset at December 31, are as follows:

	2007	(\$000 Omitted) 2006
Deferred income tax assets		
Allowance for loan losses	\$2,484	\$2,234
Interest on nonaccrual loans	120	16
Net unrealized holding loss on securities available-for-sale	347	198
Pension unfunded status valuation adjustment	887	626
Supplemental pension	531	416
Other	10	10
	<u>4,379</u>	<u>3,500</u>
Deferred income tax liabilities		
Depreciation	(495)	(557)
Amortization of goodwill and core deposit intangible	(403)	(86)
Prepaid pension	(260)	(286)
Mortgage and consumer servicing rights	(74)	(79)
	<u>(1,232)</u>	<u>(1,008)</u>
Deferred income tax asset, net	<u>\$ 3,147</u>	<u>\$ 2,492</u>

The primary sources of recovery of the deferred income tax asset are taxes paid that are available for carryback and the expectation that the deductible temporary differences will reverse during periods in which the Company generates taxable income.

Total income tax expense for the years ended December 31, 2007, 2006 and 2005 differs from the "expected" federal income tax expense at the 34% statutory rate for the following reasons:

	2007	2006	2005
Expected federal income taxes	34.0%	34.0%	34.0%
Interest on municipal securities available-for-sale and municipal loans	(23.6)	(16.8)	(9.4)
State tax expense, net of federal benefit	0.2	0.1	0.4
Other	1.9	(0.4)	(1.0)
Effective tax rates	<u>12.5%</u>	<u>16.9%</u>	<u>24.0%</u>

NOTE 16 EMPLOYEE BENEFITS

Pension Plan

The Company maintains a trustee non-contributory pension plan (the "Plan") covering substantially all full-time employees. Assuming retirement at age 65 after 30 years or more of service, the benefits are computed as the sum of one percent of final average earnings up to a covered compensation limit, plus 0.65 percent of final average earnings in excess of covered compensation, times years of service, up to 30. Final average earnings are defined as the five consecutive years out of the employee's last ten years of employment during which compensation is highest. The amounts contributed to the Plan are determined annually on the basis of (a) the maximum amount that can be deducted for federal income tax purposes or (b) the amount certified by a consulting actuary as necessary to avoid an accumulated funding deficiency as defined by the Employee Retirement Income Security Act of 1974. Contributions are intended to provide not only benefits attributed to service to date but also for those expected to be earned in the future.

The following table sets forth information about the Plan as of December 31, using a measurement date of December 31, and for the years then ended:

	(\$000 Omitted)		
	2007	2006	2005
Accumulated benefit obligation at the end of the year	<u>\$ 6,652</u>	<u>\$ 5,863</u>	<u>\$ 4,986</u>
<u>Change in projected benefit obligation</u>			
Projected benefit obligation at beginning of year	\$ 6,967	\$ 6,590	\$ 5,805
Service cost	549	519	515
Interest cost	420	371	346
Actuarial (gain) loss	405	(344)	235
Benefits paid	(363)	(169)	(311)
Projected benefit obligation at end of year	<u>7,978</u>	<u>6,967</u>	<u>6,590</u>
<u>Change in plan assets</u>			
Fair value of plan assets at beginning of year	6,226	5,730	4,601
Actual return on plan assets	257	680	295
Employer contributions	400	-	1,145
Administrative expense	(16)	(15)	-
Benefits paid	(363)	(169)	(311)
Fair value of plan assets at end of year	<u>6,504</u>	<u>6,226</u>	<u>5,730</u>
Funded status at end of year	<u>\$ (1,474)</u>	<u>\$ (741)</u>	(860)
Unrecognized net actuarial loss			2,989
Unrecognized prior service credit			(792)
Net amount recognized			<u>\$ 1,337</u>
<u>Amounts recognized in the Statement of Financial Position</u>			
Prepaid benefit cost	\$ -	\$ -	\$ 1,337
Unfunded pension liability	(1,474)	(741)	-
Total	<u>\$ (1,474)</u>	<u>\$ (741)</u>	<u>\$ 1,337</u>

NOTE 16 EMPLOYEE BENEFITS (CONTINUED)

	2007	2006	2005
<u>Amounts recognized in accumulated other comprehensive loss</u>			
Prior service credit	\$ (623)	\$ (708)	\$ -
Net actuarial loss	2,863	2,289	-
Total	<u>\$ 2,240</u>	<u>\$ 1,581</u>	<u>\$ -</u>

<u>Components of net periodic benefit cost and other amounts recognized in other comprehensive loss</u>	2007	2006	2005
Service cost	\$ 549	\$ 519	\$ 515
Interest cost	420	371	346
Expected return on plan assets	(520)	(451)	(384)
Amortization of prior service credit	(85)	(85)	(85)
Amortization of net actuarial loss	110	143	138
Net periodic benefit cost	<u>474</u>	<u>\$ 497</u>	<u>\$ 530</u>

<u>Other changes in plan assets and benefit obligations recognized in other comprehensive loss</u>	
Net actuarial loss for period	684
Amortization of prior service credit	85
Amortization of net loss	(110)
Total	<u>659</u>

Total recognized in net period pension cost and other comprehensive loss \$1,133

The estimated prior service credit and net actuarial loss that will be accreted and amortized from accumulated other comprehensive loss into net periodic benefit cost over the year ended December 31, 2008 are \$84,000 and \$132,000, respectively.

<u>Assumptions used to determine benefit obligations and benefit cost as of and for the years ending December 31,</u>	2007	2006	2005
<u>Discount rate:</u>			
Benefit obligation	6.00%	6.00%	5.75%
Benefit cost	6.00	5.75	6.00
Long-term rate of return on plan assets	8.00	8.00	8.00
Rate of compensation increase	3.50	3.50	3.50

The expected long-term rate of return for the plan's total assets is based on the expected return of asset categories identified below, weighted based on the target allocations for each class. Equity funds are expected to return 8% to 10% over the long-term and bond funds and short-term money markets are expected to return between 4% and 6%.

The Company's pension plan actual asset allocations by asset category are as follows:

<u>Asset Category</u>	Plan Assets at December 31,		
	2007	2006	2005
<u>Mutual funds:</u>			
Bond funds	36.0%	29.0%	32.7%
Equity securities	55.0	51.0	42.5
Real estate funds	9.0	7.0	8.5
Short-term money market	0.0	13.0	16.3
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

NOTE 16 EMPLOYEE BENEFITS (CONTINUED)

The investment policy, as established by the Company, is to provide for a moderate growth of capital with a moderate level of volatility by investing assets per the target allocations as follows:

<u>Asset Category</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Mutual funds:			
Bond funds	25-45%	25-45%	40-60%
Equity securities	45-65	45-65	30-50
Real estate funds	0-15	0-15	0-15
Other	0-15	0-25	-

The assets will be re-allocated quarterly to meet the above target allocations. The investment policy is reviewed on an annual basis, under the advisement of the Company's certified investment advisor, to determine if the policy should be changed.

The plan assets do not include any Company common stock at December 31, 2007 and 2006.

The Company expects to contribute \$425,000 to its pension plan in 2008.

