SECURITIES AND EXCHANGE COMMISSION

FORM 10-K

Annual report pursuant to section 13 and 15(d)

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 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, 1998 — Commission File No. 0-14895

Granite State Bankshares, Inc.
(Exact name of registrant as specified in its charter)

New Hampshire	02-0399222
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
122 West Street, Keene, New Hampshire	03431
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: (603) 352-1600

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

Securities registered pursuant to Section 12 (g) of the Act: Common Stock, $1.00 par value

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 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes (X) 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 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. ( )

The aggregate market value of the voting common stock held by non-affiliates of the Registrant, based on the closing bid price of March 18, 1999, was $100,216,000. For purposes of this calculation, the affiliates of the Registrant include its directors and executive officers. Although such directors and executive officers of the Registrant performing policy-making functions were assumed to be "affiliates" of the Registrant, this classification is not to be interpreted as an admission of such status.

As of March 18, 1999, the number of shares of the Registrant's common stock outstanding of record (exclusive of treasury shares) was 5,870,481.

DOCUMENTS INCORPORATED
BY REFERENCE

The following documents, in whole or in part, are specifically incorporated by reference in the indicated Part of the Annual Report on Form 10-K:

Document	Part
Annual Report to Stockholders for the year ended December 31, 1998	Part I, Item 1 (c) (5), "Statistical Information"
	Part II, Item 6 Selected Financial Data
	Part II, Item 7,

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	"Management's Discussion and Analysis of Financial Condition and Results of Operations"
	Part II, Item 7a, "Quantitative and Qualitative Disclosures About Market Risk"
	Part II, Item 8 "Financial Statements and Supplementary Data"
Proxy Statement for the 1999 Annual Meeting of Stockholders	Part III, Item 10, "Directors and Executive Officers of the Registrant"
	Part III, Item 11, "Executive Compensation"
	Part III, Item 12, "Security Ownership of Certain Beneficial Owners and Management"
	Part III, Item 13, "Certain Relationships and Related Transactions"

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PART I

Item 1. Description of Business

(a) General Development of Business

Granite State Bankshares, Inc. ("Granite State" or "Company") is a

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single-bank holding company which was formed in 1986 to acquire all of the stock of the Granite Bank, formerly Granite Bank of Keene and Keene Savings Bank, upon its conversion from a mutual savings bank to a state-chartered guaranty (stock) savings bank. Since that time, the Company has acquired Primary Bank, the Durham Trust Company, First Northern Co-operative Bank, First National Bank of Peterborough and the Granite Bank of Amherst.

In March of 1987, Granite State organized a mortgage corporation, GSBI Mortgage Corporation, for purposes of expanding the residential loan programs it could offer, as well as improving the efficiency and effectiveness of its participation in the secondary mortgage markets. The mortgage corporation now operates as a division of Granite Bank and services Cheshire, Hillsborough, Strafford, Merrimack and Rockingham counties, New Hampshire, with a wide variety of mortgage loan products.

In July of 1987, the Granite Bank of Amherst opened for business as a state-chartered guaranty (stock) savings bank, and was the result of the purchase from the Amoskeag Bank of their Amherst branch office. In June of 1989 it was merged into the First National Bank of Peterborough under the name of Granite Bank, N.A. In March of 1990 Granite Bank, N.A. was merged into Granite Bank.

In October of 1988, First Peterborough Bank Corp. was merged into Granite State, leaving Granite State with the First National Bank of Peterborough ("First National"). First National was a national bank engaged in substantially all of the business operations customarily conducted by a commercial bank in New Hampshire. In June of 1989 the name was changed to Granite Bank, N.A., when it absorbed Granite Bank of Amherst. In March of 1990, Granite Bank, N.A. was merged into Granite Bank.

In August of 1991, Granite Bank entered into a purchase and assumption agreement with the Resolution Trust Company ("RTC"), whereby it acquired certain assets and assumed certain liabilities of First Northern Co-operative Bank ("First Northern"), headquartered in Keene, New Hampshire, which was under RTC conservatorship.

In November of 1991, Granite Bank entered into a purchase and assumption agreement with the Federal Deposit Insurance Corporation ("FDIC"), whereby it acquired certain assets and assumed certain liabilities of Durham Trust Company ("Durham"), headquartered in Durham, New Hampshire. The FDIC was the liquidating agent of Durham Trust Company.

Granite Bank completed its conversion from a state-chartered guaranty (stock) savings bank to a New Hampshire state-chartered commercial bank during 1991.

Effective after the close of business October 31, 1997, the Company completed its acquisition of Primary Bank by the merger of Primary Bank with and into the Company's subsidiary, Granite Bank. See also Note 2 to the Consolidated Financial Statements in the Annual Report to Stockholders for the year ended December 31, 1998 which is incorporated herein by reference.

(b) Financial Information about Industry Segments

Not applicable.

(c) Narrative Description of Business

(1) General Description of Business

Granite State operates as a single bank holding company by virtue of its ownership of 100% of the stock of Granite Bank, a New Hampshire chartered commercial bank (referred to as the "Bank"). The Company has grown profitably over the past several years through several strategic acquisitions and by leveraging its capital. This activity strengthened the franchise and assisted in the transition from a thrift institution into a full-service commercial bank. Currently, the Company does not transact any significant business other than through the Bank.

The Bank has been and continues to be a community oriented commercial bank offering a variety of financial services. The principal business of the Bank consists of attracting deposits from the general public and underwriting loans secured by residential and commercial real estate and other loans. The

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bank also originates fixed rate residential real estate loans for sale in the secondary mortgage market.

The Company has, and continues to devote considerable resources toward the enhancement of computer systems and operating procedures to position itself to compete effectively in its local markets.

The Bank offers a wide range of consumer and commercial services, including: commercial demand deposits, consumer regular and interest-bearing (NOW) checking and regular savings accounts; certificates of deposit; residential and commercial real estate loans; secured and unsecured consumer and commercial loans; and cash management services.

The Company's distribution network for its services is comprised of its main office in Keene, full-service banking offices in Antrim, Amherst, Chesterfield, Concord, Durham, Hillsborough, Jaffrey, Merrimack, Milford, Nashua, Portsmouth, Peterborough and Weare and 41 automatic teller machines ("ATMs") located in Antrim, Amherst, Chesterfield, Concord, Dublin, Durham, Fitzwilliam, Greenfield, Hillsborough, Jaffrey, Keene, Merrimack, Milford, Nashua, Portsmouth, Peterborough, West Swanzey, North Swanzey and Weare. All of the office and ATM locations are in the State of New Hampshire.

Risk Management

In the normal course of business, the Company is subject to various risks, the most significant of which are credit, liquidity and market risk, which includes interest rate risk. Although the Company cannot eliminate these risks, it has risk management processes designed to provide for risk identification, measurement, monitoring and control. The Board of Directors establishes policies with respect to risk management, lending, investment, asset/liability management and interest rate risk and reviews and approves these policies annually. The Board of Directors delegates the responsibility for carrying out these policies to management.

Credit Risk

Credit risk represents the possibility that a customer or counterparty may not perform in accordance with contractual terms. Credit risk results from extending credit to customers, purchasing securities and entering into certain off-balance-sheet financial transactions (which are primarily commitments to originate loans, unused lines and standby letters of credit or unadvanced portions of construction loans). Risk associated with the extension of credit (including off-balance sheet items) includes general risk, which is inherent in the lending business, and risk specific to individual borrowers. Risk associated with purchasing securities primarily centers around the credit quality of the issuer of the security. The Company seeks to manage credit risk through portfolio diversification, investments in highly rated securities, loan underwriting policies and procedures and loan monitoring practices.

Liquidity Risk

Liquidity represents an institution's ability to generate cash or otherwise obtain funds at reasonable rates to satisfy commitments to borrowers and demands of depositors and to invest in strategic initiatives. Liquidity risk represents the likelihood the Company would be unable to generate cash or otherwise obtain funds at reasonable rates for such purposes. Liquidity is managed through the coordination of the relative maturities of assets, liabilities and off-balance sheet positions and is enhanced by the ability to raise funds with direct borrowings.

Market Risk

Market risk reflects the risk of economic loss resulting from adverse changes in market prices and interest rates. The risk of loss can be reflected in diminished current values and/or reduced potential net interest income in future periods. The Company's market risk arises primarily from interest rate risk. The Company is also exposed to market price risk through its investments in marketable equity securities. Market price risk related to investments in marketable equity securities is the potential loss in estimated fair value

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resulting from adverse changes in prices quoted by stock markets. The Company manages this risk by closely monitoring market developments and reviewing current financial statements and other reports published by the issuers of the equity securities.

Interest Rate Risk

Interest rate risk arises primarily through the Company's normal business activities of extending loans and taking deposits. Interest rate risk is the sensitivity of net interest income and the market value of financial instruments to the timing, magnitude and frequency of changes in interest rates. Interest rate risk results from various repricing frequencies and the maturity structure of assets, liabilities and off-balance-sheet positions. Interest rate risk also results from, among other factors, changes in the relationship or spread between interest rates. Many factors, including economic and financial conditions, general movements in market interest rates and consumer preferences, affect the spread between interest earned on assets and interest paid on liabilities. Interest rate caps are used to alter the interest rate characteristics on the net interest spread. The Company uses a number of measures to monitor and manage interest rate risk, including financial planning models which recalculates the estimated net present value of equity and net interest and dividend income of the Company assuming instantaneous, permanent parallel shifts in market interest rates.

For additional information relating to the Company's risk management processes, see Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's Annual Report to Stockholders for the year ended December 31, 1998, which is incorporated herein by reference.

(2) Regulation and Supervision

General

Granite State is a registered bank holding company under the Bank Holding Company Act of 1956 ("BHCA"), and as such, is subject to regulation by the Federal Reserve Board ("FRB"). Granite Bank is a New Hampshire-chartered commercial bank, the deposit accounts of which are insured by the FDIC. As such, it is subject to the regulation, supervision and examination of the New Hampshire Bank Commissioner ("Commissioner") and the FDIC. See "New Hampshire Law" and "Insurance of Deposits". It is a member of the Federal Home Loan Bank of Boston ("FHLB").

The federal and state laws and regulations which are applicable to banks regulate, among other things, the scope of their business, their investments, the reserves required to be kept against deposits, the timing of the availability of deposited funds and the nature and amount of collateral for certain loans. The laws and regulations governing the Bank generally have been promulgated to protect depositors and not for the purpose of protecting stockholders. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the Commissioner, the FRB, the FDIC or the United States Congress, could have a material adverse impact on the Company, the Bank and their operations.

New Hampshire Law

As a New Hampshire-chartered commercial bank, Granite Bank is subject to the applicable provisions of state law and the regulations adopted thereunder by the Commissioner. Granite Bank derives its lending and investment powers from New Hampshire law and is subject to periodic examination by and reporting requirements of the Commissioner, who also has specific statutory jurisdiction over certain banking activities, mergers and the creation of new powers. The Commissioner has authority to take various enforcement actions against banks, or bank directors or officers, that engage in violations of law or unsafe or unsound practices. The Commissioner also may appoint a receiver or conservator for a bank under certain circumstances.

The Bank is required under New Hampshire law to maintain a reserve of

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the lesser of not less than 12% of the amount of demand deposits and 5% of the amount of time and savings deposits in cash or in specified short-term investments, or the reserve requirements established by the FRB. At December 31, 1998 this requirement was satisfied.

Granite State is also subject to the periodic examination and reporting requirements of the Commissioner. Under New Hampshire law, Granite State may not acquire ownership or control of more than 12 banking affiliates, including (i) banking institutions chartered by the state and actively engaged in business as such in the State and (ii) national banks authorized to transact business in the State, neither may it acquire ownership or control of any of the foregoing if, as a result, the Company and its banking affiliates would hold deposits in New Hampshire in excess of 20% of the total deposits of all federal and state-chartered banking institutions, including savings associations, operating in New Hampshire. At the present time the total of the Bank's deposits are substantially less than 20% of total New Hampshire deposits.

The Bank pays assessments to the Commissioner's office to support its operations. In 1998, these assessments totaled $13,852.

Federal Deposit Insurance Corporation

Safety and Soundness Regulations

The federal regulatory agencies, including the FDIC, were required to prescribe standards for depository institutions under their jurisdiction relating to a variety of operating matters such as internal controls, information systems and internal audit systems, loan documentation and credit underwriting, interest rate risk exposure, asset growth and quality and employee compensation. The federal banking agencies have adopted a final rule containing Interagency Guidelines Prescribing Standards for Safety and Soundness ("Guidelines") to implement safety and soundness standards required under the Federal Deposit Insurance Act. The Guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The standards set forth in the Guidelines address internal controls and information systems; internal audit systems; credit underwriting; loan documentation; interest rate risk exposure; asset growth; and compensation, fees and benefits. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the Guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard, as required by the Federal Deposit Insurance Act. The final rule establishes deadlines for the submission and review of such safety and soundness compliance plans when such plans are required.

Investment Authority

The FDIC regulations restrict investments by and activities of insured state banks such as the Bank. Effective December 19, 1992, neither state banks nor their subsidiaries may engage in activities, as principal, not permissible for national banks or their subsidiaries unless the FDIC determines that the activity would pose no significant risk to the deposit insurance fund and the bank is and continues to comply with applicable federal capital standards. Additionally, subject to exceptions for majority-owned subsidiaries and certain other limited exceptions, state banks may not acquire or retain any equity investment of a type or in an amount not permissible for national banks. The Federal Deposit Insurance Act does contain a partial exception from these requirements for stock and mutual fund ownership by banks which were authorized to make such investments by state law and had made such investments during a specified time period. The Bank believed it qualified for the exception and applied to the FDIC for approval. During 1993, the Bank received approval from the FDIC to invest in equity securities listed on a national exchange and registered shares of mutual funds, which are otherwise impermissible investments for national banks, in an amount not to exceed 100 percent of its Tier 1 capital, which amounted to $66,369,000 at December 31, 1998.

Capital Requirements

The FDIC has issued regulations that require Bank Insurance Fund-insured

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banks, such as the Bank, to maintain minimum levels of capital. The regulations establish a minimum leverage (core) capital requirement of not less than 3% core capital to total assets for banks in the strongest financial and managerial condition, with a CAMELS Rating of 1 (the highest rating of the FDIC for banks). For all other banks, the minimum leverage capital requirement is 3% plus an additional cushion of at least 1% to 2%. Core capital is comprised of the sum of common stockholders' equity, noncumulative perpetual preferred stock (including any related surplus) and minority interests in consolidated subsidiaries, minus all intangible assets (other than qualifying servicing rights and purchased credit card relationships), identified losses and investments in certain subsidiaries. At December 31, 1998, the Bank's ratio of core capital to average total assets equaled 7.82%, which exceeded the minimum leverage requirement.

The FDIC also requires that banks meet a risk-based capital standard. The risk-based capital standard requires the maintenance of a ratio of total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of 8.00%. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on the risks the FDIC believes are inherent in the type of asset. The components of core capital are equivalent to those discussed earlier under the leverage capital requirement. The components of supplementary capital currently include cumulative perpetual preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock and allowance for loan and lease losses. Allowance for loan and lease losses included in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of capital counted toward supplementary capital cannot exceed 100% of core capital. At December 31, 1998, the Bank met its risk based capital requirements with a core risk-based capital to risk-weighted assets ratio of 12.60% and a total risk-based capital to risk-weighted assets ratio of 13.85%.

Prompt Corrective Action Regulations

Effective December 19, 1992, the regulatory agencies, including the FDIC, were required to take certain supervisory actions against undercapitalized banks. The severity of such action depends upon the degree of undercapitalization. The regulations generally require subject to a narrow exception, the appointment of a receiver or conservator for banks whose tangible capital level falls below 2% of assets, which appointment is to be made within a maximum of 270 days after the threshold is reached. At December 31, 1998, the subsidiary bank was considered "well capitalized" for purposes of the FDIC's prompt corrective action regulations. See also Capital Resources and Liquidity - Capital Resources in the Management's Discussion and Analysis Section of the Annual Report to Stockholders for the year ended December 31, 1998.

The FDIC may institute proceedings against any insured bank or any director, trustee, officer or employee of such bank who engages in unsafe and unsound practices, or the violation of applicable laws and regulations. The FDIC has the authority to terminate or suspend insurance of accounts pursuant to procedures established for that purpose and may appoint a receiver or conservator under certain circumstances.

Community Reinvestment Act

Under the Community Reinvestment Act, as amended ("CRA"), every FDIC-insured institution has a continuing and affirmative obligation consistent with safe and sound banking practices to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the FDIC to assess the Bank's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications, such as a merger or the establishment of a branch, by the Bank. An unsatifactory rating may be used as the basis for the denial of an application by the FDIC. The Bank's latest CRA rating, received from the FDIC was "satisfactory".

Insurance of Deposits

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The deposit accounts of the Bank are insured by the FDIC up to applicable limits, generally $100,000 per insured depositor. The FDIC issues regulations, conducts periodic examinations, requires the filing of reports and generally supervises the operations of its insured banks. The approval of the FDIC is required prior to a merger or consolidation, or the establishment or relocation of an office facility. The majority of the Bank's deposits are insured by the Bank Insurance Fund ("BIF"). Approximately 6.3% of the Bank's deposits are OAKAR deposits, which are deposits purchased from institutions previously insured by the Savings Association Insurance Fund ("SAIF"), and are assessed at the premium rate applicable to SAIF deposits.

During 1998, the Bank paid annual insurance premiums of $93,000 compared with $82,000 in 1997.

The FDIC has issued regulations which established a system for setting deposit insurance premiums based upon the risks a particular bank or savings association poses to the deposit insurance funds. Under the rule, the FDIC assigns an institution to one of three capital categories consisting of 1) well capitalized, 2) adequately capitalized or 3) undercapitalized, and one of three supervisory subcategories. An institution's assessment rate depends on the capital category and supervisory category to which it is assigned. In view of the BIF's achieving a statutory required capitalization ratio, the FDIC adopted a new assessment rate of 0 to 27 basis points per $100 of deposits.

On September 30, 1996, the President of the United States signed into law the Deposit Insurance Funds Act of 1997 (the "Funds Act") which, among other things, imposed a special one-time assessment on SAIF deposits to recapitalize the SAIF. As required by the Funds Act, the FDIC imposed a special assessment on SAIF assessable deposits held as of March 31, 1995, payable November 27, 1996 (the "SAIF Special Assessment"). The SAIF Special Assessment on the Bank's SAIF - assessable OAKAR deposits was recognized as an expense in the quarter ended September 30, 1996 and was paid by the Bank during the quarter ended December 31, 1996 and was tax deductible. The SAIF Special Assessment recorded by the Bank amounted to $187,000.

The Funds Act also spreads the obligations for payment of the Financing Corporation ("FICO") bonds across all SAIF and BIF members. Beginning on January 1, 1997, BIF deposits will be assessed for FICO payments at a rate of 20% of the rate assessed on SAIF deposits. Based on current estimates by the FDIC, BIF deposits will be assessed a FICO payment of 1.3 basis points, while SAIF deposits will pay an estimated 6.3 basis points. Full pro rata sharing of the FICO payments between BIF and SAIF members is expected to occur on the earlier of January 1, 2000 or the date the BIF and SAIF are merged.

As a result of the Funds Act, the FDIC lowered SAIF assessments to 0 to 27 basis points effective January 1, 1997, a range comparable to that of BIF members. However, SAIF deposits will continue to be assessed at the higher FICO rate described above. Management cannot predict the level of FDIC insurance assessments on an on-going basis, or whether the BIF and SAIF will eventually be merged.

Federal Reserve System

Under FRB regulations, the Bank is required to maintain reserves against its transaction accounts (primarily checking and NOW accounts), non-personal money market deposit accounts, and non-personal time deposits. Because reserves must generally be maintained in cash or in non-interest bearing accounts, the effect of the reserve requirement is to increase the Bank's cost of funds. For most of 1998, these regulations required reserves of 3% of total transaction accounts of up to $47.8 million. Total transaction accounts amounting to over $47.8 million required a reserve of $1.4 million plus 10% (this rate is set by the FRB and can range from 8% to 14%) of that portion of total transaction accounts in excess of such amount. Institutions were permitted to designate and exempt $4.7 million of reservable liabilities from these reserve requirements. These amounts and percentages are subject to adjustment by the FRB. The Bank was in compliance with its reserve requirements at December 31, 1998. The Bank also has the authority to borrow from the Federal Reserve Board "discount window" to meet its short-term liquidity needs.

During December, 1998, the amount of reservable liabilities exempt from reserve requirements was increased to $4.9 million and the level at which reservable liabilities would be subject to the 10% rate was lowered to $46.5

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million. Under the FRB regulations the survivor of a merger is also entitled to a tranche loss adjustment in the calculation of the reserve requirement. In connection with the acquisition of Primary Bank, the Company received a tranche loss adjustment of $3.6 million as of October 31, 1997. This tranche loss adjustment is reduced by 12.5% approximately every 3 months and will be reduced to zero by August 12, 1999. The effects of these recent actions will not have any significant impact on the Bank's liquidity and profitability.

Under the Federal Change in Bank Control Act ("CIBCA"), a prior notice must be submitted to the FRB if any person or group acting in concert seeks to acquire 10% or more of Granite State common stock, unless (if less than 25% is to be beneficially owned) the FRB finds that the acquisition will not result in change in control. Under CIBCA, the FRB has 60 days within which to act, taking into consideration factors similar to those under the Bank Holding Company Act ("BHCA"). Under the BHCA, any company would be required to obtain prior approval from the FRB before obtaining control of the Holding Company. Control generally is defined as beneficial ownership of 25 percent or more of any class of voting securities of the Company. An existing bank holding company would need to receive prior FRB approval before acquiring more than 5% of the voting securities of the Company.

Granite State and its subsidiary are subject to examination, regulation and periodic reporting by the FRB under the BHCA. FRB approval is required for acquisitions of either financial institutions or other entities, or the commencement of new activities by the Company. Pursuant to recent legislation, interstate holding company acquisitions of banks are permitted generally without regard to state law, except state laws regarding deposit concentration. The legislation also contemplates interstate expansion by bank merger or de novo branching if the states involved allow. Granite State and its subsidiary may engage only in activities that are deemed to be related to banking by the FRB. The FRB has adopted capital adequacy guidelines for bank holding companies (on a consolidated basis) substantially similar to those of the FDIC for the Bank.

The Federal Reserve Board has issued guidelines for a risk-based approach to measuring the capital adequacy of bank holding companies and state-chartered banks which are members of the Federal Reserve System. These capital requirements generally call for an 8 percent total capital ratio, of which 4 percent must be comprised of Tier I capital. Risk-based capital ratios are calculated by weighting assets and off-balance sheet instruments according to their relative credit risks. In addition to the risk-based capital standard, bank holding companies such as the Company must maintain a minimum leverage ratio of Tier I capital to total assets of at least 4 percent, with Tier I capital for this purpose being defined consistent with the risk-based capital guidelines. At December 31, 1998, Granite State had consolidated Tier I and total risk-based capital ratios of 13.17% and 14.42%, respectively and a leverage ratio of Tier I capital to average total assets of 8.18%.

Federal Home Loan Bank System

Granite Bank is a member of the FHLB of Boston, which is one of 12 regional Federal Home Loan Banks. The FHLB serves as a reserve or central bank for its members. It is funded primarily from proceeds derived from the sale of consolidated obligations of the Federal Home Loan Bank system. It makes advances (i.e., loans) to members in accordance with policies and procedures established by the Board of Directors of the FHLB. The Bank's membership in the FHLB is voluntary and can be terminated by the Bank at any time when its advances are paid.

As a member of the FHLB, the Bank is required to purchase and hold stock in the FHLB in an amount equal to the greater of 1% of the aggregate of unpaid residential mortgage loan balances and the carrying value of mortgage-backed securities outstanding at the end of the year; a percentage of its outstanding advances from the FHLB of Boston; or 1% of 30% of total assets. As of December 31, 1998, Granite Bank held stock in the FHLB in the amount of $7,201,000 and was required to maintain an investment in such stock of $4,031,000.

(3) Monetary Policies

Granite State and the Bank are affected by the monetary and fiscal policies of various agencies of the United States Government, including the Federal Reserve System. In view of changing conditions in the national economy and in the money markets, it is impossible for the management of Granite State

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to accurately predict future changes in monetary policy or the effect of such changes on the business or financial condition of Granite State.

(4) Employees

As of December 31, 1998, Granite State and its subsidiary employed 309 full time equivalent officers and employees. Granite State considers relations with its employees to be satisfactory. None of the employees of the Company or its subsidiary are represented by a collective bargaining group.

(5) Statistical Information

The statistical information on Granite State set forth in the following sections is furnished pursuant to Industry Guide 3 under the Securities Exchange Act of 1934.

(A) Distribution of Assets, Liabilities, and Stockholders' Equity; Interest Rates and Interest Differential

Information regarding the distribution of assets, liabilities and stockholders' equity; interest rates and interest differential for each of the three years in the period ended December 31, 1998, on page 21 of the Annual Report to Stockholders for the year ended December 31, 1998 are incorporated herein by reference.

(B) Rate/Volume Analysis

Information regarding the dollar amount of changes in interest income and interest expense for interest earning assets and interest bearing liabilities attributable to changes in interest rates and changes in volume for each of the two years in the period ended December 31, 1998, on page 22 of the Annual Report to Stockholders for the year ended December 31, 1998 are incorporated herein by reference.

(C) Investment Portfolio

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; debt and equity securities that are bought and held principally for the purpose of selling in the near term are 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 in accumulated other comprehensive income as a separate component of stockholders' equity, net of estimated income taxes. The Company classifies its securities into three categories: held-to-maturity, available-for-sale and held for trading. The Company had no securities classified as trading securities at or during the years ended December 31, 1998, 1997 and 1996. In the fourth quarter of 1997 the acquisition of Primary Bank necessitated a transfer of securities held to maturity with an amortized cost of $22,226,000 and a net unrealized loss of $156,000 to securities available for sale in order to maintain the Company's existing interest rate risk profile.

The following table sets forth the amortized cost, unrealized gains and losses, and estimated market values of securities held to maturity and securities available for sale at December 31, 1998, 1997 and 1996.

<TABLE>
<CAPTION>

<S>	Amortized Cost <C>	Unrealized Gains <C>	Unrealized Losses <C>	Estimated Market Value <C>
		(In Thousands)		
Securities held to maturity				
At December 31, 1998				
US Government agency obligations	$ 17,265	$ 230		$ 17,495
Other corporate obligations	5,012	41		5,053
Total securities held to maturity	$ 22,277	$ 271	$ 0	$ 22,548

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Securities available for sale				
At December 31, 1998				
US Treasury obligations	$ 82,521	$ 1,195		$ 83,716
US Government agency obligations	55,961	112	$ 75	55,998
Other corporate obligations	46,593	150	286	46,457
Mortgage-backed securities:				
FNMA	7,045	35	49	7,031
FHLMC	2,876	2	25	2,853
GNMA	1,190	59	3	1,246
SBA	552	16		568
Total mortgage-backed securities	11,663	112	77	11,698
Mutual Funds	6,326	105	29	6,402
Marketable equity securities	14,122	2,785	1,413	15,494
Total securities available for sale	$ 217,186	$ 4,459	$ 1,880	$ 219,765
Securities held to maturity				
At December 31, 1997				
US Government agency obligations	$ 33,910	$ 285	$ 25	$ 34,170
Total securities held to maturity	$ 33,910	$ 285	$ 25	$ 34,170
Securities available for sale				
At December 31, 1997				
US Treasury obligations	$ 82,470	$ 499		$ 82,969
US Government agency obligations	44,218	31	$ 50	44,199
Other corporate obligations	8,493	16	1	8,508
Mortgage-backed securities:				
FNMA	11,723	49	95	11,677
FHLMC	6,562	26	41	6,547
GNMA	2,418	84		2,502
SBA	765	17		782
Total mortgage-backed securities	21,468	176	136	21,508
Mutual Funds	6,005	130	22	6,113
Marketable equity securities	6,719	8,664		15,383
Total securities available for sale	$ 169,373	$ 9,516	$ 209	$ 178,680
Securities held to maturity				
At December 31, 1996				
US Government agency obligations	$ 67,711	$ 109	$ 504	$ 67,316
Mortgage-backed securities:				
FNMA	7,030	32	141	6,921
FHLMC	1,000		99	901
GNMA	7,227	112	113	7,226
SBA	1,011	11	7	1,015
Other	424		11	413
Total mortgage-backed securities	16,692	155	371	16,476
Total securities held to maturity	$ 84,403	$ 264	$ 875	$ 83,792
Securities available for sale				
At December 31, 1996				
US Treasury obligations	$ 25,847	$ 26	$ 21	$ 25,852
US Government agency obligations	65,748	21	424	65,345
Other corporate obligations	6,475		39	6,436
Mortgage-backed securities:				
FNMA	33,284	59	233	33,110
FHLMC	32,402	39	260	32,181
GNMA	3,577	1	69	3,509
Total mortgage-backed securities	69,263	99	562	68,800
Mutual Funds	5,439	11	27	5,423
Marketable equity securities	7,282	3,329	5	10,606

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Total securities available for sale	$ 180,054	$ 3,486	$ 1,078	$ 182,462

</TABLE>

As a member of the Federal Home Loan Bank (FHLB) of Boston, the Bank is required to invest in $100 par value stock of the FHLB of Boston in the amount of 1% of its outstanding loans secured by residential housing, or 1% of 30% of total assets, or a percentage of its outstanding advances from the FHLB of Boston, whichever is higher. When such stock is redeemed, the Bank would receive from the FHLB of Boston an amount equal to the par value of the stock. As of December 31, 1998, 1997 and 1996, the Company had investments in FHLB of Boston stock of $7,201,000, $7,201,000, and $6,365,000 respectively. At December 31, 1998 the weighted average yield on FHLB of Boston stock was 6.40%.

The following table sets forth the maturity distribution of securities held to maturity and securities available for sale at December 31, 1998 and the weighted average yields of such securities (calculated on the basis of the amortized cost and effective yields weighted for the scheduled maturity of each security).

<TABLE>
<CAPTION>

<S>	Amortized Cost <C> (In Thousands)	Weighted Average Yield <C>
US Treasury obligations		
Due within 1 year	$ 49,980	5.83%
Due after 1 but within 5 years	32,541	6.13%
Total	82,521	5.95%
US Government Agency obligations		
Due within 1 year	-	-
Due after 1 but within 5 years	54,961	5.93%
Due after 5 but within 10 years	18,265	6.59%
Total	73,226	6.09%
Other corporate obligations		
Due within 1 year	-	-
Due after 1 but within 5 years	28,087	5.73%
Due after 5 but within 10 years	18,147	5.78%
Due after 10 years	5,371	7.26%
Total	51,605	5.91%
Mortgage-backed securities		
Due within 1 year	16	9.00%
Due after 1 but within 5 years	143	7.74%
Due after 5 but within 10 years	1,179	6.59%
Due after 10 years	10,325	5.98%
Total	11,663	6.07%
Total debt securities	219,015	5.99%
Mutual fund shares*	6,326	5.28%
Marketable equity securities*	14,122	2.71%
Net unrealized gains on securities available for sale	2,579	-
Total securities held to maturity and securities available for sale	$ 242,042	5.78%

</TABLE>

Included in total debt securities above are U.S. Government Agency and other corporate obligations classified as securities held to maturity, with an

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amortized cost of $22,277,000, all of which are due after five years, but within ten years with a weighted average yield of 6.52%. All other debt securities are classified as securities available for sale.

*Mutual fund shares and marketable equity securities have no stated maturity, and are therefore considered to be due after 10 years.

The Company owned one security included in securities available for sale of an individual issuer, with a book value in excess of 10% of stockholders' equity, excluding U.S. Treasury and U.S. Government agency obligations, at December 31, 1998. The Company owned $10,000,000 par value of Household Finance Corporation floating rate notes due June 17, 2005 with an amortized cost of $9,984,000 and a book value and estimated market value of $9,838,000.

(D) Loan Portfolio

The following table shows Granite State's loan distribution as of December 31:

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>	1996 <C>	1995 <C>	1994 <C>
			(In Thousands)		
Commercial, financial and agricultural	$ 48,418	$ 68,513	$ 63,543	$ 72,657	$ 59,505
Real estate-residential	328,243	245,577	200,983	189,513	196,670
Real estate-commercial	146,093	151,474	139,400	124,319	106,835
Real estate-construction and land development	2,281	6,000	5,355	3,318	6,768
Installment	7,809	11,588	12,076	12,195	14,741
Other	22,855	26,013	20,940	24,484	26,233
Total Loans	555,699	509,165	442,297	426,486	410,752
Less:					
Allowance for possible loan losses	(7,122)	(7,651)	(6,253)	(7,151)	(7,080)
Unearned income	(1,506)	(1,432)	(1,860)	(2,356)	(2,930)
Net Loans	$ 547,071	$ 500,082	$ 434,184	$ 416,979	$ 400,742

</TABLE>

(E) Maturity of Loans

The following table shows the maturity distribution of loans outstanding, excluding non-accrual loans of $3,013,000 as of December 31, 1998.

<TABLE>
<CAPTION>

<S>	One Year or Less <C>	Over One Year to Five Years <C>	Over Five Years <C>	Total <C>
		(In Thousands)		
Commercial, financial and agricultural	$ 12,904	$ 16,855	$ 17,981	$ 47,740
Real estate-residential	4,603	9,128	313,165	326,896
Real estate-commercial	11,046	26,114	108,341	145,501
Real estate-construction and land development	1,602	301		1,903
Installment	1,723	5,573	495	7,791
Other	2,078	1,439	19,338	22,855
	$ 33,956	$ 59,410	$ 459,320	$ 552,686
Loans maturing after one year:				
Fixed interest rate		$ 28,511	$ 152,076	$ 180,587
Variable interest rate		30,899	307,244	338,143
		$ 59,410	$ 459,320	$ 518,730

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</TABLE>

Included in the loan maturity table above, are loans with a variable interest rate totaling $30,899,000 which are scheduled to mature in one to five years, of which $25,834,000 are scheduled to reprice within one year or less, with the remaining $5,065,000 scheduled to reprice within one to five years. Also included in the loan maturity table, are loans with a variable interest rate totaling $307,244,000 which are scheduled to mature after five years, of which $158,548,000 are scheduled to reprice within one year or less; $91,543,000 which are scheduled to reprice within one to five years, with the remaining $57,153,000 scheduled to reprice after five years.

(F) Nonperforming Loans and Assets

The following table summarizes Granite State's nonperforming loans and assets at December 31. Amounts shown reflect principal only.

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>	1996 <C>	1995 <C>	1994 <C>
			($ In Thousands)		
Nonperforming Loans:					
Commercial, financial and agricultural	$ 678	$ 956	$ 204	$ 670	$ 733
Real estate-residential	1,347	1,489	2,707	4,231	2,648
Real estate-commercial	592	4,261	1,032	2,106	2,656
Real estate-construction and land development	378	92	102	444	298
Installment and other	18	347	41	256	292
Total nonperforming loans	3,013	7,145	4,086	7,707	6,627
Other real estate owned	1,601	1,905	3,492	4,779	7,464
Total nonperforming loans and other real estate owned	$ 4,614	$ 9,050	$ 7,578	$12,486	$14,091
Percentage of nonperforming loans and other real estate owned to total loans receivable	0.83%	1.78%	1.71%	2.93%	3.43%
Percentage of nonperforming loans and other real estate owned to total assets	0.53%	1.11%	0.95%	1.71%	2.11%
Loans delinquent 90 days or more still accruing, not included in above	$ 146	$ 535	$ 93	$ 0	$ 21

</TABLE>

Accrual of interest on loans is discontinued either when reasonable doubt exists as to the full, timely collection of interest or principal, or when a loan becomes contractually past due by ninety days unless the loan is well secured and in the process of collection. When a loan is placed on nonaccrual status, all interest previously accrued and not received is reversed against current period earnings.

For the year ended December 31, 1998, the gross interest income on nonperforming loans that would have been recorded, had such loans been current in accordance with their original terms amounted to $441,000. The amount of interest income on those loans included in net earnings for the year ended December 31, 1998 amounted to $145,000.

The Company has identified loans as impaired in accordance with SFAS No. 114, when it is probable that interest and principal will not be collected according to the terms of the loan agreements. The balance of impaired loans was $1,556,000 and $4,559,000, respectively, at December 31, 1998 and 1997. The average recorded investment in impaired loans was $3,502,000, $3,001,000 and $3,933,000, respectively, in 1998, 1997 and 1996. No income was recognized on impaired loans during 1998 and 1997 and $4,000 of income was recognized during 1996. Total cash collected on impaired loans during 1998, 1997 and 1996 was

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$710,000, $779,000 and $2,427,000, respectively, of which $710,000, $779,000 and $2,423,000, respectively, was credited to the principal balance outstanding on such loans.

Changes in the allowance for possible loan losses allocated to impaired loans, which is included in the allowance for possible loan losses are as follows:

	1998	1997	1996
	(In Thousands)		
Balance at beginning of year	$ 1,054	$ 457	$ 1,114
Provision for possible loan losses	201	983	499
Loans charged off	(1,022)	(386)	(1,156)
Balance at end of year	$ 233	$ 1,054	$ 457

At December 31, 1998, 1997 and 1996, there were no impaired loans which did not have an allowance for possible loan losses determined in accordance with SFAS No. 114.

The Company's policy for interest income recognition on impaired loans is to recognize income on nonaccrual loans under the cash basis when the loans are both current and the collateral on the loan is sufficient to cover the outstanding obligation to the Company; if these factors do not exist, the Company does not recognize income.

Other real estate owned is comprised of properties acquired through foreclosure proceedings or acceptance of a deed in lieu of foreclosure. Real estate formally acquired in settlement of loans is recorded at the lower of the carrying value of the loan or the fair value of the property received less an allowance for estimated costs to sell. Loan losses arising from the acquisition of such properties are charged against the allowance for possible loan losses. Provisions to reduce the carrying value to net realizable value are charged to current period earnings as realized and reflected as an addition to the valuation allowance. Operating expenses and gains and losses upon disposition are reflected in earnings as realized.