Estimated future benefit payments, which reflect future service, as appropriate, are as follows for the years ended December 31:

	(\$000 Omitted)
2008	226
2009	227
2010	241
2011	275
2012	329
2013-2017	2,094

401(k) Plan

The Company offers a contributory 401(k) Plan. Under the Northway Financial, Inc. 401(k) and Profit Sharing Plan (the "401K Plan") employees must have attained age 21, completed six months of service and be credited with 1,000 hours of service in order to participate. Employees of the Company are eligible to participate. Under the 401K Plan, the Company matches 50 percent of the first 4 percent of employee contributions. Total 401(k) matching expense in 2007, 2006 and 2005 amounted to \$144,000, \$151,000 and \$139,000, respectively, and there was no Profit Sharing contribution expense for each of the three years ended December 31, 2007.

Supplemental Executive Retirement Plan (SERP)

Effective May 29, 2003, the existing Executive Life program sponsored by the Company was terminated and replaced with a SERP in which the Chief Executive Officer ("CEO") participates. The existing Split Dollar Life Insurance policy designed to support the Executive Life program is now fully owned by Northway. This policy will be maintained by Northway and is used as the benchmark for the SERP.

The total retirement SERP benefit is as follows: Upon the CEO's termination of employment for reasons other than death or for cause, the account balance is paid out to him in ten (10) equal annual installments on the first day of the month following the month in which employment is terminated. Upon death after retirement, the unpaid account balance, if any, is paid out in a lump sum to the CEO's named beneficiary. During retirement, an additional retirement payment, based on the policy gains associated with the prior calendar year, will also be paid on an annual basis until the executive's death. In the event of the CEO's death while employed by the Company, the SERP permits a death benefit of \$2,000,000 be paid to his beneficiary. As of December 31, 2007 and 2006, the Company has accrued a liability related to the SERP in the amount of \$1,435,000 and \$1,095,000, respectively.

NOTE 16 EMPLOYEE BENEFITS (CONTINUED)

Stock-Based Compensation

The Board of Directors (the "Committee") administers the 1999 Stock Option and Grant Plan (the "1999 Plan") which is described below.

Under the 1999 Plan, the Committee may select the individuals to whom awards may from time-to-time be granted; determine the time or times of grant; and determines the extent, if any, of incentive stock options, non-qualified stock options, restricted stock awards, unrestricted stock awards, performance share awards, or any combination of the foregoing.

The 1999 Plan expires in February 2009. The aggregate number of shares of the Company's common stock which may be issued upon the exercise of options granted under the 1999 Plan is 350,000. The option price is fixed by the Committee at the time of the grant and may not be less than 100 percent of the fair market value of the stock, as determined by the Committee, in good faith as of the grant date. Each option may be exercised at such times as shall be determined by the Committee at or after the grant date; provided, however, that no option may be exercised ten years after the date of grant. The fair value of each option granted is estimated on grant date using the Black-Scholes option pricing model.

A summary of the status of the Company's 1999 Plan as of December 31, 2007, 2006 and 2005 and changes during the years then ended is presented below:

	2007		2006		2005	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	61,000	\$12.33	68,000	\$12.50	76,000	\$12.48
Exercised	(6,000)	11.31	-	-	(8,000)	12.32
Forfeited	-	-	(7,000)	14.00	-	-
Outstanding, end of year	<u>55,000</u>	12.44	<u>61,000</u>	12.33	<u>68,000</u>	12.50
Options exercisable at year-end	55,000		61,000		68,000	

The following table summarizes information about fixed stock options outstanding as of December 31, 2007:

Options Outstanding			Options Exercisable	
Weighted Average Exercise Price	Number Outstanding as of 12/31/07	Weighted Average Remaining Contractual Life	Number Exercisable as of 12/31/07	Weighted Average Exercise Price
\$14.00	23,000	1.50 years	23,000	\$14.00
11.32	32,000	2.63 years	32,000	11.32
12.44	<u>55,000</u>	2.16 years	<u>55,000</u>	12.44

Change in Control

The Company and its subsidiary have entered into Key Employee agreements with specific Executive Officers as well as other Senior Officers of the Company. These agreements provide for payments, under certain circumstances, to the officer upon the officer's termination after a change in control. Payments will be made under these agreements upon the officer's termination or resignation in connection with certain specified actions adverse to the officer's employment status after a change in control. The amount of such payments ranges from 1.0 to 1.5 times such officer's annual compensation.

NOTE 17 FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to originate loans and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for loan commitments and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Financial instruments with off-balance sheet credit risk at December 31, are as follows:

	(\$000 Omitted)	
	2007	2006
Financial instrument whose contract amounts represent credit risk:		
Unadvanced portions of home equity loans	\$17,731	\$17,691
Unadvanced portions of lines of credit	26,668	21,424
Unadvanced portions of commercial real estate loans	16,660	17,421
Unadvanced portions of Bounce Protection™	13,057	13,667
Commitments to originate all other loans	16,355	20,742
Commitments to originate municipal notes	3,838	972
Standby letters of credit	222	303
Total	<u>\$94,531</u>	<u>\$92,220</u>

Commitments to originate loans and municipal notes, unadvanced portions of home equity loans, lines of credit and commercial real estate loans are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without having been drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the borrower.

Unadvanced portions of Bounce Protection™ represent the unused portion of the Bank's overdraft privilege program.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers. As of December 31, 2007 and 2006, the maximum potential amount of the Company's obligation was \$222,000 and \$303,000, respectively, for financial and standby letters of credit. The Company's outstanding letters of credit generally have a term of less than one year. If a letter of credit is drawn upon, the Company may seek recourse through the customer's underlying line of credit. If the customer's line of credit is also in default, the Company may take possession of the collateral, if any, securing the line of credit.

NOTE 18 FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents approximates the fair value of those assets.

Securities: Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

FHLB Stock: The carrying amount reported in the consolidated balance sheets for FHLB Stock approximates its fair value. If redeemed, the Company will receive an amount equal to the par value of the stock.

Loans held-for-sale: Fair values for loans held-for-sale are estimated based on outstanding investor commitments, or in the absence of such commitments, are based on current investor yield requirements.

Loans: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The fair values of nonaccrual loans was estimated using discounted cash flow analyses or the estimated fair value of the underlying collateral where applicable.

Accrued interest receivable: The carrying value of accrued interest receivable approximates its fair value because of the short-term nature of this financial instrument.

Deposits: The fair value of demand deposits (e.g. NOW and super NOW checking, noninterest bearing checking, regular savings, money market accounts and mortgagors' escrow accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). Fair values for certificates of deposit are estimated using a discounted cash flow technique that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities of time deposits.

Short-term borrowings: The carrying value of short-term borrowings approximates its fair value because of the short-term nature of these financial instruments.

Long-term debt: The fair values of long-term debt are determined by discounting the anticipated future cash payments by using the rates currently available to the Company for debt with similar terms and remaining maturities.

Junior subordinated debentures: The fair values of junior subordinated debentures are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Off-balance sheet instruments: The fair value of commitments to originate loans is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments and the unadvanced portion of loans, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligation with the counterparties at the reporting date. See NOTE 17 for further information.