Other real estate owned at December 31 was comprised as follows:

	1998	1997	1996	1995	1994
	(In Thousands)				
Condominiums and apartment projects	$ 131	$ 371	$ 780	$ 1,124	$ 1,797
Single family housing projects	739	792	1,281	1,367	2,107
Retail and office			83	1,272	1,477
Non-retail commercial	756	773	798	1,996	1,482
Residential	451	437	1,078	625	1,192
	2,077	2,373	4,020	6,384	8,055
Less: Valuation allowance	476	468	528	1,605	591
	$ 1,601	$ 1,905	$ 3,492	$ 4,779	$ 7,464

As of December 31, 1998, there were no loan concentrations exceeding 10% of total loans.

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As of December 31, 1998, neither Granite State nor its subsidiary, Granite Bank, had any foreign loans.

(G) Summary of Loan Loss Experience and Allocation of the Allowance for Possible Loan Losses

The allowance for possible loan losses is maintained through provisions for possible loan losses based upon management's ongoing evaluation of the risks inherent in the loan portfolio. The methodology for determining the amount of the allowance for possible loan losses consists of several elements. Nonperforming, impaired and delinquent loans are reviewed individually and the value of any underlying collateral is considered in determining estimates of possible losses associated with those loans. Another element involves estimating losses inherent in categories of loans, based primarily on historical experience, industry trends and trends in the real estate market and the current economic environment in the Company's primary market areas. The last element is based on management's evaluation of various conditions, and involves a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments. The conditions evaluated in connection with this element include the following: industry and regional conditions; seasoning of the loan portfolio and changes in the composition of and growth in the loan portfolio; the strength and duration of the current business cycle; existing general economic and business conditions in the lending areas; credit quality trends, including trends in nonperforming loans expected to result from changes in existing conditions; historical loan charge-off experience; and the results of bank regulatory examinations. At December 31, 1996, the level of the allowance was lower than the level of the allowance at December 31, 1995 and December 31, 1994 due primarily to a reduction in the level of nonperforming loans. At December 31, 1997, the level of the allowance was higher than the level of the allowance at December 31, 1996 due primarily to increases in nonperforming and impaired loans, and an increase in the total loan portfolio, including growth in commercial business loans and commercial real estate loans. At December 31, 1998, the level of the allowance was lower than the 1997 level, due to reductions in the level of nonperforming and impaired loans in 1998 compared with 1997, increased net charge-offs for 1998 compared with 1997, as well as a change in the mix of loans to primarily residential real estate loans which accounted for 59.1% of total loan portfolio at December 31, 1998 compared to 48.2% at December 31, 1997, while commercial real estate and commercial and industrial loans accounted for 35.0% of the total loan portfolio in 1998 compared to 43.2% in 1997. While management believes that the allowance for possible loan losses at December 31, 1998 is adequate based on its current review and estimates, further provisions to the allowance may be necessary if the market in which the Company operates deteriorates.

Additionally, regulatory agencies review the Company's allowance for loan losses as part of their examination process. Such agencies may require the Company to recognize additions to the allowance based upon judgments which may be different from those of management.

Changes in the allowance for possible loan losses for the year ended December 31 are as follows:

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>	1996 <C>	1995 <C>	1994 <C>
			(In Thousands)		
Balance at beginning of year	$ 7,651	$ 6,253	$ 7,151	$ 7,080	$ 6,950
Provision for possible loan losses	1,125	2,425	1,372	3,337	1,032
Loans charged off	(2,113)	(1,205)	(3,020)	(3,573)	(1,346)
Recoveries of loans previously charged off	459	178	750	307	444
Balance at end of year	$ 7,122	$ 7,651	$ 6,253	$ 7,151	$ 7,080

</TABLE>

A summary of loan charge-offs by loan category for the year ended December 31, follows:

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<TABLE>
<CAPTION>

(In Thousands)	1998	1997	1996	1995	1994
Commercial, financial and agricultural	$ 503	$ 356	$ 684	$ 1,085	$ 362
Real estate-residential	298	613	918	606	303
Real estate-commercial	903	150	907	1,736	409
Real estate-construction and land development	15	19	78	0	0
Installment and other loans	394	67	433	146	272
	$ 2,113	$ 1,205	$ 3,020	$ 3,573	$ 1,346

</TABLE>

A summary of loan recoveries by loan category for the year ended December 31, follows:

<TABLE>
<CAPTION>

(In Thousands)	1998	1997	1996	1995	1994
Commercial, financial and agricultural	$ 82	$ 35	$ 460	$ 67	$ 163
Real estate-residential	199	64	60	110	62
Real estate-commercial	78	56	105	76	201
Real estate-construction and land development	1	1	57	38	0
Installment and other loans	99	22	68	16	18
	$ 459	$ 178	$ 750	$ 307	$ 444

</TABLE>

The ratio of net loan charge-offs to average loans outstanding for the year ended December 31, is summarized as follows:

<TABLE>
<CAPTION>

($ In Thousands)	1998	1997	1996	1995	1994
Net loan charge-offs	$ 1,654	$ 1,027	$ 2,270	$ 3,266	$ 902
Average loans outstanding	$536,596	$474,844	$423,421	$419,533	$411,165
Ratio of net loan charge-offs to average loans outstanding	0.31%	0.22%	0.54%	0.78%	0.22%

</TABLE>

An allocation of the allowance for possible loan losses as of December 31 follows:

<TABLE>
<CAPTION>

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	1998		1997		1996	
	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans
<S>	<C>	<C>	<C>	<C>	<C>	<C>
			($ In Thousands)			
Commercial, financial and agricultural	$ 1,245	8.71%	$ 1,507	13.46%	$ 1,291	14.37%
Real estate-residential	1,182	59.07%	973	48.23%	968	45.44%
Real estate-commercial	2,567	26.29%	3,229	29.75%	2,415	31.52%
Real estate-construction and land development	278	0.41%	125	1.18%	120	1.21%
Installment and other loans	542	5.52%	690	7.38%	580	7.46%
Unallocated	1,308	-	1,127	-	879	-
	$ 7,122	100.00%	$ 7,651	100.00%	$ 6,253	100.00%

<CAPTION>

	1995		1994	
	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans
<S>	<C>	<C>	<C>	<C>
		($ In Thousands)		
Commercial, financial and agricultural	$ 1,401	17.04%	$ 1,931	14.49%
Real estate-residential	1,204	44.43%	924	47.88%
Real estate-commercial	2,493	29.15%	2,331	26.01%
Real estate-construction and land development	131	0.78%	178	1.65%
Installment and other loans	600	8.60%	591	9.97%
Unallocated	1,322	-	1,125	-
	$ 7,151	100.00%	$ 7,080	100.00%

</TABLE>

The allowance for possible loan losses as a percentage of loans outstanding at December 31 of each reported period is as follows:

<TABLE>
<CAPTION>

	1998	1997	1996	1995	1994
<S>	<C>	<C>	<C>	<C>	<C>
Allowance for possible loan losses as a percentage of total loans outstanding	1.28%	1.50%	1.41%	1.68%	1.72%

</TABLE>

(H) Risks Associated with Commercial Real Estate, Commercial and Construction Loans

Commercial real estate and commercial lending involves significant additional risks compared with one-to-four family residential mortgage lending, and therefore typically accounts for a disproportionate share of delinquent loans and real estate owned through foreclosure or by deed in lieu of foreclosure. Such lending generally involves larger loan balances to single borrowers or groups of related borrowers than does residential lending, and repayment of the loan depends in part on the underlying business and financial condition of the borrower and is more susceptible to adverse future

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developments. If the cash flow from income-producing property is reduced, for example, because leases are not obtained or renewed, the borrower's ability to repay the loan may be materially impaired. These risks can be significantly affected by considerations of supply and demand in the market for office, manufacturing and retail space and by general economic conditions. As a result, commercial real estate and commercial loans are likely to be subject, to a greater extent than residential real estate loans, to adverse conditions in the general economy.

Construction loans are, in general, subject to the same risks as commercial real estate loans, but involve additional risks as well. Such additional risks are due to uncertainties inherent in estimating construction costs, delays arising from labor problems, shortages of material, uncertain marketability of a complete project and other unpredictable contingencies that make it relatively difficult to determine accurately the total loan funds required to complete a project or the value of the completed project. Construction loan funds are advanced on the security of the project under construction, which is of uncertain value prior to the completion of construction. This uncertainty is increased in depressed real estate markets. When a construction project encounters cost overruns, marketing or other problems, it may become necessary, in order to sustain the project and preserve collateral values, for the lender to advance additional funds and to extend the maturity of its loan. In a declining market, there is no assurance that this strategy will successfully enable the lender to recover outstanding loan amounts and interest due. Moreover, foreclosing on such properties results in administrative expense and substantial delays in recovery of outstanding loan amounts and provides no assurance that the lender will recover all monies due to it, either by developing the property, subject to regulatory limitations and to the attendant risks of development, or by selling the property to another developer.

(I) Deposits

The average balance of deposits and the average rates paid thereon are summarized as follows:

<TABLE>
<CAPTION>

	1998		1997		1996	
	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate
<S>	<C>	<C>	<C>	<C>	<C>	<C>
			($ In Thousands)			
Interest bearing deposits:						
Interest bearing NOW deposits	$ 183,692	2.59%	$ 158,374	2.64%	$ 141,311	2.63%
Money market deposits	24,474	2.75%	34,628	2.67%	40,232	2.72%
Savings deposits	88,473	2.55%	90,510	2.57%	92,593	2.58%
Time deposits	267,764	5.55%	283,514	5.61%	262,165	5.64%
Total interest bearing deposits	$ 564,403	4.00%	$ 567,026	4.11%	$ 536,301	4.10%
Noninterest bearing deposits	$ 69,575	N/A	$ 63,870	N/A	$ 58,935	N/A

</TABLE>

(J) Maturities of Time Deposits

The maturity distribution of time certificates of deposit of $100,000 or more at December 31, 1998 follows:

<TABLE>
<CAPTION>

REMAINING MATURITY	BALANCE
<S>	<C>

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	(In Thousands)
3 months or less	$ 6,161
Over 3 through 6 months	7,136
Over 6 through 12 months	15,566
Over 12 through 36 months	3,796
Over 36 months	886
	$ 33,545

</TABLE>

(K) Return on Equity and Assets

Operating and capital ratios for the year ended December 31 follows:

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>	1996 <C>
Net earnings to average assets	1.17%	0.29%	0.95%
Net earnings to average stockholders' equity	13.30%	3.57%	12.88%
Dividend pay out ratio on common stock -basic	30.49%	69.05%	14.81%
-diluted	31.25%	72.50%	15.63%
Average equity to average total assets	8.82%	8.02%	7.40%

</TABLE>

(L) Borrowings

Information regarding borrowings in Note 14 to the consolidated Financial Statements in the Annual Report to Stockholders for the year ended December 31, 1998 is incorporated herein by reference.

Short-Term Borrowings

Outstanding short-term borrowings at December 31 were as follows:

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C> (In Thousands)	1996 <C>
Securities sold under agreements to repurchase	$ 70,905	$ 66,025	$ 64,961
Short-term and current portion of other borrowings	$ 45	$ 25,269	$ 42,221

</TABLE>

The maximum amount of securities sold under agreements to repurchase and short-term and current portion of other borrowings outstanding at any month end during the year ended December 31 were as follows:

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>	1996 <C>

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		(In Thousands)	
Securities sold under agreements to repurchase	$ 73,392	$ 67,693	$ 64,961
Short-term and current portion of other borrowings	$ 10,178	$ 74,918	$ 53,303

</TABLE>

The average balance of securities sold under agreements to repurchase and short-term and current portion of other borrowings and weighted average interest rates thereon for the year ended December 31 were as follows:

<TABLE>
<CAPTION>

	1998		1997		1996	
	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate
<S>	<C>	<C>	<C>	<C>	<C>	<C>
			($ in Thousands)			
Securities sold under agreements to repurchase	$ 67,562	4.36%	$ 59,826	4.76%	$ 51,220	4.76%
Short-term and current portion of other borrowings	$ 4,681	6.15%	$ 33,043	5.70%	$ 33,229	5.78%

</TABLE>

Other borrowings, consist of advances from the FHLBB. Scheduled maturities and interest rates on such advances at December 31, are as follows:

<TABLE>
<CAPTION>

Maturity	Interest Rate	1998	1997
<S>	<C>	<C>	<C>
		(In Thousands)	
January 1998	7.05%		$ 15,000
March 1998	5.99%		5,000
Amortizing advance, final payment, May 1998	4.69%		470
September 1998	6.24%		3,756
October 1998	6.15%		1,000
April 2003	5.84%	$ 20,000	
May 2003	5.92%	10,000	
Amortizing advance, final payment, October 2005	6.13%	355	395
May 2008	6.09%	10,000	
October 2008	4.49%	20,000	
December 2013	4.18%	20,000	
January 2014	5.00%	48	48
April 2014	5.00%	78	78
June 2014	5.00%	60	60
Amortizing advance, final payment, August 2014	5.00%	67	70
Total other borrowings		80,608	25,877
Less: short-term and current portion of other borrowings		45	25,269
Long-term portion of other borrowings		$ 80,563	$ 608

</TABLE>

Principal payments due on long-term borrowings after December 31, 1998 are $45,000 in 1999, $48,000 in 2000, $51,000 in 2001, $55,000 in 2002, $30,057,000 in 2003 and $50,352,000 in years thereafter. The FHLBB has the right to call and require the repayment of $20,000,000 of borrowings at an interest

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rate of 4.49% due in 2008 during 2001. Additionally, the FHLBB has the right to call and require the repayment of $20,000,000 of borrowings at an interest rate of 4.18% due in 2013 during 2000.

(M) Competition

The Bank continues to experience substantial competition in attracting and retaining deposit accounts and in making mortgage and other loans. There are numerous federally-insured banks and thrifts with offices within Granite Bank's principal market areas, many of which are headquartered there. In addition, the Bank experiences competition from credit unions and other financial intermediaries which are not subject to similar State and Federal regulations.

The primary factors in competing for deposit accounts are service, interest rates, convenience and, to a lesser extent, products offered. Competitors for deposit accounts include other depository institutions and other investment vehicles such as mutual funds, government and corporation obligations, and the equity capital markets.

The primary factors in competing for loans are interest rates, loan origination fees and the quality and range of lending products and services offered. Competition for origination of loans comes primarily from savings institutions, mortgage banking firms, and other commercial banks.

(N) Subsidiaries

Granite State owns 100% of the capital stock of Granite Bank, a New Hampshire chartered commercial bank, its sole subsidiary.

(d) Financial Information about Foreign and Domestic Operations and Export Sales

Not applicable.

Item 2. Properties

The following table sets forth the location of the Company's offices as of December 31, 1998. See also Notes 10 and 15 to the Consolidated Financial Statements in the Annual Report to Stockholders for the year ended December 31, 1998 which are incorporated herein by reference.

Office Type	Location	City/Town	Status
Full service (Headquarters)	122 West Street	Keene	Owned <F*>
Full service	Routes 9 and 63	Chesterfield	Owned <F*>
Full service	Elm Street at Route 101	Milford	Owned <F*>
Full service	Lorden Plaza	Milford	Leased <F*>
Full service	Route 101A & 122	Amherst	Owned <F*>
Full service	21 Grove Street <F1>	Peterborough	Owned <F*>
Full service	Jct Route 101 & 202 <F2>	Peterborough	Leased <F*>
Full service	35 Main Street	Peterborough	Owned <F*>
Full service	Route 101 Peterborough Plaza <F1>	Peterborough	Leased <F*>
Full service	70 Main Street	Durham	Owned <F*>
Full service	Southgate Plaza, Route 1	Portsmouth	Owned <F*>
Full service	93 Middle Street	Portsmouth	Owned <F*>
Full service	9 Child's Way and Route 9	Hillsborough	Owned <F*>
Full service	Lanctot's Shopping Center Rte 114	Weare	Owned <F*>
Full service	62 Peterborough Street	Jaffrey	Owned <F*>
Full service	167 Main Street	Antrim	Owned <F*>
Full service	197 Loudon Road	Concord	Leased <F*>
Full service	66 No. Main Street	Concord	Leased <F*>
Full service	Pennichuck Square	Merrimack	Leased <F*>
Full service	146 Main Street	Nashua	Leased <F*>

<FN>

<F*> Office includes an ATM facility. The Durham branch has two ATM

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facilities on site.
<F1> The Company has notified the FDIC and the state bank commissioner that these branches are expected to close in April 1999.
<F2> As of December 31, 1998 this branch has been closed for renovation and is expected to reopen in April 1999.

</FN>

</TABLE>

Additionally, the Company operates twenty-one ATMs at other locations in Keene, Fitzwilliam, Milford, Amherst, Durham, West Swanzey, North Swanzey, Peterborough, Hillsborough, Concord, Dublin and Greenfield, New Hampshire. The ATM facilities and their enclosures are owned by the Company; the property on which they are located is leased. All offices and ATM facilities are located in New Hampshire.

The Company believes that its current facilities are adequate to meet its present needs, subject to possible future expansion.

Item 3. Legal Proceedings

The Company is a defendant in various legal actions incident to its business, none of which is believed by management to be material to the financial condition of the Company.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Additional Item. Executive Officers

Information regarding executive officers not listed as directors in the Proxy Statement is as follows:

Charles B. Paquette (age 46) is the Executive Vice President, Secretary and Chief Operations Officer of Granite State and Senior Executive Vice President, Secretary and Chief Operations Officer of Granite Bank, positions he assumed in 1986 and 1991, respectively. Mr. Paquette has been employed in a management position by the Company and Granite Bank since 1980.

William C. Henson (age 43) is the Executive Vice President of Granite State and Director of Community Banking of Granite Bank, positions he assumed in 1986 and 1997, respectively. Mr. Henson joined the Bank in 1980, and has since served in a management capacity.

William G. Pike (age 47) is the Executive Vice President and Chief Financial Officer of Granite State and Granite Bank, positions he assumed in December 1991 when he joined the Company.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

(a) Market Information

Granite State's common stock is quoted on the NASDAQ Stock Market under the symbol GSBI. The following table shows the range of the high and low prices and dividend information on a quarterly basis for Granite State's common stock for 1998 and 1997. The table does not reflect inter-dealer prices, potential mark-ups, mark-downs or commissions, and may not necessarily represent actual transactions.

<TABLE>
<CAPTION>

	1998			
	4th Qtr	3rd Qtr	2nd Qtr	1st Qtr
<S>	<C>	<C>	<C>	<C>
Dividends declared per share	$ .125	$ .125	$ .125	$ .125
Stock Price				

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High..........................	23.75	28.13	30.00	27.75
Low...........................	16.50	17.63	24.75	22.75

<CAPTION>

	1997			
	4th Qtr	3rd Qtr	2nd Qtr	1st Qtr
<S>	<C>	<C>	<C>	<C>
Dividends declared per share	$ .11	$ .06	$ .06	$ .06
Stock Price				
High..........................	27.00	21.50	19.00	17.67
Low...........................	21.25	18.75	16.16	14.50

</TABLE>

(b) Holders

As of March 18, 1999, Granite State had approximately 1,283 common shareholders of record.

(c) Dividends

The holders of common stock of Granite State are entitled to receive and share pro-rata in such dividends as may be declared by the Board of Directors of Granite State out of funds legally available therefore. Granite State is permitted by New Hampshire corporate law to pay dividends out of unreserved and unrestricted earned surplus or from unreserved and unrestricted net earnings of a current fiscal year and the next preceding fiscal year taken as a single period, as and when declared by its Board of Directors.

New Hampshire banking regulations prohibit the payment of a cash dividend if the effect thereof would cause the net worth of the Bank to be reduced below either the amount required for its liquidation account or applicable capital requirements. The liquidation account was established in connection with Granite Bank's and Primary Bank's conversions from mutual to a stock savings bank ("conversions") for the benefit of certain depositors in the event of a liquidation of the Bank. The initial amount of the liquidation account, as originally established, equaled the Banks' net worth at the respective dates of conversion and has since been declining as deposits have been reduced or withdrawn (it will never be increased, despite additional deposits). The balance of the liquidation account at December 31, 1998 was approximately $1,958,000. The Federal Deposit Insurance Act prohibits the Bank from making a capital distribution, including payment of a cash dividend, if the Bank would not meet applicable capital requirements after the payment. Furthermore, the Federal Deposit Insurance Act prohibits the Bank from paying dividends on its capital stock if it is in default in the payment of any assessment to the FDIC.

Item 6. Selected Financial Data

Selected Financial Data on page 62 of the Annual Report to Stockholders for the year ended December 31, 1998 is incorporated herein by reference.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations on pages 11 to 29, inclusive, of the Annual Report to Stockholders for the year ended December 31, 1998 is incorporated herein by reference.

Item 7a. Quantitative and Qualitative Disclosures About Market Risk

Quantitative and Qualitative Disclosures About Market Risk on pages 16 to 19 inclusive, of the Annual Report to Stockholders for the year ended December 31, 1998 is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

(a) Financial Statements Required by Regulation S-X

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Information relating to financial statements on pages 31 to 61, inclusive, of the Annual Report to Stockholders for the year ended December 31, 1998 is incorporated herein by reference.

(b) Supplementary Financial Information

(1) Selected Quarterly Financial Data

The Selected Quarterly Financial Data on page 61 of the Annual Report to Stockholders for the year ended December 31, 1998 is incorporated herein by reference.

(2) Information on the Effects of Changing Prices

Management's discussion of the effects of inflation on page 28 of the Annual Report to Stockholders for the year ended December 31, 1998 is incorporated herein by reference.

(3) Information About Oil and Gas Producing Activities

Not applicable.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

Information regarding directors and executive officers of Granite State on pages 3, 4 and 11 of the Proxy Statement for the 1999 Annual Meeting of Stockholders is incorporated herein by reference.

Item 11. Executive Compensation

Information regarding executive compensation on pages 5 to 11 of the Proxy Statement for the 1999 Annual Meeting of Stockholders is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Information regarding security ownership of certain beneficial owners and Granite State's management on pages 2 to 4 of the Proxy Statement for the 1999 Annual Meeting of Stockholders is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

Information regarding certain relationships and related transactions on page 11 of the Proxy Statement for the 1999 Annual Meeting of Stockholders is incorporated herein by reference.

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) List of Documents Filed as Part of this Report

(1) Financial Statements

The financial statements listed below and the report of independent certified public accountants are incorporated herein by reference to the Annual Report to Stockholders for the year ended December 31, 1998, in Item 8. Page references are to such Annual Report.

Financial Statements	Page Reference
Granite State Bankshares, Inc. and Subsidiary	
Report of Independent Certified Public Accountants	31

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Consolidated Statements of Financial Condition	32
Consolidated Statements of Earnings	33
Consolidated Statements of Comprehensive Income	34
Consolidated Statements of Stockholders' Equity	35
Consolidated Statements of Cash Flows	36
Notes to Consolidated Financial Statements	37 - 61

(2) Financial Statements Schedules

Schedules of the Consolidated Financial Statements required by the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

The remaining information appearing in the Annual Report to Stockholders for the year ended December 31, 1998, is not deemed to be filed as part of this report, except as expressly provided herein.

(b) Reports on Form 8-K

None

(c) Exhibits

The exhibits listed below are filed herewith or are incorporated by reference to other filings.

Exhibit Index to Form 10-K

<TABLE>

<S>	<C>
Exhibit 2	Agreement and Plan of Reorganization by and among Granite State, Granite Bank and Primary Bank, as amended, dated as of April 29, 1997 and the Agreement and Plan of Merger among Granite Bank and Primary Bank and joined in by Granite State <F*>
Exhibit 3.1	Articles of Incorporation <F**>
Exhibit 3.2	Bylaws <F***>
Exhibit 10.1	Stock Option Plan <F**>
Exhibit 10.2	Employment Agreement with Charles W. Smith <F**>
Exhibit 10.3	Amendment No. 1 to Employment Agreement with Charles W. Smith <F***>
Exhibit 10.4	Form of Special Termination Agreement with Messrs. Charles B. Paquette, William C. Henson, William G. Pike and William D. Elliott <F***>
Exhibit 10.5	Employee Stock Ownership Plan <F**>
Exhibit 10.6	Employment Separation Agreement and Release with Christopher J. Flynn
Exhibit 10.7	1997 Granite State Bankshares, Inc. Long-Term Incentive Stock Benefit Plan <F****>
Exhibit 10.8	Restated Executive Supplemental Retirement Income Agreement for Charles W. Smith <F*****>
Exhibit 11	Calculations of Basic Earnings Per Share and Diluted Earnings Per Share (See Note 3 to Notes to Consolidated Financial Statements)

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Exhibit 13 Portions of the Annual Report to Stockholders for the year ended December 31, 1998

Exhibit 21 Subsidiary of Granite State Bankshares, Inc. (See Part I, Item 1(a) and Item 1(c)(5)(N) of Form 10-K.)

Exhibit 23.1 Consent of Independent Certified Public Accountant-Grant Thornton LLP

Exhibit 23.2 Consent of Independent Certified Public Accountant-KPMG Peat Marwick LLP

Exhibit 27.1 Financial Data Schedule - Fiscal Year End 1998

Exhibit 99 Independent Auditor's Report of Primary Bank

<FN>
<F*> Incorporated by reference from Appendix A to the Granite State Bankshares, Inc., and Primary Bank Joint Proxy Statement dated August 8, 1997.

<F**> Incorporated by reference from Granite State Bankshares, Inc., Form S-1, filed on April 18, 1986.

<F***> Incorporated by reference from Granite State Bankshares, Inc., Form 10-KSB, filed on March 27, 1997.

<F****> Incorporated by reference from Appendix A to the Proxy Statement for the 1998 Annual Meeting of Stockholders.

<F*****> Incorporated by reference from Granite State Bankshares, Inc. Form 10K, Exhibit 10.8 filed on March 27, 1998

</FN>
</TABLE>

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Granite State Bankshares, Inc., the registrant, has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

GRANITE STATE BANKSHARES, INC.

/s/ Charles W. Smith

Dated : March 26, 1999 By: Charles W. Smith
Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934 this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Charles W. Smith

Charles W. Smith
3/26/99
Chief Executive Officer (Principal Executive Officer) and Chairman of the Board

/s/ William G. Pike

William G. Pike
3/26/99
Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

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/s/ Dr. David M.Bartley ----------------------- Dr.David M.Bartley	3/26/99	Director
/s/ Philip M. Hamblet --------------------- Philip M. Hamblet	3/26/99	Director
/s/ Joseph S. Hart ------------------ Joseph S. Hart	3/26/99	Director
/s/ David J. Houston -------------------- David J. Houston	3/26/99	Director
/s/ James L. Koontz ------------------- James L. Koontz	3/26/99	Director
/s/ Forrest McKerley -------------------- Forrest McKerley	3/26/99	Director
/s/ Jane B. Reynolds -------------------- Jane B. Reynolds	3/26/99	Director
/s/ William Smedley V --------------------- William Smedley V	3/26/99	Director
/s/ C. Robertson Trowbridge --------------------------- C. Robertson Trowbridge	3/26/99	Director
/s/ James C. Wirths III ----------------------- James C. Wirths III	3/26/99	Director
/s/ E. Story Wright -------------------	3/26/99	Director

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E. Story Wright

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EXHIBIT 10.6

GRANITE STATE BANKSHARES, INC. AND SUBSIDIARY

EMPLOYMENT SEPARATION AGREEMENT AND RELEASE WITH CHRISTOPHER J. FLYNN

EMPLOYMENT SEPARATION AGREEMENT AND RELEASE

THIS AGREEMENT AND RELEASE, is effective as of the 20th day of November, 1998 by and between CHRISTOPHER J. FLYNN ("Executive") and GRANITE BANK ("Granite") and GRANITE STATE BANKSHARES, INC. ("Granite State").

WHEREAS, Executive has served Granite in the position of President since October 31, 1997; and

WHEREAS, the parties have mutually decided to discontinue Executive's employment and directorships with Granite and Granite State (references to Granite shall include Granite State unless otherwise indicated) on the following terms and conditions, which contain the entire agreement of the parties relating to the termination of Executive's employment, and any prior agreements, including the Employment Agreement entered into by and between Executive and Granite Bank as of October 31, 1997, ("Employment Agreement"), shall be superceded by this Agreement and Release, unless otherwise provided herein.

NOW, THEREFORE, in consideration of the promises and payments stated and other good and valuable consideration, the receipt and adequacy of which is acknowledged by each of the parties and who intend to be legally bound by this Agreement and Release, the parties state and agree as follows:

1. Executive resigns from employment with Granite effective December 31, 1998. Executive resigns as a director of Granite effective November 30, 1998.

2. Executive has no further obligation to perform services as an employee of Granite. Executive and Granite have entered into a Consulting Agreement, effective January 1, 1999 ("Consulting Agreement"), pursuant to which Executive shall perform services as a consultant to Granite.

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3. Executive shall continue to preserve the confidences and proprietary information of Granite and its subsidiaries, parent corporations and affiliates, including information that has been disclosed to Executive relating to Granite's business activities, as set forth in Section 10 of the Employment Agreement which Section is incorporated herein by reference.

4. (a) Granite Bank shall pay Executive a cash severance payment in the aggregate amount of $558,069, payable as follows: $258,069 on December 22, 1998; $150,000 on January 15, 1999 and $150,000 on February 15, 1999. All payments shall be subject to requisite federal and state tax withholding, including without limitation withholdings for Medicare, FICA, and Federal Income Tax. The first payment is being made to Executive on or after the Waiting Period Expiration Date (as defined in paragraph 8 of this Agreement and Release).

(b) Executive shall be entitled to receive bi-weekly salary payments from Granite Bank, at the rate of salary payment in effect as of the date of this Agreement and Release, through December 31, 1998, paid in accordance with Granite's regular payroll practices, including tax withholdings. Executive shall be considered employed by Granite Bank for purposes of the Granite State Employee Stock Ownership Plan through December 31, 1998.

(c) Granite shall either: (i) continue to provide medical and dental coverage to Executive substantially identical to the coverage maintained by Granite prior to his termination of employment, except to the extent such coverage may be changed in its application to all Granite Executives; or (ii) if coverage under Granite's existing plans is unavailable, Granite shall pay the cost of providing Executive substantially equivalent coverage, except to the extent such coverage may be changed in its application to all Granite Executives. Such coverage shall cease upon the earlier of December 31, 2001 or upon the date of Executive's employment with another employer that provides substantially equivalent coverage.

(d) As of the date of this Agreement and Release, Executive shall vest in 1,500 shares of restricted stock previously awarded to Executive under the 1997 Long-term Incentive Stock Benefit Plan (the "Stock Benefit Plan"). The remaining 6,000 shares of restricted stock which have been previously awarded to Executive shall be forfeited and returned to Granite.

(e) As of the date of this Agreement and Release, Executive shall vest in all unvested options previously awarded to Executive under the Stock Benefit Plan . Such options shall be exercisable for so long as Executive continues to perform services for Granite as a consultant, pursuant to the Consulting Agreement, and within thirty days of the termination of the Consulting Agreement, but in no event later than December 31, 2001.

(f) Executive shall retain the 1996 Ford Explorer that was prior hereto owned by Granite and used by Executive during the term of his employment. Title to this vehicle shall be transferred to Executive as of the date of this Agreement and Release.

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(g) The ownership of the following life insurance policies owned by Granite shall be transferred to Executive as of the date of this Agreement and Release: the Lincoln Benefit Life Company Flexible Premium Life Insurance Policy, Policy Number U0207843; and the MassMutual Policy Number 7399899. Granite shall have no further interest in, or obligation under, these policies.

5. (a) The foregoing shall satisfy all obligations of Granite (including Granite Bank as the successor to Primary Bank) to Executive that now exists or hereinbefore existed relating to the employment of Executive by Granite (including Granite Bank as the successor to Primary Bank), and the service by Executive as a director of Granite (including Granite Bank as the successor to Primary Bank), and the termination of the employment by Granite of Executive (and the termination of his service as a director of Granite), except as may be set forth in the Consulting Agreement and except that Executive's rights under any tax-qualified plan maintained by Granite shall not be effected hereby.

(b) In consideration of the foregoing, Executive hereby irrevocably and unconditionally, waives and releases Granite, its affiliates and subsidiaries, officers, directors, and Executives, from any and all causes of action, debts and claims, known and unknown, which Executive may now have or may have in the future, concerning Executive's employment under the Employment Agreement, or separation from service thereunder, including but not limited to any claims for alleged breach of contract, wrongful discharge, or any rights or claims arising out of title VII of the Civil Rights Act of 1964, as amended, the Age Discrimination in Employment Act ("ADEA"), the Americans with Disabilities Act ("ADA"), or any other federal, state or municipal statute or ordinance relating to discrimination in employment. However, Executive may pursue claims or institute legal action to enforce the provisions of this Agreement and Release, and the Consulting Agreement. Nothing herein contained shall be construed to require Executive's release of any rights granted to him as a former employee, officer or director of Granite under its Charter and Bylaws or under New Hampshire law. Executive shall continue to be indemnified by Granite for any actions taken as an employee, officer or director to the fullest extent provided by Granite's Charter and Bylaws and New Hampshire law.

6. Executive further covenants that Executive will neither file nor cause nor permit to be filed on Executive's behalf and, as the case may be waives Executive's right to recover in his/her own right upon filing, any lawsuits, claims, grievances, complaints, or charges with any Court, State, federal or local agency, concerning or relating to any dispute arising out of the employment relationship, alleged breaches of employment, covenants or contracts, abusive or wrongful and constructive discharge, unlawful employment discrimination, or otherwise relating to Executive's employment or resignation from that employment with Granite.

7. Both parties agree that this is a separation of convenience, and neither party will state or infer a contrary intention or understanding. Neither the Chief Executive Officer nor the Chief Financial Officer of Granite is aware, as of the date of this Agreement, of any basis for any claim by

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Granite against Executive relating to Executive's service as an employee of Granite. The nature and terms of the parties Agreement and Release are Confidential and may not be publicly disclosed with the exception of required court documents prepared and filed in connection with legal actions initiated to enforce the provisions of this Agreement and Release.

8. (a) Executive further states that Executive has carefully read the foregoing, has had sufficient opportunity to review and deliberate the foregoing with or without counsel of Executive's own choosing, knows and understands its contents, and signs the same as Executive's free and independent act. No inducements, representations, or agreements have been made or relied upon to make this Agreement and Release except as stated in this Agreement and Release.

(b) Executive has twenty-one (21) days from November 20, 1998 (the date of the initial receipt of these terms) within which to consider accepting and being bound by the terms of this Agreement and Release. Executive understands and acknowledges that this release and waiver of claims is exchanged for the payments described in Paragraph 4. Executive also understands that he may revoke this waiver and release of claims under the ADEA for a period of seven (7) days following the date the Executive signs this Agreement and Release and that the Executive's waiver of the ADEA claims will not become effective until the revocation period has expired. Such date that is seven (7) days after Executive signs this Agreement and Release is referred to as the "Waiting Period Expiration Date."

9. Section 9 of the Employment Agreement shall remain in effect as to Executive for the one year period from December 31, 1998.

10. This Agreement and Release may not be amended or modified except in a writing signed by the party to be charged. This Agreement and Release constitutes the entire understanding of the parties, and all prior discussions and agreements between the parties are merged herein.

11. Any term or provision of this Agreement and Release which is held to be invalid or unenforceable shall be ineffective to the extent of such invalidity or unenforceability without rendering invalid or unenforceable the remaining terms and provisions of this Agreement and Release.

12. The terms and provisions of, and the obligations under, the Employment Agreement shall be superceded by this Agreement and Release, and shall be of no further force or effect, unless otherwise expressly stated herein.

IN WITNESS WHEREOF, the parties hereto have signed their Agreement and Release.

DATE: November 20, 1998

/s/ Christopher J. Flynn

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Christopher J. Flynn

GRANITE BANK
/s/ Charles W. Smith

Charles W. Smith

GRANITE STATE BANKSHARES, INC.
/s/ Charles W. Smith

Charles W. Smith

STATE OF NEW HAMPSHIRE)
: ss.
COUNTY OF CHESHIRE)

On this 20th day of November, 1998, before me personally came CHRISTOPHER J. FLYNN, to me known, and known to me to be the individual described in the foregoing instrument, who, by his free act and deed, signed his name to the foregoing instrument.

/s/ Faith E. Wilder

Notary Public

STATE OF NEW HAMPSHIRE)
: ss.:
COUNTY OF CHESHIRE)

On this 20th day of November, 1998, before me personally came Charles W. Smith, to me known, who, being by me duly sworn, did depose and say that he is an executive officer of GRANITE BANK, the bank described in and which executed the foregoing instrument; that he knows the seal of said bank; that the seal affixed to said instrument is such seal; that it was so affixed by authority of the Board of Directors of said bank; and that he signed his or her name thereto by like authority.

/s/ Faith E. Wilder

Notary Public

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STATE OF NEW HAMPSHIRE)

: ss.:

COUNTY OF CHESHIRE)

On this 20TH day of November, 1998, before me personally came Charles W. Smith, to me known, who, being by me duly sworn, did depose and say that he is an executive officer of GRANITE STATE BANKSHARES, INC., the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such seal; that it was so affixed by authority of the Board of Directors of said corporation; and that he signed his name thereto by like authority.

/s/ Faith E. Wilder

Notary Public

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Management's Discussion and Analysis

GENERAL

Granite State Bankshares, Inc. ("Granite State" or the "Company") is a single-bank holding company which owns all of the stock of the Granite Bank (the "subsidiary bank"), a New Hampshire chartered commercial bank. The Company has grown profitably over the past several years through several strategic acquisitions and by leveraging its capital. This activity strengthened the franchise and assisted in the transition from a thrift institution into a full-service commercial bank. This discussion of the financial condition and results of operations of the Company should be read in conjunction with the financial statements and supplemental financial data contained elsewhere in this report.