The estimated fair values of the Company's financial instruments are as follows:

	(\$000 Omitted)			
	December 31,			
	<u>2007</u>		<u>2006</u>	
	<u>Carrying</u>	<u>Estimated</u>	<u>Carrying</u>	<u>Estimated</u>
	<u>Amount</u>	<u>Fair Value</u>	<u>Amount</u>	<u>Fair Value</u>
Financial assets:				
Cash and cash equivalents	\$ 19,784	\$ 19,784	\$ 24,808	\$ 24,808
Securities available-for-sale	143,543	143,543	125,838	125,838
FHLB stock	4,779	4,779	3,782	3,782
Loans held-for-sale	403	407	263	268
Loans, net	483,729	481,829	458,600	447,501
Accrued interest receivable	3,205	3,205	2,941	2,941

NOTE 18 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

(\$000 Omitted)
December 31,

	<u>2007</u>		<u>2006</u>	
	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>
Financial liabilities:				
Deposits	\$478,462	\$478,683	\$484,677	\$484,266
Short-term borrowings	63,865	63,865	36,497	36,497
Long-term debt	76,000	74,495	53,000	51,900
Junior subordinated debentures	20,620	17,124	20,620	20,646

The carrying amounts of financial instruments shown in the above table are included in the consolidated balance sheets under the indicated captions except that accrued interest receivable is included with other assets and junior subordinated debentures are included with long-term debt.

At December 31, 2007 and 2006 all the Company's financial instruments were held for purposes other than trading.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for some of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, cash flows, current economic conditions, risk characteristics, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions and changes in the loan, debt and interest rate markets could significantly affect the estimates. Further, the income tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on the fair value estimates and have not been considered. The fair value amounts presented do not represent the underlying value of the Company because fair values of certain other financial instruments, assets and liabilities have not been determined.

NOTE 19 CONDENSED PARENT ONLY FINANCIAL STATEMENTS

Condensed financial statements of Northway Financial, Inc. (Parent Company only) as of December 31, 2007 and 2006 and for the three years ended December 31, 2007 follow:

Balance Sheets

(\$000 Omitted)

	<u>2007</u>	<u>2006</u>
	Assets	
Cash and cash equivalents	\$ 1,889	\$ 5,182
Investment in subsidiary, Northway Bank	61,662	64,126
Investment in affiliates, Northway Capital Trust I, II, III & IV	620	620
Equipment, net	508	960
Due from subsidiary and affiliates	201	145
Other assets	<u>3,553</u>	<u>4,126</u>
Total assets	<u>\$68,433</u>	<u>\$75,159</u>
Liabilities and stockholders' equity		
Accrued expenses	\$ 198	\$ 541
Other liabilities	2,970	1,849
Junior subordinated debentures	<u>20,620</u>	<u>20,620</u>
Total liabilities	<u>23,788</u>	<u>23,010</u>
Stockholders' equity		
Common stock	3,462	1,732
Additional paid-in capital	311	2,064
Retained earnings	58,223	56,140
Treasury stock	(15,470)	(6,531)
Accumulated other comprehensive loss	<u>(1,881)</u>	<u>(1,256)</u>
Total stockholders' equity	<u>44,645</u>	<u>52,149</u>
Total liabilities and stockholders' equity	<u>\$68,433</u>	<u>\$75,159</u>

NOTE 19 CONDENSED PARENT ONLY FINANCIAL STATEMENTS (CONTINUED)

Statements of Income

	(\$000 Omitted)		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
Income			
Dividends from subsidiary	\$ 6,340	\$ 2,210	\$ 2,036
Interest income	402	210	120
Management fee income from subsidiary	2,713	1,913	8,750
Other	<u>120</u>	<u>290</u>	<u>202</u>
	<u>9,575</u>	<u>4,623</u>	<u>11,108</u>
Expense			
Interest expense	1,804	1,832	1,463
Salaries and employee benefits	973	940	5,536
Office occupancy and equipment expense	455	611	1,137
Professional fees	609	257	661
Other	<u>676</u>	<u>104</u>	<u>1,417</u>
	<u>4,517</u>	<u>3,744</u>	<u>10,214</u>
Income before income tax benefit and equity in undistributed net income of subsidiary	5,058	879	894
Income tax benefit	<u>(458)</u>	<u>(531)</u>	<u>(438)</u>
Income before equity in undistributed net income of subsidiary	5,516	1,410	1,332
Equity in undistributed net (loss) income of subsidiary	<u>(2,237)</u>	<u>1,805</u>	<u>1,341</u>
Net income	<u>\$ 3,279</u>	<u>\$ 3,215</u>	<u>\$ 2,673</u>

Statements of Cash Flows

	(\$000 Omitted)		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
Cash flows from operating activities			
Net income	\$ 3,279	\$ 3,215	\$ 2,673
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	450	597	630
(Increase) decrease in amount due from subsidiary	(56)	395	268
Decrease (increase) in other assets	835	411	(622)
Increase (decrease) in accrued expenses and other liabilities	118	(261)	4
Loss on disposal of assets	2	14	2
Undistributed net loss (income) of subsidiary	<u>2,237</u>	<u>(1,805)</u>	<u>(1,341)</u>
Net cash provided by operating activities	<u>6,865</u>	<u>2,566</u>	<u>1,614</u>
Cash flows from investing activities			
Investment in affiliate	(620)	-	-
Redemption of investment in affiliate	620	-	-
Capital contributions to subsidiary	-	-	-
Additions to premises and equipment	-	-	(145)
Purchase of company owned life insurance	<u>-</u>	<u>-</u>	<u>-</u>
Net cash used by investing activities	<u>-</u>	<u>-</u>	<u>(145)</u>
Cash flows from financing activities			
Redemption of junior subordinated debentures	(20,620)	-	-
Issuance of junior subordinated debentures	20,620	-	-
Exercise of stock options	67	-	99
Purchases of treasury stock	(9,029)	-	(563)
Cash dividends paid	<u>(1,196)</u>	<u>(1,164)</u>	<u>(1,068)</u>
Net cash used by financing activities	<u>(10,158)</u>	<u>(1,164)</u>	<u>(1,532)</u>
Net (decrease) increase in cash and cash equivalents	(3,293)	1,402	(63)
Cash and cash equivalents at beginning of year	<u>5,182</u>	<u>3,780</u>	<u>3,843</u>
Cash and cash equivalents at end of year	<u>\$ 1,889</u>	<u>\$ 5,182</u>	<u>\$ 3,780</u>

QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

Summarized quarterly financial data for 2007 and 2006 follows:

(\$000 Omitted, except earnings per share)

	2007 Quarters Ended			
	Mar. 31,	Jun. 30,	Sep. 30,	Dec. 31,
Interest and dividend income	\$9,507	\$10,008	\$10,234	\$10,044
Interest expense	<u>4,323</u>	<u>4,536</u>	<u>4,573</u>	<u>4,556</u>
Net interest and dividend income	5,184	5,472	5,661	5,488
Provision for loan losses	120	210	210	270
Noninterest income	1,445	1,538	1,501	1,323
Noninterest expense	<u>5,522</u>	<u>5,876</u>	<u>5,681</u>	<u>5,974</u>
Income before taxes	987	924	1,271	567
Income tax expense	<u>141</u>	<u>108</u>	<u>191</u>	<u>30</u>
Net income	<u>\$ 846</u>	<u>\$ 816</u>	<u>\$1,080</u>	<u>\$ 537</u>
Basic earnings per common share	<u>\$ 0.29</u>	<u>\$ 0.27</u>	<u>\$ 0.38</u>	<u>\$ 0.22</u>
Earnings per common share assuming dilution	<u>\$ 0.29</u>	<u>\$ 0.27</u>	<u>\$ 0.37</u>	<u>\$ 0.22</u>

	2006 Quarters Ended			
	Mar. 31,	Jun. 30,	Sep. 30,	Dec. 31,
Interest and dividend income	\$8,543	\$8,937	\$9,179	\$9,308
Interest expense	<u>2,901</u>	<u>3,293</u>	<u>3,623</u>	<u>3,948</u>
Net interest and dividend income	5,642	5,644	5,556	5,360
Provision for loan losses	105	120	120	120
Noninterest income	1,572	1,324	1,507	1,468
Noninterest expense	<u>5,699</u>	<u>5,921</u>	<u>5,904</u>	<u>6,217</u>
Income before taxes	1,410	927	1,039	491
Income tax expense (benefit)	<u>330</u>	<u>171</u>	<u>185</u>	<u>(34)</u>
Net income	<u>\$1,080</u>	<u>\$ 756</u>	<u>\$ 854</u>	<u>\$ 525</u>
Basic earnings per common share	<u>\$ 0.36</u>	<u>\$ 0.26</u>	<u>\$ 0.29</u>	<u>\$ 0.17</u>
Earnings per common share assuming dilution	<u>\$ 0.36</u>	<u>\$ 0.25</u>	<u>\$ 0.29</u>	<u>\$ 0.17</u>

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shatswell, MacLeod & Company, P.C.
Certified Public Accountants
83 Pine Street
West Peabody, Massachusetts 01960

The Board of Directors and Stockholders
Northway Financial, Inc.
Berlin, New Hampshire

We have audited the accompanying consolidated balance sheets of Northway Financial, Inc. and Subsidiaries as of December 31, 2007 and 2006 and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Northway Financial, Inc. and Subsidiaries as of December 31, 2007 and 2006 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

Shatswell, MacLeod + Company, P.C.
SHATSWELL, MacLEOD & COMPANY, P.C.

West Peabody, Massachusetts
March 20, 2008

Stockholder Information

Corporate Headquarters

9 Main Street
Berlin, New Hampshire 03570

Contact

Richard P. Orsillo
Senior Vice President
Chief Financial Officer
(603) 752-1171

Stock Listing

Northway Financial, Inc. common stock
trades on the Over the Counter Bulletin
Board ("OTCBB") under the symbol:

NWYF

Transfer Agent

Computershare Trust Company, N.A.
PO Box 43078
Providence, RI 02940-3078
781-575-2879
<http://www.computershare.com>

Market Makers

Howe Barnes Hoefler & Arnett has generally
been a market maker for Northway Financial,
Inc. common stock.



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**First Quarter Report
2008**

SKU # 320 002CS61297



TO OUR STOCKHOLDERS:

We are pleased to report that, even in today's uncertain and volatile economy, our net income surpassed that of the same quarter last year by 20.7%. This is the result of several factors, including a significant improvement in net interest and dividend income, gains on the sale of investment securities, and careful monitoring of overhead expenses. The increase of \$32,000,000 in our loan portfolio is reflective of Northway's strong lending position in northern and central New Hampshire.

With the assistance of our new executive management team, we are ramping up our efforts to be the "Bank of Choice", by strengthening and expanding relationships with our customers. This is an intensive Bank-wide initiative that we expect will yield positive and lasting results.

We also are pleased to report that we have not participated in the sub-prime lending that has been so damaging to many other lenders. Nevertheless, in today's rapidly evolving economy, our Board of Directors and management remain alert to changes that might threaten shareholder value, and will address such situations with all of the resources at our disposal."

Net income for the quarter ended March 31, 2008 of \$1,021,000, or \$0.41 per share-basic, compared to \$846,000, or \$0.29 per share-basic, for the same quarter in 2007, an increase of \$175,000, or 20.7%. Per share results were favorably affected by the reduction in outstanding shares as a result of the previously reported reverse and forward stock split transactions, which occurred on September 11, 2007.

Net interest and dividend income for the quarter ended March 31, 2008 increased \$225,000 to \$5,409,000 compared to \$5,184,000 for the same period last year due primarily to an increase in average earning assets of \$28,000,000. The provision for loan losses for the quarter ended March 31, 2008 increased \$150,000 to \$270,000 compared to \$120,000 for the same period in 2007, primarily due to the potential impact of the current unfavorable economic conditions; and, to a lesser degree, a 7% increase in gross loans. Securities gains for the quarter ended March 31, 2008 increased \$120,000 to \$261,000 compared to \$141,000 for the same period

last year. Other noninterest income for the quarter ended March 31, 2008 decreased \$119,000 to \$1,185,000 compared to \$1,304,000 for the same period last year. Other operating expense decreased \$180,000 to \$5,342,000 for the quarter ended March 31, 2008 compared to \$5,522,000 for the same period last year due primarily to a decrease in salaries and benefits expense and equipment expense. Income tax expense for the quarter ended March 31, 2008 increased \$81,000 from the quarter ended March 31, 2007.

At March 31, 2008, the Company had total assets of \$683,881,000 compared to \$678,729,000 at March 31, 2007, an increase of \$5,152,000. Federal funds sold decreased \$17,065,000 from March 31, 2007 to March 31, 2008. Securities available-for-sale decreased \$8,397,000 to \$135,341,000 at March 31, 2008 compared to \$143,738,000 at March 31, 2007. Loans at March 31, 2008 increased \$32,745,000 to \$499,535,000 compared to \$466,790,000 at March 31, 2007. Total deposits were \$477,819,000 at March 31, 2008 compared to \$489,080,000 at March 31, 2007, a decrease of \$11,261,000. Securities sold under agreements to repurchase increased \$8,599,000 to \$48,718,000 at March 31, 2008 compared to \$40,119,000 at March 31, 2007. Other borrowings increased \$18,800,000 to \$106,730,000 at March 31, 2008 compared to \$87,930,000 at March 31, 2007.

Total equity decreased \$7,761,000 to \$45,100,000 at March 31, 2008 compared to \$52,861,000 at March 31, 2007 due primarily to the shares cashed out in the reverse and forward stock split transaction. Stockholders' equity of \$45,100,000 resulted in a book value of \$17.99 per share at March 31, 2008, based on 2,506,804 shares of common stock outstanding, an increase of \$0.30 per share.

On April 30, 2008, the Board of Directors declared a dividend of \$0.135 cents per share, an increase of 8% over the dividend declared last quarter. This dividend is payable on May 19, 2008 to shareholders of record on May 9, 2008.