The subsidiary bank has been and continues to be a community oriented commercial bank offering a variety of financial services. The principal business of the subsidiary bank consists of attracting deposits from the general public and underwriting loans secured by residential and commercial real estate and other loans. The subsidiary bank also originates fixed rate residential real estate loans for sale in the secondary mortgage market. The subsidiary bank has nineteen full service offices and an additional twenty one remote automatic teller locations. The subsidiary bank is a full service community bank with a diversified lending operation that services Cheshire, Hillsborough, Merrimack, Strafford and Rockingham counties, New Hampshire.

The subsidiary bank's deposits are primarily insured by the Bank Insurance Fund ("BIF") of the Federal Deposit Insurance Corporation ("FDIC"), with the remaining portion of the subsidiary bank's deposits (approximately 6.3% of total deposits at December 31, 1998) being OAKAR deposits, which are deposits purchased from institutions previously insured by the Savings Association Insurance Fund ("SAIF") of the FDIC. These deposits are still insured by the SAIF. As a result of the foregoing, the subsidiary bank is subject to regulation by the FDIC. The Company, as a bank holding company, is subject to regulation by the Federal Reserve Board ("FRB").

Financial institutions in general, including the Company, are significantly affected by economic conditions, competition and the monetary and fiscal policies of the Federal government. Lending activities are influenced by the demand for and supply of housing and local economic activity, competition among lenders, the interest rate conditions and funds availability. Deposit balances and cost of funds are influenced by prevailing market rates on competing investments, customer preference and the levels of personal income and savings in the subsidiary bank's primary market areas.

Forward-Looking Statements

Certain statements contained herein are not based on historical facts and are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements which are based on various assumptions (some of which are beyond the Company's control), are subject to numerous risks and uncertainties and statements for periods subsequent to December 31, 1998 are subject to greater uncertainty because of the increased likelihood of changes in underlying factors and assumptions. Such forward-looking statements may be identified by reference to a future period or periods, or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "estimate," "anticipate," "continue," or similar terms or variations on those terms, or the negative of these terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, those related to the economic environment, particularly in the market areas in which the Company operates, competitive products and pricing, the ability of the Company and its competitors, vendors and customers to respond effectively to issues related to the Year 2000, fiscal and monetary policies of the U.S. Government, changes in government regulations affecting financial institutions, including regulatory fees and capital requirements, changes in prevailing interest rates, acquisitions and the integration of acquired businesses, credit risk management, asset-liability management, the financial and securities markets and the availability of and costs associated with sources of liquidity.

The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

Acquisition

Effective after the close of business October 31, 1997, the Company

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completed its merger with Primary Bank. Each of Primary Bank's 2,194,685 outstanding shares of common stock were converted into 1.1483 shares of the Company's common stock resulting in the issuance of 2,520,157 shares of the Company's common stock to Primary Bank stockholders. Primary Bank was a state-chartered guaranty (stock) savings bank with total assets of $388 million, headquartered in Peterborough, New Hampshire. Primary Bank was merged into Granite Bank, the Company's wholly-owned subsidiary, as part of the transaction.

The transaction was accounted for by the pooling-of-interests method of accounting, and, accordingly, the consolidated financial statements for all periods presented prior to the merger

have been restated to present the combined financial condition and results of operations as if the combination had been in effect for all periods presented. The acquisition provided an expanded penetration of the Company into commercial and industrial lending and served to connect existing branch facilities in southwestern, central and southeastern New Hampshire. Expenses directly attributable to the merger were charged to earnings at the date of combination and are described in detail in the noninterest expense portion of the results of operations section of this Management's Discussion and Analysis.

FINANCIAL CONDITION

Consolidated assets at December 31, 1998 were $878.1 million, up $64.4 million or 7.9% from $813.7 million at December 31, 1997.

Interest Bearing Deposits in other banks

Interest bearing deposits in other banks, which primarily consist of deposits with the Federal Home Loan Bank of Boston ("FHLBB"), were $19.5 million at December 31, 1998 and $27.5 million at December 31, 1997. Such investments are short-term overnight investments and the level of the Company's investment in these instruments fluctuates as investments are made in other interest earning assets such as loans, securities held to maturity and securities available for sale, and as balances of interest bearing liabilities such as deposits, securities sold under agreements to repurchase and other borrowings fluctuate. These instruments are also used to fund cash and due from bank requirements.

Securities Held to Maturity and
Securities Available for Sale

The Company classifies its investments in debt and equity securities as securities held to maturity, securities available for sale or trading securities. Securities held to maturity are carried at amortized cost, securities available for sale are carried at market value with unrealized gains and losses shown in accumulated other comprehensive income as a separate component of stockholders' equity, net of related tax effects, and trading securities are carried at market value with unrealized gains and losses reflected in earnings. The Company had no securities classified as trading securities during 1998, 1997 or 1996.

At December 31, 1998 and 1997, the carrying values of securities held to maturity and securities available for sale consisted of the following:

<TABLE>
<CAPTION>

	December 31, 1998 (In Thousands)	December 31, 1997 (In Thousands)
<S>	<C>	<C>
Securities held to maturity		
US Government agency obligations	$ 17,265	$ 33,910
Other corporate obligations	5,012	
Total securities held to maturity	$ 22,277	$ 33,910
Securities available for sale		
US Treasury obligations	$ 83,716	$ 82,969
US Government agency obligations	55,998	44,199
Other corporate obligations	46,457	8,508
Mortgage-backed securities	11,698	21,508
Mutual funds	6,402	6,113
Marketable equity securities	15,494	15,383

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Total securities available for sale	$219,765	$178,680

</TABLE>

At December 31, 1998 the net unrealized gains on securities available for sale, net of related tax effects were $1.6 million, compared to $5.7 million at December 31, 1997. These net unrealized gains are shown in accumulated other comprehensive income as a separate component of stockholders' equity.

As a result of the Company's acquisition of Primary Bank after the close of business October 31, 1997, and to be consistent with the Company's existing interest rate risk profile, securities held to maturity, with an amortized cost of $22.2 million and a net unrealized loss of $156 thousand, were transferred to securities available for sale in the fourth quarter of 1997.

The weighted average maturity for all debt securities held to maturity and available for sale, excluding mortgage-backed securities, is 48 months. Actual maturities may differ from contractual maturities because certain issuers have the right to call obligations without call penalties. The weighted average maturity of mortgage-backed securities available for sale is 281 months, based upon their final maturities. However, normal principal repayments and prepayments of mortgage-backed securities are received regularly, substantially reducing their weighted-average maturities.

The decrease in securities held to maturity were primarily used to fund increases in net loans and securities available for sale, while the increase in securities available for sale was attributable to the increased level of other borrowings with the FHLBB, as well as reductions in the level of cash and due from banks and interest bearing deposits in other banks.

Loans

At December 31, 1998 and 1997 the Company's loan portfolio consisted of the following:

<TABLE>
<CAPTION>

	December 31,	
	1998	1997
	(In Thousands)	
<S>	<C>	<C>
Commercial, financial and agricultural	$ 48,418	$ 68,513
Real estate-residential	328,243	245,577
Real estate-commercial	146,093	151,474
Real estate-construction and land development	2,281	6,000
Installment	7,809	11,588
Other	22,855	26,013
Total loans	555,699	509,165
Less:		
Unearned income	(1,506)	(1,432)
Allowance for possible loan losses	(7,122)	(7,651)
Net loans	$547,071	$500,082

</TABLE>

Loans outstanding before deductions for unearned income and the allowance for possible loan losses increased $46.5 million or 9.14% to $555.7 million at December 31, 1998 from $509.2 million at December 31, 1997.

Residential real estate loans increased $82.7 million or 33.66% to $328.2 million at December 31, 1998 from $245.6 million at December 31, 1997. The increase in residential real estate loans occurred throughout 1998 as the low interest rate environment during 1997 continued throughout 1998 and encouraged borrowers to refinance their loans. New home purchases were also stronger in 1998 than during 1997.

As shown in the table above, commercial, financial and agricultural loans decreased $20.1 million, or 29.33%, commercial real estate loans decreased $5.4 million, or 3.55% and real estate construction and land development loans decreased $3.7 million or 61.98% in 1998 compared to 1997.

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The decrease in commercial, financial and agricultural loans and commercial real estate loans related primarily to the pace of loan repayments as a result of the continued low interest rate environment prevalent in 1998 and the highly competitive environment for attracting loans amongst financial institutions in the Company's market areas, coupled with borrowers of certain loans, assumed in the merger with Primary Bank in October 1997, refinancing their loans with other financial institutions during 1998. The decrease in real estate construction and land development loans related primarily to the pace of loan repayments, coupled with the Company's general determination not to originate new land development loans.

Decreases in installment loans of $3.8 million, or 32.61% and other loans of $3.2 million, or 12.14% were due to the competitive, low interest rate environment that was prevalent during 1998, which allowed borrowers to find alternative forms of financing for consumer purchases at lower rates, coupled with the ability of borrowers refinancing their residential real estate loans to include other borrowings in the refinanced loans.

Total loan originations during 1998 and 1997, were $238.8 million and $248.1 million, respectively. Loan originations for portfolio, excluding loans originated for sale in the secondary mortgage market during 1998 and 1997 were $198.7 million and $221.7 million, respectively. Loan repayments for 1998 and 1997, were $149.4 million and $153.1 million, respectively. Loans charged off, net during 1998 and 1997 were $1.7 million and $1.0 million, respectively. Loans transferred to other real estate owned during 1998 and 1997 amounted to $724 thousand and $732 thousand, respectively.

The subsidiary bank originates fixed rate residential loans for sale in the secondary mortgage market. Mortgage loans held for sale at December 31, 1998 and 1997 were $1.8 million and $1.1 million, respectively. Loans originated for sale in the secondary mortgage market during 1998 and 1997 were $40.1 million and $26.4 million, respectively. Loans sold in the secondary mortgage market during 1998 and 1997 were $39.3 million and $26.4 million, respectively. The Company began originating fifteen year fixed rate residential real estate loans for portfolio effective July 1, 1996. Such loans had previously been sold in the secondary mortgage market. The Company continues to write thirty year fixed rate residential real estate loans for sale in the secondary mortgage market. At December 31, 1998 and 1997 the Company serviced residential real estate loans for others totaling $148.0 million and $163.9 million, respectively.

Risk Elements

The Company's management believes that New Hampshire has witnessed steady economic growth since 1992. There can be no assurance that this will continue to be the case, however, and the economies and real estate markets in the Company's primary market areas will continue to be significant determinants of the quality of the Company's assets in future periods, and thus its results of operations.

The following table sets forth the Company's nonperforming loans and other real estate owned at the dates indicated. The Company generally does not accrue interest on any loans that are 90 days or more past due, unless the loan is well secured and in the process of collection. At the dates indicated, all loans delinquent 90 days or more were on nonaccrual status and

therefore considered nonperforming, with the exception of $146 thousand of loans at December 31, 1998, $535 thousand of loans at December 31, 1997, and $93 thousand of loans at December 31, 1996, all of which were in the process of collection at those dates.

<TABLE>
<CAPTION>

	December 31,		
	1998	1997	1996
	($ In Thousands)		
<S>	<C>	<C>	<C>
Nonperforming loans:			
Residential real estate	$1,347	$1,489	$2,707
Commercial real estate	592	4,261	1,032
Construction and land development real estate	378	92	102
Commercial, financial and agricultural	678	956	204
Installment and other	18	347	41
Total nonperforming loans	3,013	7,145	4,086
Total other real estate			

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owned	1,601	1,905	3,492
Total nonperforming assets	$4,614	$9,050	$7,578
Ratios:			
Total nonperforming loans to total loans	0.54%	1.40%	0.92%
Total nonperforming assets to total assets	0.53%	1.11%	0.95%

</TABLE>

The Company's nonperforming assets decreased $4.4 million or 49.02% from $9.0 million at December 31, 1997 to $4.6 million at December 31, 1998. The decrease in nonperforming assets relates primarily to decreases in nonperforming commercial real estate loans of $3.7 million, a decrease in nonperforming installment and other loans of $329 thousand, a decrease in nonperforming commercial, financial and agricultural loans of $278 thousand, a decrease in nonperforming residential real estate loans of $142 thousand, and a decrease in other real estate owned of $304 thousand, partially offset by an increase in nonperforming construction and land development loans of $286 thousand. The decrease in nonperforming assets relates to the Company's continued focus on asset quality issues and the significant resources allocated to the asset quality control functions of credit policy and administration and loan review. The asset workout and collection functions focus on reducing nonperforming assets. Despite the continued focus on asset quality and reduction of nonperforming asset levels, there can be no assurance that adverse changes in economic conditions and the real estate markets in the Company's primary market areas will not result in higher levels of nonperforming assets in the future and negatively impact the Company's operations through higher provisions for possible loan losses, decreases in accruals of interest income and increased noninterest expenses relating to the collection and workout of nonperforming assets.

The Company has identified loans as impaired in accordance with Statement of Financial Accounting Standards ("SFAS") No. 114, when it is probable that interest and principal will not be collected according to the terms of the loan agreements. The balance of impaired loans was $1.6 million and $4.6 million, respectively, at December 31, 1998 and 1997. The average recorded investment in impaired loans was $3.5 million, $3.0 million and $3.9 million, respectively, in 1998, 1997 and 1996. No income was recognized on impaired loans during 1998 and 1997 and $4 thousand of income was recognized during 1996. Total cash collected on impaired loans during 1998, 1997 and 1996 was $710 thousand, $779 thousand and $2.4 million, respectively, all of which with the exception of $4 thousand recognized as income during 1996, was credited to the principal balance outstanding on such loans.

The portion of the allowance for possible loan losses applicable to impaired loans amounted to $233 thousand, $1.1 million, $457 thousand and $1.1 million, respectively, at December 31, 1998, 1997, 1996 and 1995. During 1998, 1997 and 1996, provisions for possible loan losses applicable to impaired loans were $201 thousand, $1.0 million and $499 thousand, respectively. Impaired loans charged off during 1998, 1997 and 1996 were $1.0 million, $386 thousand and $1.2 million, respectively. At December 31, 1998, 1997 and 1996, there were no impaired loans which did not have an allowance for possible loan losses determined in accordance with SFAS No. 114.

The Company's policy for interest income recognition on impaired loans is to recognize income on nonaccrual loans under the cash basis when the loans are both current and the collateral on the loan is sufficient to cover the outstanding obligation to the Company; if these factors do not exist, the Company does not recognize income.

Other real estate owned is comprised of properties acquired through foreclosure proceedings or acceptance of a deed in lieu of foreclosure. Real estate acquired in settlement of loans is recorded at the lower of the carrying value of the loan or the fair value of the property received less an allowance for estimated costs to sell. Loan losses arising from the acquisition of such properties are charged against the allowance for possible loan losses. Provisions to reduce the carrying value to net realizable value are charged to current period earnings as realized and reflected as an additional valuation allowance. Operating expenses and gains and losses upon disposition are reflected in earnings as realized. Other

real estate owned amounted to $1.6 million and $1.9 million at December 31, 1998 and 1997, respectively. See note 11 of Notes to Consolidated Financial Statements for further information on other real estate owned.

The allowance for possible loan losses is a significant factor in the

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Company's operating results and is established through charges against earnings and is maintained at a level considered adequate to provide for potential loan losses based on management's evaluation of known and inherent risks in the loan portfolio. When a loan, or a portion of a loan, is considered uncollectible it is charged against the allowance. Recoveries of loans previously charged off are credited to the allowance when received.

Management's evaluation of the allowance is based on a continuing review of the loan portfolio. The methodology for determining the amount of the allowance for possible loan losses consists of several elements. Nonperforming, impaired and delinquent loans are reviewed individually and the value of any underlying collateral is considered in determining estimates of possible losses associated with those loans. Another element involves estimating losses inherent in categories of loans, based primarily on historical experience, industry trends and trends in the real estate market and the current economic environment in the Company's primary market areas. The last element is based on management's evaluation of various conditions, and involves a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments. The conditions evaluated in connection with this element include the following: industry and regional conditions; seasoning of the loan portfolio and changes in the composition of and growth in the loan portfolio; the strength and duration of the current business cycle; existing general economic and business conditions in the lending areas; credit quality trends, including trends in nonperforming loans expected to result from changes in existing conditions; historical loan charge-off experience; and the results of bank regulatory examinations.

At December 31, 1998, 1997 and 1996, the allowance for possible loan losses was $7.1 million, $7.7 million and $6.3 million, respectively, and the ratio of the allowance to total loans outstanding was 1.28%, 1.50% and 1.41%, respectively. At December 31, 1998, 1997 and 1996, the allowance for possible loan losses represented 236.4%, 107.1% and 153.0%, respectively, of nonperforming loans. The amount of the allowance for possible loan losses decreased at December 31, 1998 compared to December 31, 1997, primarily as a result of decreases in nonperforming and impaired loans and a change in the composition of the loan portfolio which was more predominantly residential real estate in 1998, partially offset by the overall growth of the loan portfolio. The amount of the allowance for possible loan losses increased at December 31, 1997 compared to December 31, 1996, primarily as a result of increases in nonperforming and impaired loans, and an increase in the total loan portfolio, including growth in commercial business loans and commercial real estate loans.

While management believes that the allowance for possible loan losses at December 31, 1998 is adequate based on its current review and estimate, further provisions to the allowance may be necessary if the market in which the Company operates deteriorates. Additionally, regulatory agencies review the Company's allowance for possible loan losses as part of their examination process. Such agencies may require the Company to recognize additions to the allowance based on judgments which may be different from those of management.

Deposits

A summary of deposits at December 31, 1998 and 1997 follows:

<TABLE>
<CAPTION>

	December 31, 1998	December 31, 1997
	(In Thousands)	
NOW accounts	$203,068	$166,773
Savings accounts	87,150	89,278
Money market deposit accounts	19,659	31,486
Time certificates	266,901	290,176
Total interest bearing deposits	576,778	577,713
Noninterest bearing deposits	73,709	71,270
Total deposits	$650,487	$648,983

</TABLE>

Total deposits remained relatively stable increasing $1.5 million, or 0.23% during 1998. The decrease in time certificates of $23.3 million and a portion of the $11.8 million decrease in money market deposit accounts related primarily to depositors looking to achieve higher yields by investing their funds in alternate sources outside of traditional bank products, while the continued success of the NOW account product introduced by the subsidiary bank in 1995 contributed to the $36.3 million increase in NOW accounts and the decrease in a portion of the money market deposit

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accounts, as some money market deposit accounts shifted into the NOW account product. Noninterest bearing deposits increased $2.4 million, while savings accounts decreased $2.1 million during 1998.

Time certificates with minimum balances of $100 thousand decreased $3.9 million, from $37.4 million at December 31, 1997 to $33.5 million at December 31, 1998. The Company does not use brokers to solicit deposits.

Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase increased $4.9 million or 7.4% to $70.9 million at December 31, 1998 from

$66.0 million at December 31, 1997. The increase in securities sold under agreements to repurchase was used to fund loan growth. These short-term borrowings are instruments which are used by municipalities and businesses to invest their excess cash and are collateralized by US Treasury and US Government Agency obligations.