William J. Woodward,
Chairman, President and Chief Executive Officer

NORTHWAY FINANCIAL, INC.**STATEMENTS OF CONDITION**

(Unaudited)

	MAR. 31,	DEC. 31,	MAR. 31,
(Dollars in thousands, except per share data)	2008	2007	2007
Assets:			
Cash and due from banks and interest-bearing deposits	\$ 14,136	\$ 19,784	\$ 15,765
Federal funds sold	-	-	17,065
Securities available-for-sale, at fair value	135,341	143,543	143,738
Federal Home Loan Bank stock	4,851	4,779	3,671
Loans held-for-sale	139	403	65
Loans, net before allowance for loan losses	499,535	489,969	466,790
Less: Allowance for loan losses	6,433	6,240	5,701
Loans, net	<u>493,102</u>	<u>483,729</u>	<u>461,089</u>
Premises and equipment, net	11,882	12,180	13,002
Other real estate owned	841	666	-
Core deposit intangibles	1,583	1,702	2,056
Goodwill	10,577	10,577	10,577
Other assets	11,429	11,410	11,701
Total assets	<u>\$ 683,881</u>	<u>\$ 688,773</u>	<u>\$ 678,729</u>
Liabilities and stockholders' equity:			
Liabilities:			
Interest bearing deposits	\$ 412,983	\$ 410,685	\$ 419,706
Noninterest bearing deposits	64,838	67,777	69,374
Short-term borrowings	55,826	63,885	40,119
Long-term debt	99,620	96,620	87,930
Other liabilities	5,516	5,181	8,739
Total liabilities	<u>638,781</u>	<u>644,128</u>	<u>625,868</u>
Stockholders' equity:			
Total stockholders' equity	<u>45,100</u>	<u>44,645</u>	<u>52,861</u>
Total liabilities and stockholders' equity	<u>\$ 683,881</u>	<u>\$ 688,773</u>	<u>\$ 678,729</u>

NORTHWAY FINANCIAL, INC.

STATEMENTS OF INCOME

(Unaudited)

Three Months
Ended March 31,
2008 2007

(Dollars in thousands, except per share data)

Interest and dividend income:		
Loans	\$ 7,791	\$ 7,817
Interest on debt securities:		
Taxable	1,253	1,215
Tax-exempt	376	315
Dividends	212	87
Federal funds sold	12	69
Interest bearing deposits	3	4
Total interest and dividend income	<u>9,647</u>	<u>9,507</u>
Interest expense:		
Deposits	2,730	2,853
Borrowed funds	1,508	1,470
Total interest expense	<u>4,238</u>	<u>4,323</u>
Net interest and dividend income	5,409	5,184
Provision for loan losses	270	120
Net interest and dividend income after provision for loan losses	<u>5,139</u>	<u>5,064</u>
Noninterest income:		
Service charges and fees on deposit accounts	741	714
Securities gains, net	261	141
Gains on sales of loans, net	39	33
Other	405	557
Total noninterest income	<u>1,446</u>	<u>1,445</u>
Noninterest expense:		
Salaries and employee benefits	2,906	2,977
Office occupancy and equipment	916	1,015
Amortization of core deposit intangibles	118	121
Other	1,402	1,409
Total noninterest expense	<u>5,342</u>	<u>5,522</u>
Income before income tax expense	1,243	987
Income tax expense	222	141
Net income	<u>\$ 1,021</u>	<u>\$ 846</u>
Per share data:		
Basic earnings per common share	\$ 0.41	\$ 0.29
Earnings per common share assuming dilution	\$ 0.41	\$ 0.29
Weighted average number of common shares, basic	2,506,804	2,982,815
Weighted average number of common shares, diluted	2,522,125	2,997,635

Stockholder Information

Corporate Headquarters

9 Main Street
Berlin, New Hampshire 03570

Contact

Richard P. Orsillo
Senior Vice President
Chief Financial Officer
(603) 752-1171

Stock Listing

Northway Financial, Inc. common stock
trades on the Over the Counter Bulletin
Board ("OTCBB") under the symbol:

NWYF

Transfer Agent

Computershare Trust Company, N.A.
PO Box 43078
Providence, RI 02940-3078
781-575-2879
<http://www.computershare.com>

Market Makers

Howe Barnes Hofer & Arnett has generally
been a market maker for Northway Financial,
Inc. common stock.



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**Second Quarter Report
2008**

TO OUR STOCKHOLDERS:

We are pleased with the improvement in earnings, particularly in light of the difficulty in the economy and the slowdown in the housing market. Not only are our earnings improving, but our loan demand continues to be strong. The total loan portfolio at June 30 has increased by \$53 million over the year-ago balances, and is a reflection of Northway's strong capability in commercial, real estate mortgage, and municipal lending, even in the face of a difficult economic environment. This growth in loan balances has been a major contributor to the total asset growth of \$30 million over last year. In the current circumstances, we continue to closely monitor asset quality, with respect to both existing loans and requests for new loans.

Net income for the quarter ended June 30, 2008 was \$1,143,000, or \$0.45 per share-basic, compared to \$816,000, or \$0.27 per share-basic, for the same quarter in 2007, an increase of \$327,000, or 40.1%. Net income for the six months ended June 30, 2008 was \$2,164,000, or \$0.86 per share-basic, compared to \$1,662,000, or \$0.56 per share-basic, for the six months ended June 30, 2007, an increase of \$502,000, or 30.2%. In addition to improved earnings, per share results were favorably affected by the reduction in outstanding shares as a result of the previously reported reverse and forward stock split transactions, which occurred on September 11, 2007.

Net interest and dividend income for the quarter ended June 30, 2008 increased \$255,000 to \$5,727,000 compared to \$5,472,000 for the same period last year. The provision for loan losses for the quarter ended June 30, 2008 increased \$150,000 to \$360,000 compared to \$210,000 for the same period in 2007. Securities gains for the quarter ended June 30, 2008 decreased \$84,000 to \$122,000 compared to \$206,000 for the same period last year. Other noninterest income for the quarter ended June 30, 2008 increased \$19,000 to \$1,351,000 compared to \$1,332,000 for the same period last year. Other operating expense decreased \$406,000 to \$5,470,000 for the quarter ended June 30, 2008 compared to \$5,876,000 for the same period last year. Income tax expense for the quarter ended June 30, 2008 increased \$119,000 from the quarter ended June 30, 2007.

Net interest and dividend income for the six months ended June 30, 2008 increased \$480,000 to \$11,136,000 compared to \$10,656,000 for the same period last year due primarily to an increase in average earning assets of \$27,000,000. The provision for loan losses for the six months ended June 30, 2008 increased \$300,000 to \$630,000 compared to \$330,000 for the same period in 2007, primarily due to the potential impact of the current

unfavorable economic conditions; and, to a lesser degree, an 11% increase in gross loans. Securities gains for the six months ended June 30, 2008 increased \$36,000 to \$383,000 compared to \$347,000 for the same period last year. Other noninterest income for the six months ended June 30, 2008 decreased \$100,000 to \$2,536,000 compared to \$2,636,000 for the same period last year. Other operating expense decreased \$586,000 to \$10,812,000 for the six months ended June 30, 2008 compared to \$11,398,000 for the same period last year due primarily to a decrease in salaries and benefits expense and equipment expense. Income tax expense for the six months ended June 30, 2008 increased \$200,000 from the same period in 2007.

At June 30, 2008, the Company had total assets of \$719,885,000 compared to \$689,954,000 at June 30, 2007, an increase of \$29,931,000. Federal funds sold decreased \$5,305,000 from June 30, 2007 to June 30, 2008. Securities available-for-sale decreased \$16,835,000 to \$123,972,000 at June 30, 2008 compared to \$140,807,000 at June 30, 2007. Loans at June 30, 2008 increased \$52,616,000 to \$540,988,000 compared to \$488,372,000 at June 30, 2007. Total deposits were \$502,964,000 at June 30, 2008 compared to \$497,896,000 at June 30, 2007, an increase of \$5,068,000. Securities sold under agreements to repurchase increased \$5,238,000 to \$52,641,000 at June 30, 2008 compared to \$47,403,000 at June 30, 2007. Other borrowings increased \$17,947,000 to \$106,970,000 at June 30, 2008 compared to \$89,023,000 at June 30, 2007.