Other Borrowings

Other borrowings which consists of borrowings from the FHLBB increased $54.7 million from $25.9 million at December 31, 1997 to $80.6 million at December 31, 1998. Proceeds of new borrowings from the FHLBB during 1998 were $80.0 million and repayments were $25.3 million. FHLBB borrowings increased because the growth in interest earning assets, primarily loans and to a lesser extent securities available for sale exceeded the growth in deposits and securities sold under agreements to repurchase.

Stockholders' Equity

Stockholders' equity was $72.6 million at December 31, 1998, an increase of $5.7 million from $66.9 million at December 31, 1997. Book value per share was $12.31 at December 31, 1998, up $0.30 or 2.5% from $12.01 at December 31, 1997. See "Capital Resources and Liquidity" for further information on stockholders' equity.

Risk Management

In the normal course of business, the Company is subject to various risks, the most significant of which are credit, liquidity and market risk, which includes interest rate risk. Although the Company cannot eliminate these risks, it has risk management processes designed to provide for risk indentification, measurement, monitoring and control. The Board of Directors establishes policies with respect to risk management, lending, investment, asset/liability management and interest rate risk and reviews and approves these policies annually. The Board of Directors delegates the responsibility for carrying out these policies to management.

Credit risk represents the possibility that a customer or counterparty may not perform in accordance with contractual terms. Credit risk results from extending credit to customers, purchasing securities and entering into certain off-balance-sheet financial transactions (which are primarily commitments to originate loans, unused lines and standby letters of credit or unadvanced portions of construction loans). Risk associated with the extension of credit (including off-balance-sheet items) includes general risk, which is inherent in the lending business, and risk specific to individual borrowers. Risk associated with purchasing securities primarily centers around the credit quality of the issuer of the security. The Company seeks to manage credit risk through portfolio diversification, investments in highly rated securities, loan underwriting policies and procedures and loan monitoring practices.

Liquidity represents an institution's ability to generate cash or otherwise obtain funds at reasonable rates to satisfy commitments to borrowers and demands of depositors and to invest in strategic initiatives. Liquidity risk represents the likelihood the Company would be unable to generate cash or otherwise obtain funds at reasonable rates for such purposes. Liquidity is managed through the coordination of the relative maturities of assets, liabilities and off-balance sheet positions and is enhanced by the ability to raise funds with direct borrowings.

Market risk reflects the risk of economic loss resulting from adverse changes in market prices and interest rates. The risk of loss can be reflected in diminished current values and/or reduced potential net interest income in future periods. The Company's market risk arises primarily from interest rate risk. The Company is also exposed to market price risk through its investments in marketable equity securities.

Asset/Liability Management, Interest Rate Sensitivity and Market Risk

The Company's primary objective regarding asset/liability management

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is to position the Company so that changes in interest rates do not have a material adverse impact upon net earnings (through changes in net interest and dividend income) and the estimated net present value of equity of the Company. The Company's primary strategy for accomplishing its asset/liability management objective is achieved by managing the weighted average maturities of assets, liabilities and off-balance-sheet items (duration matching). At December 31, 1998, approximately 65.6% of the Company's loan portfolio was comprised of adjustable rate loans. Approximately 69.2% of its securities available for sale and securities held to maturity portfolios are debt securities maturing in less than five years. With regard to deposit liabilities, only 41.0% of total deposits and 46.3% of interest bearing deposits are comprised of time certificates. Unlike other deposit products such as NOW, money market deposit and savings accounts, time certificates carry a high degree of interest rate sensitivity and therefore their renewal will vary based on the competitiveness of the Company's interest rates. The Company has also entered into interest rate cap agreements to manage its exposure to interest rate risk. At December 31, 1998 the Company had interest rate cap agreements in effect with notional amounts of $20.0 million with a weighted average strike rate of 7.77%, which mature in the year 2004. The Company receives an interest payment if the three-

month London Interbank Offer Rate ("LIBOR") increases above the strike rate.

To measure the impact of interest rate changes, the Company utilizes a comprehensive financial planning model that recalculates the estimated net present value of equity and net interest and dividend income of the Company assuming instantaneous, permanent parallel shifts in the yield curve of both up and down 100 and 200 basis points. Larger increases or decreases in estimated net interest and dividend income and the estimated net present value of equity of the Company as a result of these interest rate changes represent greater interest rate risk than do smaller increases or decreases.

The results of the financial planning model are highly dependent on numerous assumptions. These assumptions generally fall into two categories: those relating to the interest rate environment and those relating to general business and economic factors. Assumptions related to the interest rate environment include the prepayment speeds on mortgage-related assets and the cash flows and maturities of financial instruments. Assumptions related to general business and economic factors include changes in market conditions, loan volumes and pricing, deposit sensitivity, customer preferences, competition, and management's financial and capital plans. The assumptions are developed based on current business and asset/liability management strategies, historical experience, the current economic environment, forecasted economic conditions and other analyses. These assumptions are inherently uncertain and subject to change as time passes. The Company endeavors to maintain a position where it experiences no material changes in estimated net present value of equity and no material fluctuation in estimated net interest and dividend income as a result of assumed 100 and 200 basis point increases and decreases in interest rates. However, there can be no assurances that the Company's forecasts in this regard will be achieved.

Management believes that the above method of measuring and managing interest rate risk is consistent with the FDIC regulation regarding an interest rate risk component of regulatory capital.

The following table summarizes the timing of the Company's anticipated maturities or repricing of and interest rates applicable to rate-sensitive assets and rate-sensitive liabilities as of December 31, 1998. This table has been generated using certain assumptions which the Company believes fairly and accurately represent repricing volumes in a dynamic interest rate environment. Adjustable rate loans are reflected in periods in which they reprice, and fixed rate loans are shown in accordance with their contractual maturities (scheduled amortization). The earlier of contractual maturities or the next repricing date are used on all securities. Certain marketable equity securities and stock in the FHLBB totaling $20.7 million, are not susceptible to interest rate sensitivity and have therefore been excluded from this analysis. The gap maturity categories for savings deposits (including NOW, savings, and money market deposit accounts) are allocated based on the Company's historical experience in retaining such deposits in changing interest rate environments, as well as management's philosophy of repricing core deposits in reaction to changes in the interest rate environment. Time deposits are reflected at the earlier of contractual maturities or their next repricing date. Repricing frequencies will vary at different points in the interest cycle and as supply and demand for credit change.

Nonperforming loans totaling $3.0 million have been excluded from this analysis.

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INTEREST RATE SENSITIVITY GAP ANALYSIS
at December 31, 1998

<TABLE>
<CAPTION>

	Sensitivity Period					
	0-6 Months	6 Months- 1 Year	1-3 Years	3-5 Years	Over 5 Years	Total
	($ In Thousands)					
<S> <S>	<C>	<C>	<C>	<C>	<C>	<C>
Rate-sensitive Assets:						
Interest bearing deposits in other banks.....................................$	$ 19,532					$ 19,532
Rate	4.84%					4.84%
Securities.................................$	33,788	$ 37,180	$ 52,563	$ 65,082	$ 39,935	228,548
Rate	5.75%	5.88%	5.97%	5.92%	6.32%	5.97%
Loans and loans held for sale.............$	152,978	78,387	87,906	82,831	150,906	553,008
Rate	8.87%	8.47%	8.21%	8.32%	6.99%	8.11%
Total..................................	$206,298	$115,567	$140,469	$147,913	$190,841	$801,088
Rate-sensitive Liabilities:						
Money Market Deposit Accounts.................................$	$ 3,932	$ 5,898	$ 9,829			$ 19,659
Rate	2.56%	2.56%	2.56%			2.56%
Savings and NOW Accounts...................$	23,217	34,826	116,087	$ 58,044	$ 58,044	290,218
Rate	2.32%	2.32%	2.32%	2.32%	2.32%	2.32%
Time certificates..........................$	103,301	122,849	34,221	6,218	312	266,901
Rate	5.13%	5.52%	5.77%	5.68%	5.55%	5.41%
Securities sold under agreements to repurchase and other borrowings..........................$	70,583	367	99	30,112	50,352	151,513
Rate	4.29%	4.71%	6.06%	5.87%	4.69%	4.74%
Total..................................	$201,033	$163,940	$160,236	$ 94,374	$108,708	$728,291
Period Sensitivity Gap.......................	$ 5,265	$(48,373)	$(19,767)	$ 53,539	$ 82,133	$ 72,797
Cumulative Sensitivity Gap...................	$ 5,265	$(43,108)	$(62,875)	$ (9,336)	$ 72,797	
Cumulative Sensitivity Gap as a Percent of Total Rate-sensitive Assets.......	0.66%	(5.38)%	(7.85)%	(1.17)%	9.09%	

</TABLE>

The ability to assess interest rate risk using gap analysis is limited. Gap analysis does not capture the impact of cash flow or balance sheet mix changes over a forecasted future period and it does not measure the amount of price change expected to occur in the various asset and liability categories. Thus, management does not use gap analysis exclusively in its assessment of interest rate risk. The Company's interest rate risk exposure is also measured by the estimated net interest and dividend income and discounted cash flow market value sensitivities referred to above.

The Company's limits on interest rate risk specify that if interest rates were to shift immediately up or down 200 basis points, hypothetical net interest and dividend income should decline by less than 8%. The change in hypothetical net interest and dividend income would not differ materially from the change in pretax earnings. Additionally, the Company's limits on interest rate risk also specify that if interest rates were to shift immediately up or down 200 basis points, the change in the estimated net present value of equity should decline by less than 15%. The following table presents as of December 31, 1998, the Company's interest rate risk as measured by the changes in the estimated net present value of equity and hypothetical net interest and dividend income for instantaneous and sustained parallel shifts of 100 and 200 basis points in market interest rates.

<TABLE>
<CAPTION>

Change in Interest Rates	$ Change in Estimated Net Present Value of Equity	% Change in Estimated Net Present Value of Equity	$ Change in Hypothetical Net Interest and Dividend Income	% Change in Hypothetical Net Interest and Dividend Income

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(Basis Points)	(In Thousands)		(In Thousands)	
<S>	<C>	<C>	<C>	<C>
+200	$(3,503)	(3.21)%	$(567)	(1.72)%
+100	18	0.02	140	0.43
Flat Rate	0	0	0	0
-100	(3,509)	(3.21)	261	0.79
-200	(8,196)	(7.50)	(84)	(0.26)

</TABLE>

Management also believes that the assumptions utilized in evaluating the vulnerability of the Company's net interest and dividend income and estimated net present value of equity to changes in interest rates approximate actual experience. However, the interest rate sensitivity of the Company's assets and liabilities as well as the estimated effect of changes in interest rates on the estimated net present value of equity or estimated net interest and dividend income, could vary substantially if different assumptions are used or actual experience differs from the experience on which the assumptions were based.

In the event the Company should experience a mismatch in its desired GAP ranges or an excessive decline in its estimated net present value of equity or estimated net interest and dividend income subsequent to an immediate and sustained change in interest rates, it has a number of options which it could utilize to remedy such mismatch. The Company could restructure its available for sale securities portfolio through sale or purchase of securities with more favorable repricing attributes. It could also emphasize loan products with appropriate maturities or repricing attributes, or it could attract deposits or obtain borrowings with desired maturities.

The Company maintains a portfolio of marketable equity securities, which are included in securities available for sale, and had estimated fair values of $15.5 million and an original cost of $14.1 million at December 31, 1998. Such securities are recorded at estimated fair market value, and are subject to market price risk. The risk is the potential loss in estimated fair value resulting from adverse changes in prices quoted by stock markets. The Company manages its market price risk by closely monitoring market developments and reviewing current financial statements and other reports published by the issuers of the equity securities.

Within the Company's portfolio of marketable equity securities, an analysis of significant quarterly movements in stock prices over the last three years, or since the stock was initially offered for purchase if less than three years, indicated a 10-20% movement in prices in 26% of the quarters, a 20-25% movement in prices in 10% of the quarters and a 25-35% movement in prices in 12% of the quarters. The market price risk in the Company's marketable equity securities portfolio, assuming hypothetical decreases in quoted stock prices of 10%, 25% and 35%, would amount to $1.5 million, $3.9 million and $5.4 milllion, respectively. The after tax impact on capital relating to these hypothetical decreases in stock prices would be $1.0 million, $2.4 million and $3.3 million, respectively.

RESULTS OF OPERATIONS

General

The operating results of the Company depend primarily on the net interest and dividend income of its subsidiary bank, which is the difference between interest and dividend income on interest earning assets, primarily loans and securities, and interest expense on interest bearing liabilities, primarily deposits, securities sold under agreements to repurchase and other borrowings. The Company's operating results are also affected by the level of its provision for possible loan losses, noninterest income, noninterest expense, and income taxes.

Comparison of Operating Results for the Years Ended December 31, 1998 and 1997

Net Earnings

Operations in 1998 resulted in net earnings of $9.6 million, an increase of $7.3 million over net earnings of $2.3 million for 1997. Basic earnings per share was $1.64 in 1998 compared to $.42 in 1997. Diluted earnings per share was $1.60 in 1998 compared to $.40 in 1997.

Earnings before income taxes were $14.7 million in 1998, an increase of $11.7 million compared to earnings before income taxes of $3.0 million in 1997. Earnings before income taxes increased in 1998 compared to 1997, primarily as a result of increases in net interest and dividend income and noninterest income and decreases in the provision for possible loan losses and noninterest expense.

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Net Interest and Dividend Income

Net interest and dividend income was $31.0 million and $30.1 million in 1998 and 1997, respectively. The increase of $862 thousand in 1998 compared to 1997 relates to an increase of $11.1 million or 1.50% in average interest earning assets to $751.3 million in 1998 from $740.2 million in 1997 and a decrease in average interest bearing liabilities of $4.9 million, or 0.73%, to $669.2 million in 1998 from $674.1 million in 1997, while the interest rate spread was fairly stable at 3.67% in 1998 compared to 3.68% in 1997.

Interest income on loans increased $3.5 million to $45.8 million in 1998 from $42.3 million in 1997. The increase was primarily the result of an increase in the average loan balances of $61.8 million, or 13.00%, to $536.6 million in 1998 from $474.8 million in 1997, partially offset by a decrease in average loan yields to 8.54% in 1998 from 8.91% in 1997. The increase in average balances in the loan portfolio reflects strong loan demand in the residential real estate market during 1998 as a result of the continued low interest rate environment which encouraged refinancing, as well as new home purchases in the subsidiary bank's market areas. Competition for loans amongst financial institutions and the continued low interest rate environment sparked loan demand and also contributed to the slightly lower yields realized in 1998 compared to 1997. The competitive loan environment also resulted in a decrease in the Company's commercial, financial and agricultural loans and commercial real estate loans, which also contributed to the lower yields realized on loans in 1998 compared to 1997. Management expects that the competition for loans will continue, which could reduce average yields realized on loans, thereby reducing the interest rate spread in future periods.

Interest and dividend income on securities, including stock in FHLBB decreased $4.1 million to $11.8 million in 1998 from $15.9 million in 1997. The decrease relates primarily to a decrease in the average balances of securities, including stock in FHLBB of $55.7 million to $195.1 million in 1998 from $250.8 million in 1997, coupled with a decrease in yields to 6.03% in 1998 from 6.35% in 1997. The decrease in average balances of securities is due to a change in mix of assets to higher yielding loans from lower yielding securities during 1998. The decrease in yields was primarily the result of the continued low interest rate environment that was prevalent during 1998.

Interest expense on deposits decreased $768 thousand to $22.6 million in 1998 from $23.3 million in 1997, with interest on time deposits decreasing $1.0 million, partially offset by an increase in interest on savings deposits of $255 thousand. The decrease related primarily to a decrease in the average cost of deposits to 4.00% during 1998 compared to 4.11% during 1997, coupled with a decrease in the average balances of deposits of $2.6 million to $564.4 million in 1998 from $567.0 million in 1997. Average balances of time certificates decreased $15.7 million to $267.8 million during 1998 from $283.5 million during 1997 which was partially offset by an increase in average balances of savings deposits of $13.1 million to $296.6 million during 1998 from $283.5 million during 1997. The decrease in the average balances of time certificates related primarily to depositors looking to achieve higher yields by investing their funds in alternate sources outside of traditional bank products, while the continued success of the NOW account product introduced by the subsidiary bank in 1995 was the primary reason for the increase in the average balances of savings deposits.

Interest expense on securities sold under agreements to repurchase and other borrowings decreased $479 thousand to $5.1 million in 1998 from $5.6 million in 1997. The decrease was primarily related to a decrease in the cost of these borrowings to 4.87% in 1998 compared to 5.21% in 1997, coupled with a decrease in the average balances of $2.3 million to $104.8 million in 1998 from $107.1 million in 1997. The decrease in average balances related to a decrease in average balances of other borrowings of $10.0 million, partially offset by an increase in the average balances on securities sold under agreements to repurchase of $7.7 million. The increase of $7.7 million was primarily the result of local municipalities and commercial accounts making greater use of securities sold under agreements to repurchase in investing their excess funds. The cost of securities sold under agreements to repurchase was 4.36% and 4.76% in 1998 and 1997, respectively, while the cost of other borrowings was relatively stable, at 5.79% during 1998 and 5.78% during 1997.

Average Balance Sheets and Net Interest and Dividend Income

The following table presents, for the periods indicated, average balances, the total dollar amount of interest and dividend income from interest earning assets and their resultant yields, as well as the interest expense on interest bearing liabilities, and their resultant costs:

<TABLE>

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	Year Ended December 31,								
	1998			1997			1996		
	Average Balance	Interest	Yield/ Cost	Average Balance	Interest	Yield/ Cost	Average Balance	Interest	Yield/ Cost
	($ In Thousands)								
Assets									
Interest earning assets									
Loans and loans held for sale[F1]	$536,596	$45,832	8.54%	$474,844	$42,307	8.91%	$423,421	$37,969	8.97%
Interest bearing deposits in other banks	19,634	1,029	5.24	14,570	781	5.36	16,956	857	5.05
Securities, including stock in FHLBB[F2]	195,051	11,765	6.03	250,783	15,923	6.35	254,599	15,604	6.13
Total interest earning assets	751,281	58,626	7.80	740,197	59,011	7.97	694,976	54,430	7.83
Non-interest earning assets	70,690			72,400			66,828		
Allowance for possible loan losses	(7,557)			(6,594)			(6,702)		
Total assets	$814,414			$806,003			$755,102		
Liabilities and Stockholders' Equity									
Interest bearing liabilities									
Savings deposits	$296,639	7,684	2.59	$283,512	7,429	2.62	$274,136	7,212	2.63
Time deposits	267,764	14,870	5.55	283,514	15,893	5.61	262,165	14,787	5.64
Total interest bearing deposits	564,403	22,554	4.00	567,026	23,322	4.11	536,301	21,999	4.10
Securities sold under agreements to repurchase and other borrowings	104,784	5,099	4.87	107,062	5,578	5.21	100,304	5,244	5.23
Total interest bearing liabilities	669,187	27,653	4.13	674,088	28,900	4.29	636,605	27,243	4.28
Non-interest bearing liabilities									
Demand deposits	69,575			63,870			58,935		
Other liabilities	3,784			3,368			3,669		
Total non-interest bearing liabilities	73,359			67,238			62,604		
Stockholders' equity	71,868			64,677			55,893		
Total liabilities and stockholders' equity	$814,414			$806,003			$755,102		
Net interest and dividend income/interest rate spread		$30,973	3.67%		$30,111	3.68%		$27,187	3.55%
Net earning balance/net yield on interest earning assets	$ 82,094		4.12%	$ 66,109		4.07%	$ 58,371		3.91%

[F1] Loans on nonaccrual status are included in the average balances for all periods presented.

[F2] The yield on securities, including stock in FHLBB is calculated using interest and dividend income divided by the average balance of the amortized historical cost.

Rate Volume Analysis

The following table presents the dollar amount of changes in interest and dividend income, interest expense and net interest and dividend income which are attributable to changes in the average amounts of interest earning assets and interest bearing liabilities and/or changes in rates earned or paid thereon. The net changes attributable to both volume and rate have been allocated proportionately.

	Year Ended December 31, 1998 vs. 1997 Increase (Decrease) Due To		
	Volume	Rate	Total

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	Volume	Rate	Total
	(In Thousands)		
Interest income on loans	$ 5,179	$(1,654)	$ 3,525
Interest income on interest bearing deposits in other banks	265	(17)	248
Interest and dividend income on securities and stock in FHLBB	(3,389)	(769)	(4,158)
Total interest and dividend income	2,055	(2,440)	(385)
Interest expense on deposits	(113)	(655)	(768)
Interest expense on securities sold under agreements to repurchase and other borrowings	(118)	(361)	(479)
Total interest expense	(231)	(1,016)	(1,247)
Net interest and dividend income	$ 2,286	$(1,424)	$ 862

	Year Ended December 31, 1997 vs. 1996 Increase (Decrease) Due To		
	Volume	Rate	Total
	(In Thousands)		
Interest income on loans	$ 4,591	$ (253)	$ 4,338
Interest income on interest bearing deposits in other banks	(136)	60	(76)
Interest and dividend income on securities and stock in FHLBB	(229)	548	319
Total interest and dividend income	4,226	355	4,581
Interest expense on deposits	1,269	54	1,323
Interest expense on securities sold under agreements to repurchase and other borrowings	354	(20)	334
Total interest expense	1,623	34	1,657
Net interest and dividend income	$ 2,603	$ 321	$ 2,924

Provision for Possible Loan Losses

The provision for possible loan losses was $1.1 million in 1998, representing a $1.3 million or 53.6% decrease from the provision of $2.4 million in 1997. The decrease in the provision resulted primarily from a change in the mix of loans to residential real estate loans, which accounted for 59.1% of the total loan portfolio at December 31, 1998 compared to 48.2% at December 31, 1997, while commercial real estate and commercial and industrial loans accounted for 35.0% of the total loan portfolio in 1998 compared to 43.2% in 1997. Also contributing to the decrease in the provision was a decrease of $4.1 million in nonperforming loans to $3.0 million at December 31, 1998 from $7.1 million at December 31, 1997, and management's overall evaluation of the loan portfolio and the adequacy of the level of the allowance for possible loan losses. Loans charged off in 1998 were $2.1 million compared to $1.2 million in 1997. Recoveries of loans previously charged off were $459 thousand in 1998 compared to $178 thousand in 1997. Net loans charged off were $1.7 million in 1998 compared to $1.0 million in 1997.

Noninterest Income

Noninterest income was $9.1 million in 1998, an increase of $2.0 million or 27.48% compared to $7.1 million in 1997. The increase in 1998 over 1997, was primarily attributable to increases in net gains on sales of securities available for sale of $2.0 million, net gains on sales of loans into the secondary mortgage market of $310 thousand and other noninterest income of $397 thousand, partially offset by decreases in customer account fees and service charges of $686 thousand and mortgage service fees of $68 thousand. The increase in net gains on sales of securi-

ties available for sale was a result of the Company continuing to closely monitor the equity markets in light of their continued volatility in 1998. The increase in net gains on sales of loans in the secondary mortgage market was as a result of an increase in loans originated for and sold into the secondary mortgage market in 1998 compared to 1997, because of the continued

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low interest rate environment during 1998, which kept demand for residential real estate loans at a very high level. The increase in other noninterest income was primarily as a result of gains on sales of other assets during 1998. The decrease in customer account fees and service charges related to the elimination of and/or restructuring of certain deposit programs which the Company assumed in its merger with Primary Bank in 1997. The elimination and/or restructuring of these deposit programs provided efficiencies through the reduction of noninterest expense.

Noninterest Expense

Noninterest expense was $24.2 million in 1998, a decrease of $7.6 million compared to $31.8 million in 1997. The decrease was primarily attributable to a decrease in salaries and benefit expenses of $1.4 million to $12.4 million in 1998 compared to $13.8 million in 1997 and a decrease in merger-related costs from $5.9 million in 1997 to $34 thousand in 1998.

The decrease in salaries and benefits expense of $1.4 million was primarily attributable to a decrease in salaries, related to personnel efficiencies realized from the merger with Primary Bank, which were partially offset by normal salary increases, increased costs for commissions to loan originators and nondeposit product sales staff and $760 thousand relating to the cost of termination of certain officers. Additionally, decreases in employee benefits related primarily to merger efficiencies and a $1.1 million expense incurred in 1997 associated with the vesting of performance based stock options assumed in the merger with Primary Bank, for which there was no related expense in 1998, partially offset by an increase of $362,000 in expense related to the 1998 restricted stock grants.

Occupancy and equipment expense increased $761 thousand from $4.2 million in 1997 to $5.0 million in 1998. The increase is primarily attributable to the Company recording a $712 thousand writedown on bank buildings based upon an appraisal on property used as a branch office which is being closed.

Other real estate owned expense increased $294 thousand from $63 thousand in 1997 to $357 thousand in 1998 as a result of an increase in foreclosure activity related to nonperforming loans and costs related to the disposition of foreclosed properties.

In connection with the completion of the merger with Primary Bank, effective after the close of business October 31, 1997, the Company incurred merger-related charges of $5.9 million which were recorded at the date of combination. Merger-related charges associated with the Primary Bank merger in 1998 were $34 thousand.

Other expenses decreased $1.4 million primarily as a result of efficiencies realized in the merger with Primary Bank in the following areas: advertising and marketing expenses decreased $643 thousand, data processing and transmission costs decreased $614 thousand, general liability insurance decreased $154 thousand and directors fees decreased $167 thousand. These efficiencies were offset by increases in amortization expense of $56 thousand, an increase in Year 2000 expenses of $101 thousand from $0 in 1997 to $101 thousand in 1998 and an increase in telephone expense of $119 thousand. The increase in amortization expense was primarily attributable to increases in originated mortgage servicing rights, while the increase in telephone expense relates to increased data transmission and call volume amongst the branch network as well as higher customer call volume for account activity through the subsidiary bank's telephone banking system in 1998 as compared with 1997.

Income Taxes

Income tax expense increased $4.4 million to $5.1 million in 1998 compared to $704 thousand in 1997 and represented effective tax rates of 35.0% and 23.4%, respectively, of pretax income. The reason the tax rate is lower in 1997 compared to 1998, relates primarily to the reversal in 1997 of the remainder of the valuation allowance on deferred tax assets established for net operating losses as a result of current and projected earnings, partially offset by nondeductible merger related charges and nondeductible performance based stock option charges incurred in 1997.

Comparison of Operating Results for the Years
Ended December 31, 1997 and 1996

Net Earnings

Operations in 1997 resulted in net earnings of $2.3 million, a decrease of $4.9 million over net earnings of $7.2 million for 1996. Basic earnings per share was $.42 in 1997 compared to $1.35 in 1996. Diluted earnings per share was $.40 in 1997 compared to $1.28 in 1996.

Earnings before income taxes were $3.0 million in 1997, a decrease of $5.9 million compared to earnings before income taxes of $8.9 million in 1996. Earnings before income taxes decreased in 1997 compared to 1996, primarily as a result of increases in noninterest expense (including merger-related charges of $5.9 million) and the provision for possible loan losses, partially offset by increases in net interest and dividend income and noninterest income.

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Net Interest and Dividend Income

Net interest and dividend income was $30.1 million and $27.2 million in 1997 and 1996, respectively. The increase of $2.9 million in 1997 compared to 1996 relates to an increase of $45.2 million or 6.51% in average interest earning assets to $740.2 million in 1997 from $695.0 million in 1996, coupled with an increase in the interest rate spread to 3.68% in 1997 from 3.55% in 1996.

Interest income on loans increased $4.3 million to $42.3 million in 1997 from $38.0 million in 1996. The increase was primarily the result of an increase in the average loan balances of $51.4 million, or 12.14%, to $474.8 million in 1997 from $423.4 million in 1996, partially offset by a slight decrease in average loan yields to 8.91% in 1997 from 8.97% in 1996. The increase in average balances in the loan portfolio reflects the strong demand during 1997, particularly with respect to residential and commercial real estate loans. Competition for loans amongst financial institutions and the continued low interest rate environment sparked loan demand and also contributed to the slightly lower yields realized in 1997 compared to 1996.

Interest and dividend income on securities, including stock in FHLBB increased $319 thousand to $15.9 million in 1997 from $15.6 million in 1996. The increase related primarily to an increase in average yields to 6.35% in 1997 from 6.13% in 1996, partially offset by a decrease in average balances of $3.8 million to $250.8 million in 1997 from $254.6 million in 1996. The increase in yields was primarily the result of investing in securities with longer weighted average maturities during 1996, thereby increasing yields in 1997, coupled with increased prepayment activity on mortgage-backed securities in 1996, requiring an acceleration of the amortization of premiums paid for such securities during 1996.

Interest expense on deposits increased $1.3 million to $23.3 million in 1997 from $22.0 million in 1996, with interest on savings deposits increasing $217 thousand and interest on time deposits increasing $1.1 million. The increase related primarily to an increase in average balances of deposits of $30.7 million to $567.0 million in 1997 from $536.3 million in 1996. Of this increase, average balances of savings deposits increased $9.4 million and average balances of time deposits increased $21.3 million. The average cost of deposits remained stable at 4.11% during 1997 compared to 4.10% during 1996. The Company's subsidiary bank continued to offer competitive rates during 1997 on time deposits and that coupled with the continued success of a NOW account product which was first introduced by the subsidiary bank in 1995 were the primary reasons for the increases in the average balances of time and savings deposits during 1997.

Interest expense on securities sold under agreements to repurchase and other borrowings increased $334 thousand to $5.6 million in 1997 from $5.2 million in 1996. The increase was primarily related to an increase in average balances of $6.8 million to $107.1 million in 1997 from $100.3 million in 1996, while the cost of these borrowings remained relatively stable at 5.21% in 1997 compared to 5.23% in 1996. The increase in average balances related to an increase in average balances on securities sold under agreements to repurchase of $8.6 million, while average balances of other borrowings decreased by $1.8 million. The increase of $8.6 million was primarily the result of local municipalities and commercial accounts making greater use of securities sold under agreements to repurchase in investing their excess funds. The cost of securities sold under agreements to repurchase was 4.76% in both 1997 and 1996, and the cost of other borrowings was relatively stable, at 5.78% during 1997 and 5.72% during 1996.

Provision for Possible Loan Losses

The provision for possible loan losses was $2.4 million in 1997, representing a $1.0 million or 76.75% increase from the provision of $1.4 million in 1996. The increase in the provision resulted primarily from the increase in the loan portfolio as well as the increase in nonperforming loans, and management's overall evaluation of the loan portfolio and the adequacy of the level of the allowance for possible loan losses. Loans charged off in 1997 were $1.2 million compared to $3.0 million in 1996. Recoveries of loans previously charged off were $178 thousand in 1997 compared to $750 thousand in 1996. Net loans charged off were $1.0 million in 1997 compared to $2.3 million in 1996.

Noninterest Income

Noninterest income was $7.1 million in 1997, an increase of $1.4 million or 23.87% compared to $5.7 million in 1996. The increase in 1997 over 1996, was primarily attributable to an increase in net gains on sales of securities available for sale of $1.5 million and an increase in other noninterest income of $321 thousand, partially offset by a decrease in net gains on sales of loans of $383 thousand. The increase in net gains on sales of available for sale securities was primarily the result of the Company

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selling certain of its equity securities available for sale during the first quarter of 1997, based on a perceived volatility in the stock markets. The increase in other noninterest income related primarily to increases in fees associated with nondeposit product sales and income from increases in the cash surrender values of life insurance. The decrease in net gains on sales of loans was the result of an increase in the competitive environment for residential mortgage products, resulting in the pricing of loans at lower rates, thereby reducing gains on sales, as well as a decrease in loans sold in the secondary mortgage market as a result of the Company originating fifteen year fixed rate loans for its own portfolio

beginning July 1, 1996, which previously were being sold in the secondary mortgage market.

Noninterest Expense

Noninterest expense was $31.8 million in 1997, an increase of $9.2 million compared to $22.6 million in 1996. The increase was primarily attributable to an increase in salaries and benefit expenses of $2.8 million to $13.8 million in 1997 compared to $11.0 million in 1996 and merger related costs of $5.9 million in 1997 compared to $0 in 1996.

The increase in salaries and benefits of $2.8 million was primarily attributable to $1.1 million relating to compensation expense associated with the vesting of performance based stock options in 1997, normal salary increases of approximately 4.5%, additional staffing requirements, increased costs associated with health insurance and retirement plans, increased costs for commissions to loan originators and nondeposit product sales staff and increases in bonuses paid to officers. The additional staffing requirements in 1997 were: for commercial lending and mortgage loan origination staff to penetrate newer market areas, as well as to handle the significant loan demand; for the Merrimack branch office opened in February of 1997; to bolster the Company's information technology area; and for the human resource and employee training areas.

In conjunction with the acquisition of Primary Bank after the close of business October 31, 1997, the Company incurred costs of $5.9 million. These charges were comprised of personnel costs of $1.5 million, data processing costs of $1.3 million, facilities and equipment costs of $1.3 million and other costs of $1.8 million. Personnel costs related primarily to the costs of employee severance, data processing costs related primarily to the termination of data processing contracts with outside service bureaus, facilities and equipment costs related to the consolidation of certain back-office operations and consist of writedowns of properties owned and writedowns and the disposition of equipment which was unusable. Other merger expenses include investment banking fees, legal and accounting fees, due diligence costs, proxy registration/filing fees and mailing costs.

Income Taxes

Income tax expense decreased $1.0 million to $704 thousand in 1997 compared to $1.7 million in 1996 and represented effective tax rates of 23.4% and 19.1%, respectively, of pretax income. The reason the tax rate is lower than the statutory tax rate of 34% in 1997, relates primarily to the reversal of the remainder of the valuation allowance on deferred tax assets established for net operating losses as a result of current and projected earnings, partially offset by nondeductible merger related charges and nondeductible performance based stock option charges. The reason the tax rate in 1996 is lower than the statutory tax rate of 34% relates primarily to the reversal of a portion of the valuation allowance on deferred tax assets established for net operating losses as a result of current and projected earnings.

Capital Resources and Liquidity

Capital Resources

The Company's capital base totaled $72.6 million or 8.27% of total assets at December 31, 1998 compared to $66.9 million, or 8.22% of total assets at December 31,1997. Stockholders' equity increased $5.7 million, primarily related to net earnings of $9.6 million and transactions related to stock options of $3.2 million, partially offset by a decrease in unrealized gains on securities available for sale net of related tax effects of $4.1 million and dividends declared of $2.9 million.

The Company and subsidiary bank are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum 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 consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and subsidiary bank must meet

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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 classification 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 subsidiary bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). As of December 31, 1998, the Company and subsidiary bank meet all capital adequacy requirements to which they are subject.

As of December 31, 1998, the most recent notification from the FDIC categorized the Company's wholly-owned subsidiary bank as "well-capitalized" under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the subsidiary bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There have been no conditions or events since that notification that management believes would cause a change in the subsidiary bank's categorization.

The Company's and the subsidiary bank's actual capital amounts and ratios as of December 31, 1998 and 1997 are presented in the following table:

<TABLE>
<CAPTION>

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			($ In Thousands)			
<S>	<C>	<C>	<C>	<C>	<C>	<C>
As of December 31, 1998:						
Total Capital (to Risk Weighted Assets):						
Consolidated	$75,971	14.42%	$42,145	>/=8.00%	N/A	
Subsidiary Bank	$72,961	13.85%	$42,145	>/=8.00%	$52,681	>/=10.00%
Tier I Capital (to Risk Weighted Assets):						
Consolidated	$69,379	13.17%	$21,072	>/=4.00%	N/A	
Subsidiary Bank	$66,369	12.60%	$21,072	>/=4.00%	$31,609	>/=6.00%
Tier I Capital (to Average Assets):						
Consolidated	$69,379	8.18%	$33,944	>/=4.00%	N/A	
Subsidiary Bank	$66,369	7.82%	$33,944	>/=4.00%	$42,430	>/=5.00%
As of December 31, 1997:						
Total Capital (to Risk Weighted Assets):						
Consolidated	$65,688	12.87%	$40,836	>/=8.00%	N/A	
Subsidiary Bank	$63,737	12.49%	$40,830	>/=8.00%	$51,038	>/=10.00%
Tier I Capital (to Risk Weighted Assets):						
Consolidated	$59,292	11.62%	$20,418	>/=4.00%	N/A	
Subsidiary Bank	$57,342	11.24%	$20,415	>/=4.00%	$30,623	>/=6.00%
Tier I Capital (to Average Assets):						
Consolidated	$59,292	7.47%	$31,730	>/=4.00%	N/A	
Subsidiary Bank	$57,342	7.23%	$31,723	>/=4.00%	$39,654	>/=5.00%

</TABLE>

On August 13, 1996, the Company announced a Stock Repurchase Program ("1996 Program"), whereby the Company's Board of Directors authorized the repurchase of up to 10% of its outstanding common shares from time to time. Shares repurchased under the 1996 Program may be held in treasury, retired or used for general corporate purposes. As of March 31, 1997, the Company had repurchased 72,549 shares under the 1996 Program. No shares were repurchased under the 1996 Program after March of 1997, and, as a result of the merger agreement entered into with Primary Bank in April of 1997, the 1996 Program was terminated.

On August 11, 1998, the Company announced a new Stock Repurchase Program ("1998 Program"), whereby the Company's Board of Directors authorized the repurchase of up to 5% of its outstanding common shares from time to time. Any shares repurchased may be held in treasury, retired or used for general corporate purposes. As of December 31, 1998, 14,700 shares had been repurchased under the 1998 Program.

Liquidity

The principal source of funds for the payment of dividends and

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expenses by the Company, is dividends paid to it by the subsidiary bank. Bank regulatory authorities generally restrict the amounts available for payment of dividends by the subsidiary bank to the Company if the effect thereof would cause the capital of the subsidiary bank to be reduced below applicable capital requirements. These restrictions indirectly affect the Company's ability to pay dividends. Dividends paid to the Company by the subsidiary bank in 1998, 1997 and 1996 were $2.3 million, $3.0 million and $2.0 million, respectively. The primary source of liquidity in the Company is its interest bearing deposit with its subsidiary bank of $3.9 million at December 31, 1998. Management believes that these funds are adequate to provide for the Company's needs.

The subsidiary bank monitors its level of short-term assets and liabilities, maintaining an appropriate balance between

liquidity, risk and return. The major sources of liquidity are deposits, securities available for sale, maturities of securities held to maturity, interest bearing deposits in other banks, amortization, prepayments and maturities of outstanding loans and other borrowings from the FHLBB. While maturities and scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by interest rate trends, economic conditions and competition.

The Company's and subsidiary bank's liquidity, represented by cash and due from banks, is a product of its operating activities, investing activities and financing activities. These activities are summarized as follows:

<TABLE>
<CAPTION>

	Year Ended December 31,		
	1998	1997	1996
	(In Thousands)		
<S>	<C>	<C>	<C>
Cash and due from banks at beginning of year	$ 28,677	$ 30,559	$ 28,811
Operating activities:			
Net earnings	9,557	2,307	7,201
Adjustments to reconcile net earnings to net cash provided by operating activities	(1,411)	4,496	175
Net cash provided by operating activities	8,146	6,803	7,376
Net cash used in investing activities	(73,132)	(15,609)	(67,418)
Net cash provided by financing activities	59,815	6,924	61,790
Cash and due from banks at end of year	$ 23,506	$ 28,677	$ 30,559

</TABLE>

Operating activities provided positive cash flows in 1998, 1997 and 1996 and were primarily comprised of net earnings and net noncash items included in earnings which negatively affected cash flows in 1998 and positively affected cash flows in 1997 and 1996.

Investing activities used cash in 1998, 1997 and 1996. The primary investing activities of the Company and the subsidiary bank, are originating loans and purchasing securities available for sale and securities held to maturity. In 1998, 1997 and 1996, loan originations net of repayments were $48.9 million, $68.6 million and $41.3 million, respectively. Purchases of securities available for sale and securities held to maturity were $124.6 million, $154.3 million and $205.6 million, respectively, in 1998, 1997 and 1996. A substantial portion of the net loan originations and purchases of securities available for sale and securities held to maturity in 1998, 1997 and 1996, were funded by maturities and calls of securities held to maturity and maturities, calls and sales of securities available for sale in each of those years, increases in securities sold under agreements to repurchase in each of those years, increases in other borrowings in 1998 and 1996 and increases in deposits in 1997 and 1996.

Financing activities provided cash in 1998, 1997 and 1996. The primary financing activities of the Company and the subsidiary bank are deposits, short-term borrowings in the form of securities sold under agreements to repurchase and other borrowings. In 1998, 1997 and 1996, deposits increased by $1.5 million, $39.3 million and $18.5 million, respectively. Securities sold under agreements to repurchase increased $4.9 million, $1.1 million and $15.0 million, respectively in 1998, 1997 and 1996. In 1998 and 1996, proceeds from other borrowings exceeded repayments, which increased other borrowings by $54.7 million and $30.7 million, respectively, while other borrowings decreased by $33.3 million in 1997, as repayments exceeded

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proceeds of other borrowings. Net cash provided by financing activities in 1998, 1997 and 1996 was used to fund investing activities.

Liquidity management is both a daily and long-term function of management. Excess liquidity is generally invested in short-term investments such as interest bearing deposits in the FHLBB and 2 to 5 year fixed income US Treasury and US Government agency securities and, to a lesser extent, corporate securities. In addition to assets in cash on hand and due from banks of $23.5 million at December 31, 1998, the Company through its subsidiary bank has interest bearing deposits in other banks, primarily with FHLBB of $19.5 million and securities available for sale of $219.8 million. In addition to these liquidity sources the Company has significant cash flow from the repayments of loans through its subsidiary bank. If the subsidiary bank requires funds beyond its ability to generate them internally, borrowing arrangements with the FHLBB can provide additional funds. At December 31, 1998, the subsidiary bank had $80.6 million of outstanding borrowings with the FHLBB, with an additional borrowing capacity of approximately $251.8 million.

The Company anticipates that the subsidiary bank will have sufficient funds available to meet its current loan commitments. At December 31, 1998, the subsidiary bank had outstanding loan commitments of $59.1 million. For additional informa-

tion as to loan commitments, see note 15 of Notes to Consolidated Financial Statements. Time deposits which are scheduled to mature in one year or less at December 31, 1998, totaled $226.2 million. Management believes that a significant portion of such deposits will remain with the subsidiary bank.

For a discussion of the limitations that federal law places on extensions of credit from banks to their parent holding company, see note 21 of Notes to Consolidated Financial Statements.

Impact of Inflation and Changing Prices

The consolidated financial statements and related consolidated financial data herein have been presented in accordance with generally accepted accounting principles which require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Inflation can affect the Company in a number of ways, including increased operating costs and interest rate volatility. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services. Management attempts to minimize the effects of inflation by maintaining an approximate match between interest rate sensitive assets and interest rate sensitive liabilities and, where practical, by adjusting service fees to reflect changing costs.

Legal Proceedings

The Company is a defendant in ordinary and routine pending legal actions incident to its business, none of which is believed by management to be material to the financial condition of the Company.

Recent Accounting Developments

During 1998, the Company adopted SFAS No. 130, "Reporting Comprehensive Income" and SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information". The Company's adoption of these accounting pronouncements did not have a material impact on its financial condition or results of operations.

The Company adopted SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" an amendment of Financial Accounting Standards Board ("FASB") Statements Nos. 87, 88, and 106, effective January 1, 1998. SFAS No. 132 revises employers' disclosures about pension and other postretirement benefit plans. It does not change the measurement or recognition of costs or obligations under those plans. SFAS No. 132 requires a reconciliation of both the fair values of plan assets and of benefit obligations. The Company has made the required disclosures under SFAS No. 132 for all years presented.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", which is effective for fiscal years beginning after June 15, 1999. SFAS No. 133 must be adopted prospectively and retroactive application is not permitted. SFAS No. 133 will require the Company to record all derivatives on the balance sheet at fair value. Changes in derivative fair values will either be recognized in earnings as offsets to the changes in fair value of related hedged assets, liabilities and firm commitments or for forecasted transactions, deferred and recorded

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as a component of accumulated other comprehensive income in stockholders' equity until the hedged transactions occur and are recognized in earnings. The ineffective portion of a hedging derivative's change in fair value will be immediately recognized in earnings. The Company does not believe the effect of adopting SFAS No. 133 will have any material effect on its consolidated financial position or results of operations.

Year 2000

The Company is aware of the issues associated with the programming code in existing computer systems and non-computer related embedded technology as the millennium ("Year 2000") approaches. The Year 2000 problem is pervasive and complex as virtually every computer operation will be affected in some way by the rollover of the two digit year value to 00. The issue is whether computer systems will properly recognize date sensitive information when the year changes to 2000. Systems that do not properly recognize such information could generate erroneous data or cause a system to fail.

The Company has developed a Year 2000 Policy Statement which was approved by the Company's Board of Directors and is utilizing both internal and external resources to identify, correct and test the systems for Year 2000 compliance. The Year 2000 Policy Statement contains a phases approach which includes the following phases: awareness, inventory, assessment, renovation, validation, implementation and post implementation. As of December 31, 1998, the Company has substantially completed the assessment, renovation, validation and implementation phases and is actively working on the Year 2000 remediation and business resumption contingency plans. The Company has substantially completed any necessary corrections, vendor reprogramming and testing efforts as of December 31, 1998, allowing adequate time for any potential modifications in 1999. After December 31, 1998, the Company will be in the post-implementation phase, which will utilize and test the contingency plans to enhance back-

up steps and procedures to prepare for worst case scenarios. The Company's contingency plans are expected to be completed by the second quarter of 1999. To date, the Company has received a warranty of compliance from its processing vendor for loans, deposits and related products. Additionally, letters have been received from the Company's remaining vendors that plans are being developed to address the Year 2000 issue. All of these efforts are being coordinated through a Year 2000 committee which is chaired by the Company's Chief Operations Officer and includes a representative from the subsidiary bank's Board of Directors. The Chief Operations Officer reports periodically to the Company's and the subsidiary bank's Boards of Directors with respect to the Year 2000 committee's efforts. Management's estimate of the costs related to the Year 2000 compliance are approximately $300,000, of which approximately $101,000 has been incurred as of December 31, 1998. The remaining Year 2000 costs are expected to be substantially incurred in the first two quarters of 1999.

The Company reviewed its loan relationships over $250,000 and assessed a Year 2000 compliance risk for each customer. The risk assessment consisted of a detailed questionnaire relating to the customer's Year 2000 efforts and resulted in the assignment of risk levels of low, medium and high risk for noncompliance with the Year 2000. The review of borrowers included the respective borrower's customer base and the likelihood of their noncompliance. As of December 31, 1998, no relationships were assessed a high risk of noncompliance with Year 2000. In the first quarter of 1999, the Company will review all medium risk borrowing relationships and assess any exposure, which may exist at that time. The Company has also incorporated this review into the approval process for all new borrowing relationships. In addition to the analyses of the loan relationships, the Company's subsidiary bank has also identified deposit customers and customers from whom the Company borrows short-term funds in the form of securities sold under agreements to repurchase with balances greater than $250,000 and identified large community employers in communities where branches are located in order to determine an estimate of additional liquidity that may be needed as a result of the Year 2000 project. Although no assurances can be given, based on the Company's review of significant deposit and borrowing relationships through December 31, 1998, management believes these relationships will not have a material adverse affect on the Company's liquidity, financial condition or results of operations.

The most significant risk anticipated by the Company is the possibility of interruption to its customer account processing systems. Due to the progress described above, the Company does not presently foresee any interruptions to these systems, but cannot predict consequences of interruptions to these systems from outside factors, such as the loss of telecommunication and electrical power (worst case scenario). The Company's business resumption contingency plan will address resumption of business should the Company lose its telecommunications or electrical power.

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Management's Responsibility for Financial Reporting

The consolidated financial statements of Granite State Bankshares, Inc. and subsidiary have been prepared by management, which is responsible for their content and accuracy. The statements present the results of operations, cash flows, and financial position of the Company in conformity with generally accepted accounting principles and, accordingly, include amounts based on management's judgments and estimates. Information in other sections of this annual report is consistent with that included in the financial statements.

Granite State Bankshares, Inc. and its subsidiary have established and maintain an internal control structure designed to provide reasonable assurance that assets are safeguarded and that transactions are properly authorized by management and recorded in conformity with generally accepted accounting principles. This structure includes accounting controls, written policies and procedures, and a code of corporate conduct which stresses the highest ethical standards and is routinely communicated to all employees.

The Audit Committee of the Board of Directors, which is composed solely of outside directors, meets periodically with management, the internal auditor, and the independent auditors to review audit findings, adherence to corporate policies and other financial matters.

The firm of Grant Thornton LLP, Certified Public Accountants, has been engaged to audit and report on the Company's consolidated financial statements. Its audit was conducted in accordance with generally accepted auditing standards and included a review of internal accounting controls to the extent deemed necessary for the purpose of its report, which follows.

/s/ Charles W. Smith	/s/ William G. Pike
Charles W. Smith Chairman and Chief Executive Officer	William G. Pike Executive Vice President and Chief Financial Officer (principal accounting officer)

[FORM OF GRANT THORNTON LETTERHEAD]

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders
Granite State Bankshares, Inc.

We have audited the accompanying consolidated statements of financial condition of Granite State Bankshares, Inc. and subsidiary as of December 31, 1998 and 1997, and the related consolidated statements of earnings, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the management of Granite State Bankshares, Inc. Our responsibility is to express an opinion on these financial statements based on our audits.

The consolidated financial statements for the year ended December 31, 1996 reflect the pooling of interests with Primary Bank as described in note 2 of notes to consolidated financial statements. We did not audit the 1996 financial statements of Primary Bank, which statements reflect net interest and dividend income of $13,479,000 for the year ended December 31, 1996. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Primary Bank for the year ended December 31, 1996, is based solely on the report of such other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements.

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An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above, present fairly, in all material respects, the financial position of Granite State Bankshares, Inc. and subsidiary as of December 31, 1998 and 1997 and the results of their operations and their consolidated cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

/s/ Grant Thornton LLP

Boston, Massachusetts
January 11, 1999

Consolidated Statements of Financial Condition

<TABLE>
<CAPTION>

	December 31, 1998	December 31, 1997
	(In Thousands)	
<S>	<C>	<C>
ASSETS		
Cash and due from banks	$ 23,506	$ 28,677
Interest bearing deposits in other banks, at cost, which approximates market value	19,532	27,452
Securities available for sale (amortized cost $217,186,000 in 1998 and $169,373,000 in 1997)	219,765	178,680
Securities held to maturity (market value $22,548,000 in 1998 and $34,170,000 in 1997)	22,277	33,910
Stock in Federal Home Loan Bank of Boston	7,201	7,201
Loans held for sale	1,828	1,068
Loans	555,699	509,165
Less: Unearned income	(1,506)	(1,432)
Allowance for possible loan losses	(7,122)	(7,651)
Net loans	547,071	500,082
Premises and equipment	17,700	18,863
Other real estate owned	1,601	1,905
Other assets	17,666	15,832
Total assets	$878,147	$813,670
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Interest bearing deposits	$576,778	$577,713
Noninterest bearing deposits	73,709	71,270
Total deposits	650,487	648,983
Securities sold under agreements to repurchase	70,905	66,025
Other borrowings	80,608	25,877
Other liabilities	3,547	5,871
Total liabilities	805,547	746,756
STOCKHOLDERS' EQUITY:		
Preferred stock, $1.00 par value; authorized 7,500,000 shares; none issued		
Common stock, $1.00 par value; authorized 12,500,000 shares; 6,789,582 and 6,493,640 shares issued at December 31, 1998 and 1997, respectively	6,790	6,494
Additional paid-in capital	38,018	34,730
	44,808	41,224
Retained earnings	32,998	26,389
Accumulated other comprehensive income	1,583	5,713
	79,389	73,326
Less: Treasury stock, at cost, 889,759 and 920,305 shares at December 31, 1998 and		

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1997, respectively	(6,065)	(6,305)
Unallocated common stock acquired by the ESOP	(71)	(107)
Unearned restricted stock	(653)	
Total stockholders' equity	72,600	66,914
Total liabilities and stockholders' equity	$878,147	$813,670

</TABLE>

The accompanying notes are an integral part of these statements.

Consolidated Statements of Earnings

<TABLE>
<CAPTION>

	Year Ended December 31,		
	1998	1997	1996
	($ In Thousands, except per share data)		
<S>	<C>	<C>	<C>
Interest and dividend income			
Loans	$ 45,832	$ 42,307	$ 37,969
Debt securities available for sale	9,110	9,771	10,270
Marketable equity securities available for sale	725	586	294
Securities held to maturity	1,469	5,110	4,622
Interest bearing deposits in other banks	1,029	781	857
Dividends on Federal Home Loan Bank of Boston stock	461	456	418
Total interest and dividend income	58,626	59,011	54,430
Interest expense			
Deposits	22,554	23,322	21,999
Securities sold under agreements to repurchase	2,945	2,847	2,438
Other borrowings	2,154	2,731	2,806
Total interest expense	27,653	28,900	27,243
Net interest and dividend income	30,973	30,111	27,187
Provision for possible loan losses	1,125	2,425	1,372
Net interest and dividend income after provision for possible loan losses	29,848	27,686	25,815
Noninterest income			
Customer account fees and service charges	2,283	2,969	3,033
Mortgage service fees	566	634	677
Net gains on sales of securities available for sale	4,185	2,187	650
Net gains on sales of loans	725	415	798
Other	1,291	894	573
Total noninterest income	9,050	7,099	5,731
Noninterest expense			
Salaries and benefits	12,444	13,822	11,036
Occupancy and equipment	4,958	4,197	3,927
Other real estate owned	357	63	(52)
Merger-related charges	34	5,917	
Other	6,412	7,775	7,729
Total noninterest expense	24,205	31,774	22,640
Earnings before income taxes	14,693	3,011	8,906
Income taxes	5,136	704	1,705
NET EARNINGS	$ 9,557	$ 2,307	$ 7,201
Net earnings per share-basic	$ 1.64	$ .42	$ 1.35
Net earnings per share-diluted	$ 1.60	$ .40	$ 1.28
Shares used in computing net earnings per share-basic	5,818,856	5,444,350	5,323,480
Shares used in computing net earnings per share-diluted	5,990,745	5,751,262	5,614,554

</TABLE>

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The accompanying notes are an integral part of these statements.

Consolidated Statements of Comprehensive Income

	1998	1997	1996
	Year Ended December 31, (In Thousands)		
Net earnings	$ 9,557	$ 2,307	$7,201
Other comprehensive income (loss):			
Unrealized holding gains (losses) arising during the period	(2,543)	9,086	361
Related income tax effects	982	(3,620)	(217)
Net unrealized holding gains (losses), net of related income tax effects	(1,561)	5,466	144
Less: reclassification adjustment for (gains) losses realized in net earnings:			
Realized gains	(4,185)	(2,187)	(650)
Related income tax effects	1,616	845	237
Net reclassification adjustment	(2,569)	(1,342)	(413)
Total other comprehensive income (loss)	(4,130)	4,124	(269)
Comprehensive Income	$ 5,427	$ 6,431	$6,932

The accompanying notes are an integral part of these statements.

Consolidated Statements of Stockholders' Equity
Years Ended December 31, 1998, 1997 and 1996

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Unallocated Common Stock Acquired by the ESOP	Unearned Restricted Stock	Total
	(In Thousands)							
Balance as of December 31, 1995	$6,055	$31,526	$19,619	$(4,124)	$ 1,858	$(179)		$54,755
Net earnings			7,201					7,201
Payment of Employee Stock Ownership Plan Indebtedness						36		36
Employee Stock Ownership Plan distribution		25						25
Stock dividend	104	(104)						
Cash dividends declared on common stock, $.20 per share			(1,116)					(1,116)
Change in unrealized gain (loss) on securities available for sale, net of income taxes					(269)			(269)
Issuance of common stock upon exercise of stock options, including related tax effects	105	568						673
Purchase of common stock for treasury				(1,876)				(1,876)
Balance as of December 31, 1996	6,264	32,015	25,704	(6,000)	1,589	(143)		59,429
Net earnings			2,307					2,307
Payment of Employee Stock Ownership Plan Indebtedness						36		36

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Employee Stock Ownership Plan distribution		94						94
Cash dividends declared on common stock, $.29 per share			(1,622)					(1,622)
Change in unrealized gain (loss) on securities available for sale, net of income taxes					4,124			4,124
Issuance of common stock upon exercise of stock options, including related tax effects	230	2,621						2,851
Purchase of common stock for treasury				(305)				(305)
Balance as of December 31, 1997	6,494	34,730	26,389	(6,305)	5,713	(107)		66,914
Net earnings			9,557					9,557
Payment of Employee Stock Ownership Plan Indebtedness						36		36
Employee Stock Ownership Plan distribution		97						97
Cash dividends declared on common stock, $.50 per share			(2,948)					(2,948)
Change in unrealized gain (loss) on securities available for sale, net of income taxes					(4,130)			(4,130)
Issuance of common stock upon exercise of stock options, including related tax effects	296	2,898						3,194
Restricted stock awards		313		421			$(1,015)	(281)
Restricted stock award amortization							362	362
Reissuance of common stock from treasury upon