Total equity decreased \$7,270,000 to \$44,512,000 at June 30, 2008 compared to \$51,782,000 at June 30, 2007 due primarily to the shares cashed out in the reverse and forward stock split transaction. Stockholders' equity of \$44,512,000 resulted in a book value of \$17.76 per share at June 30, 2008, based on 2,506,804 shares of common stock outstanding, an increase of \$0.43 per share from June 30, 2007.

On July 30, 2008, the Board of Directors declared a dividend of \$0.15 cents per share, an increase of 11% over the dividend declared last quarter. This dividend is payable on August 18, 2008 to shareholders of record on August 8, 2008.

William J. Woodward,
Chairman, President and Chief Executive Officer

NORTHWAY FINANCIAL, INC.**STATEMENTS OF CONDITION**

(Unaudited)

	JUNE 30,	DEC. 31,	JUNE 30,
(Dollars in thousands, except per share data)	2008	2007	2007
Assets:			
Cash and due from banks and interest-bearing deposits	\$ 18,188	\$ 19,784	\$ 19,492
Federal funds sold	-	-	5,305
Securities available-for-sale, at fair value	123,972	143,543	140,807
Federal Home Loan Bank stock	5,112	4,779	3,782
Loans held-for-sale	-	403	168
Loans, net before allowance for loan losses	540,988	489,969	488,372
Less: Allowance for loan losses	6,703	6,240	5,814
Loans, net	<u>534,285</u>	<u>483,729</u>	<u>482,558</u>
Premises and equipment, net	10,990	12,180	12,505
Other real estate owned	2,553	666	-
Core deposit intangibles	1,468	1,702	1,938
Goodwill	10,577	10,577	10,577
Other assets	12,740	11,410	12,842
Total assets	<u>\$ 719,885</u>	<u>\$ 688,773</u>	<u>\$ 689,954</u>
Liabilities and stockholders' equity:			
Liabilities:			
Deposits	\$ 502,964	\$ 478,462	\$ 497,896
Securities sold under agreements to repurchase	52,841	54,430	47,403
Other borrowings	106,970	106,055	89,023
Other liabilities	12,798	5,181	3,850
Total liabilities	<u>675,373</u>	<u>644,128</u>	<u>638,172</u>
Stockholders' equity:			
Total stockholders' equity	<u>44,512</u>	<u>44,645</u>	<u>51,782</u>
Total liabilities and stockholders' equity	<u>\$ 719,885</u>	<u>\$ 688,773</u>	<u>\$ 689,954</u>

NORTHWAY FINANCIAL, INC.

STATEMENTS OF INCOME

(Unaudited)

(Dollars in thousands, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Interest and dividend income:				
Loans	\$ 8,008	\$ 8,185	\$ 15,799	\$ 16,002
Interest on debt securities:				
Taxable	1,121	1,261	2,374	2,476
Tax-exempt	376	373	752	688
Dividends	184	77	396	164
Federal funds sold	3	100	15	169
Interest bearing deposits	2	12	5	16
Total interest and dividend income	<u>9,694</u>	<u>10,008</u>	<u>19,341</u>	<u>19,515</u>
Interest expense:				
Deposits	2,609	2,939	5,339	5,792
Borrowed funds	1,358	1,597	2,866	3,067
Total interest expense	<u>3,967</u>	<u>4,536</u>	<u>8,205</u>	<u>8,859</u>
Net interest and dividend income	5,727	5,472	11,136	10,656
Provision for loan losses	360	210	630	330
Net interest and dividend income after provision for loan losses	<u>5,367</u>	<u>5,262</u>	<u>10,506</u>	<u>10,326</u>
Noninterest income:				
Service charges and fees on deposit accounts	744	771	1,485	1,485
Securities gains, net	122	206	383	347
Gains on sales of loans, net	14	45	53	78
Other	593	516	998	1,073
Total noninterest income	<u>1,473</u>	<u>1,538</u>	<u>2,919</u>	<u>2,983</u>
Noninterest expense:				
Salaries and employee benefits	2,837	2,942	5,743	5,919
Office occupancy and equipment	754	835	1,513	1,722
Amortization of core deposit intangibles	116	118	234	239
Other	1,763	1,981	3,322	3,518
Total noninterest expense	<u>5,470</u>	<u>5,876</u>	<u>10,812</u>	<u>11,398</u>
Income before income tax expense	1,370	924	2,613	1,911
Income tax expense	227	108	449	249
Net income	<u>\$ 1,143</u>	<u>\$ 816</u>	<u>\$ 2,164</u>	<u>\$ 1,662</u>
Per share data:				
Basic earnings per common share	\$ 0.45	\$ 0.27	\$ 0.86	\$ 0.56
Earnings per common share assuming dilution	\$ 0.45	\$ 0.27	\$ 0.86	\$ 0.55
Weighted average number of common shares, basic	2,506,804	2,988,348	2,506,804	2,985,597
Weighted average number of common shares, diluted	2,520,641	3,003,933	2,521,397	3,000,897

Stockholder Information

Corporate Headquarters

9 Main Street
Berlin, New Hampshire 03570

Contact

Richard P. Orsillo
Senior Vice President
Chief Financial Officer
(603) 752-1171

Stock Listing

Northway Financial, Inc. common stock
trades on the Over the Counter Bulletin
Board ("OTCBB") under the symbol:

NWYF

Transfer Agent

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Market Makers

Howe Barnes Hofer & Arnett has generally
been a market maker for Northway Financial,
Inc. common stock.



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**Third Quarter Report
2008**

TO OUR STOCKHOLDERS:

I am pleased to inform you that, on October 29, 2008, the Board of Directors of Northway Financial, Inc. (the "Company") declared a dividend of \$0.15 per share, payable on November 20, 2008 to stockholders of record on November 10, 2008.

I also am pleased to report that, even in the midst of the widespread concerns about the health of our national economy, the Company's prudent and conservative community banking practices have resulted in our having solid core earnings for the third quarter and for the nine months ended September 30, 2008.

These core earnings reflect the fact that through September 30, 2008, the Company's loan portfolio increased by \$68.7 million (14%), and deposits increased \$32.9 million (7%) over the September 30, 2007 levels. In addition, net interest and dividend income for this period increased \$542,000 (3%) over last year, and operating expenses decreased \$874,000 (5%).

It does not appear that New Hampshire is experiencing the same severe problems which, unfortunately, are plaguing other areas of the country. Northway Bank, the Company's subsidiary bank, did not participate in sub-prime lending; the kind of lending that created problems for many larger banks. Some of our borrowers, however, are experiencing pressure in keeping up their regular payments. We believe that these situations are manageable.

Notwithstanding our strong performance in lending, deposit growth, net interest and dividend income and reduced operating expenses noted above, the Company's net income for the third quarter and year-to-date September 30, 2008 has been negatively impacted by the failure of the two government sponsored enterprises ("GSE") that play a huge role in the housing sector of the country's economy. These GSE – informally known as Freddie Mac and Fannie Mae – issued common and preferred stock that many banks were encouraged to buy for their investment portfolios by their respective regulators.

Over time, Northway Bank purchased \$6.0 million of these GSE perpetual preferred stocks. With the impending failure of both GSE, in early September 2008 the federal government took over control of them, placed them under conservatorship, and immediately terminated any further payment of dividends. This action is unprecedented in recent history. As a consequence of these events, the market value of these preferred stocks dropped precipitously, and we were required under generally accepted accounting principles ("GAAP") and regulatory accounting rules to "impair" them on our books; i.e. to record a loss reflecting their current very low market value.

This after-tax impairment loss, booked in the third quarter, was \$5.1 million because we were required under GAAP and regulatory accounting rules to record it as a "capital" loss in September. However, under the provisions of the Emergency Economic Stabilization Act of 2008 passed by Congress in early October and subsequently signed into law by the President, in October we were able to reclassify the loss and treat it as an "ordinary" loss for tax purposes. Thus, in October we booked an increase of approximately \$1.7 million in the tax benefit of the September impairment write-down. The effect of this somewhat complex set of regulations is that our after-tax loss on the write-down in value of the GSE preferred stocks was approximately \$3.4 million, and not the \$5.1 million loss we were required to book in September. Considering this adjustment, net income for the month of October was \$2.1 million, of which \$379,000 was core earnings.

Despite the required impairment write-down, it is important to note that the Company and Northway Bank continue to meet their regulators' highest standards with respect to the level of capitalization, which is one of the key metrics regulators use to describe the health of a bank-holding company and a bank. I am pleased to report that, as of September 30, 2008, the Company and Northway Bank remain well-capitalized, the highest rating. Our level of capital and regulatory designation of "well-capitalized", allows Northway Bank to help its customers meet their banking needs.

The Board of Directors and Management of the Company are supportive of the actions taken by Congress, the President, the U. S. Treasury and the Federal Reserve to stabilize the economy. It is a positive and encouraging signal from the Federal Government that they are willing to inject capital into the banking system, and to purchase some of the troubled loans. Depositors should be especially pleased that the insurance provided by the FDIC has been increased from \$100,000 to \$250,000 per eligible account.

The Company recorded a net loss for the quarter ended September 30, 2008 of \$4,319,000, or \$(1.72) per share-basic, compared to net income of \$1,080,000, or \$0.38 per share-basic, for the same quarter in 2007, a decrease of \$5,399,000. For the nine months ended September 30, 2008, the Company recorded a net loss of \$2,155,000, or \$(0.86) per share-basic, compared to net income of \$2,742,000, or \$0.93 per share-basic, for the nine months ended September 30, 2007, a decrease of \$4,897,000. The third quarter and year-to-date September 30, 2008 net losses include the after-tax Fannie Mae and Freddie Mac perpetual preferred stock impairment write-down of \$5,152,000.

If the Company had not been required, under GAAP and regulatory accounting rules, to record the loss from impairment of our holdings of Freddie Mac and Fannie Mae perpetual preferred stock, net income for the quarter ended September 30, 2008 would have been \$833,000, or \$0.33 per share-basic, compared to net income of \$1,080,000, or \$0.38 per share-basic, for the same quarter in 2007, a decrease of \$247,000. For the nine months ended September 30, 2008, net income would have been \$2,997,000 or \$1.20 per share-basic, compared to net income of \$2,742,000, or \$0.93 per share-basic, for the nine months ended September 30, 2007, an increase of \$255,000.

As noted above, despite the financial statement impact of the impairment charges, the Company and Northway Bank remain "well-capitalized" at September 30, 2008 under regulatory requirements.

Net interest and dividend income for the quarter ended September 30, 2008 increased \$62,000 to \$5,723,000 compared to \$5,661,000 for the same period last year. The provision for loan losses for the quarter ended September 30, 2008 increased \$150,000 to \$360,000 compared to \$210,000 for the same period in 2007. For the quarter ended September 30, 2008 the Company recorded net securities losses of \$39,000 compared to net securities gains of \$148,000 for the quarter ended September 30, 2007, a decrease of \$187,000. All other sources of noninterest income for the quarter ended September 30, 2008 amounted to \$1,060,000, compared to \$1,353,000 for the same period last year. During the quarter ended September 30, 2008, a write-down of equity securities, relating primarily to the above mentioned impairment of Freddie Mac and Fannie Mae perpetual preferred stock, of \$5,698,000 was recorded. All other types of noninterest expense decreased \$288,000 to \$5,393,000 for the quarter ended September 30, 2008 compared to \$5,681,000 for the same period last year. Income tax expense for the quarter ended September 30, 2008 decreased \$579,000 from the quarter ended September 30, 2007.

Net interest and dividend income for the nine months ended September 30, 2008 increased \$542,000 to \$16,859,000 compared to \$16,317,000 for the same period last year due primarily to an increase in average earning assets of \$29,000,000. The provision for loan losses for the nine months ended September 30, 2008 increased \$450,000 to \$990,000 compared to \$540,000 for the same period in 2007, primarily due to the potential impact of the current unfavorable economic conditions; and, to a lesser degree, a 14% increase in gross loans. Securities gains for the nine months ended September 30, 2008 decreased \$151,000 to \$344,000 compared to \$495,000 for the same period last year. Year-to-date September 30, 2008 all other sources of noninterest income of \$3,596,000 decreased \$393,000 over the comparable prior period last year. For the nine months ended September 30, 2008, a write-down of equity securities, relating primarily to the above-mentioned impairment of Freddie Mac and

Fannie Mae perpetual preferred stock, of \$5,698,000 was recorded. All other types of noninterest expense decreased \$874,000 to \$16,205,000 for the nine months ended September 30, 2008 compared to \$17,079,000 for the same period last year due primarily to a decrease in salaries and benefits expense, equipment expense and expenses associated with the 2007 reverse and forward stock split transaction. Income tax expense for the nine months ended September 30, 2008 decreased \$379,000 from the same period in 2007.

At September 30, 2008, the Company had total assets of \$721,111,000 compared to \$685,445,000 at September 30, 2007, an increase of \$35,666,000. Securities available-for-sale at fair value decreased \$33,798,000 to \$112,659,000 at September 30, 2008 compared to \$146,457,000 at September 30, 2007. Net unrealized losses included in the fair value of the securities available-for-sale were \$7,170,000 compared to \$1,395,000 at September 30, 2008. This increase is generally reflective of current economic conditions. Loans at September 30, 2008 increased \$68,703,000 to \$558,795,000 compared to \$490,092,000 at September 30, 2007. Total deposits were \$512,340,000 at September 30, 2008 compared to \$479,435,000 at September 30, 2007, an increase of \$32,905,000. Securities sold under agreements to repurchase decreased \$3,626,000 to \$48,605,000 at September 30, 2008 compared to \$52,231,000 at September 30, 2007. Other borrowings increased \$11,500,000 to \$117,120,000 at September 30, 2008 compared to \$105,620,000 at September 30, 2007.

Total equity decreased \$6,702,000 to \$37,787,000 at September 30, 2008 compared to \$44,489,000 at September 30, 2007 due primarily to the current year-to-date net loss of \$2,155,000 as well as an increase in the tax affected unrealized loss on available-for-sale securities of \$3,488,000. Stockholders' equity of \$37,787,000 resulted in a book value of \$15.07 per share at September 30, 2008, based on 2,506,804 shares of common stock outstanding, a decrease of \$2.68 per share from September 30, 2007.

On a positive note, I am pleased to report that the dividend declared is consistent with the dividend paid in the second quarter of 2008, and these both represent a significant increase in quarterly dividends over those paid in the past two years. Your Board of Directors and Management are pleased that, notwithstanding the unusual events taking place in the general economy, Northway's core operating performance throughout this year supports the payment of this third quarter dividend.

Both the Directors and Management intend to continue the prudent and conservative community banking practices that have guided them for many years, and throughout 2008.

During this period of stress and uncertainty about our national economy and markets, we are pleased that, consistent with our long-held principles of conservative banking, Northway Bank's depositors and borrowers can continue to call the bank "My Bank of Choice."

William J. Woodward,
Chairman, President and Chief Executive Officer

Should you have any questions pertaining to this report please contact Richard P. Orsillo our Chief Financial Officer at (603) 752-1171.

NORTHWAY FINANCIAL, INC.**STATEMENTS OF CONDITION**

(Unaudited)

	Sep. 30, 2008	Dec. 31, 2007	Sep. 30, 2007
<u>(Dollars in thousands, except per share data)</u>			
Assets:			
Cash and due from banks and interest-bearing deposits	\$ 13,629	\$ 19,784	\$ 13,202
Securities available-for-sale, amortized cost	119,829	144,418	147,852
Less: Net unrealized losses	7,170	875	1,395
Securities available-for-sale, fair value	<u>112,659</u>	<u>143,543</u>	<u>146,457</u>
Federal Home Loan Bank stock	5,159	4,779	4,669
Loans held-for-sale	106	403	485
Loans, net before allowance for loan losses	558,795	489,969	490,092
Less: Allowance for loan losses	6,990	6,240	6,032
Loans, net	<u>551,805</u>	<u>483,729</u>	<u>484,060</u>
Premises and equipment, net	10,745	12,180	12,887
Other real estate owned	890	666	-
Core deposit intangibles	1,353	1,702	1,820
Goodwill	10,577	10,577	10,577
Other assets	<u>14,188</u>	<u>11,410</u>	<u>11,288</u>
Total assets	<u>\$ 721,111</u>	<u>\$ 688,773</u>	<u>\$ 685,445</u>
Liabilities and stockholders' equity:			
Liabilities:			
Deposits	\$ 512,340	\$ 478,462	\$ 479,435
Securities sold under agreements to repurchase	48,605	54,430	52,231
Other borrowings	117,120	106,055	105,620
Other liabilities	5,259	5,181	3,670
Total liabilities	<u>683,324</u>	<u>644,128</u>	<u>640,956</u>
Stockholders' equity:			
Total stockholders' equity	<u>37,787</u>	<u>44,645</u>	<u>44,489</u>
Total liabilities and stockholders' equity	<u>\$ 721,111</u>	<u>\$ 688,773</u>	<u>\$ 685,445</u>

NORTHWAY FINANCIAL, INC.

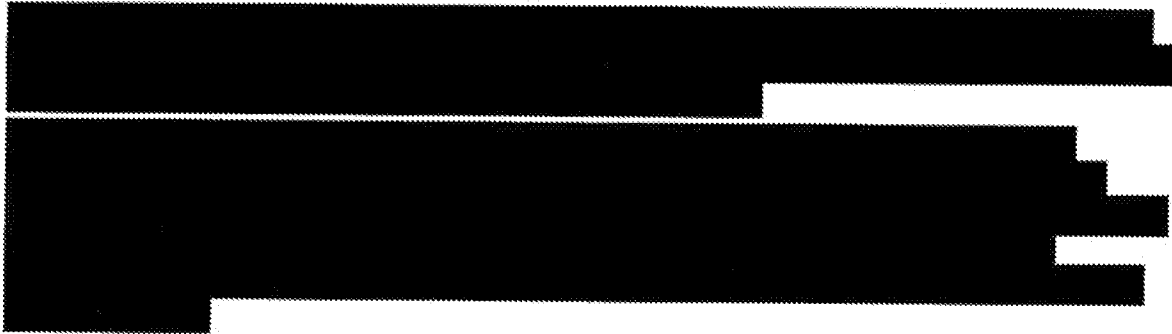
STATEMENTS OF INCOME

(Unaudited)	Three Months Ended Sep. 30,		Nine Months Ended Sep. 30,	
(Dollars in thousands, except per share data)	2008	2007	2008	2007
Interest and dividend income:				
Loans	\$ 8,263	\$ 8,406	\$ 24,062	\$ 24,351
Interest on debt securities:				
Taxable	1,006	1,368	3,380	3,844
Tax-exempt	373	319	1,125	1,064
Dividends	130	79	526	243
Federal funds sold	1	59	16	228
Interest bearing deposits	3	3	8	19
Total Interest and dividend income	<u>9,776</u>	<u>10,234</u>	<u>29,117</u>	<u>29,749</u>
Interest expense:				
Deposits	2,647	2,895	7,986	8,687
Borrowed funds	1,406	1,678	4,272	4,745
Total interest expense	<u>4,053</u>	<u>4,573</u>	<u>12,258</u>	<u>13,432</u>
Net interest and dividend income	5,723	5,661	16,859	16,317
Provision for loan losses	360	210	990	540
Net Interest and dividend income after provision for loan losses	<u>5,363</u>	<u>5,451</u>	<u>15,869</u>	<u>15,777</u>
NonInterest income:				
Service charges and fees on deposit accounts	739	707	2,224	2,192
Securities gains/(losses), net	(39)	148	344	495
Gains on sales of loans, net	25	52	78	130
Other	296	594	1,294	1,667
Total noninterest income	<u>1,021</u>	<u>1,501</u>	<u>3,940</u>	<u>4,484</u>
NonInterest expense:				
Salaries and employee benefits	2,947	2,911	8,690	8,830
Office occupancy and equipment	733	760	2,246	2,483
Amortization of core deposit intangibles	115	119	349	358
Write-down of equity securities	5,698	-	5,698	-
Other	1,598	1,891	4,920	5,408
Total noninterest expense	<u>11,091</u>	<u>5,681</u>	<u>21,903</u>	<u>17,079</u>
Income (loss) before income tax expense/(tax benefit)	(4,707)	1,271	(2,094)	3,182
Income tax expense/(tax benefit)	(388)	191	61	440
Net income (loss)	<u>\$ (4,319)</u>	<u>\$ 1,080</u>	<u>\$ (2,155)</u>	<u>\$ 2,742</u>
Per share data:				
Basic earnings per common share	\$ (1.72)	\$ 0.38	\$ (0.86)	\$ 0.93
Earnings per common share assuming dilution	\$ (1.72)	\$ 0.37	\$ (0.86)	\$ 0.92
Weighted average number of common shares, basic	2,506,804	2,883,642	2,506,804	2,951,238
Weighted average number of common shares, diluted	2,514,612	2,901,361	2,519,347	2,967,642

SCHEDULE G

NO COMPANY MATERIAL ADVERSE EFFECT

Exceptions to the representation and warranty in Section 2.2(g) of the Securities Purchase Agreement — Standard Terms:



SCHEDULE H

EMPLOYEE BENEFIT MATTERS

Exceptions to the representation and warranty in Section 2.2(n)(3) of the Securities Purchase Agreement — Standard Terms:

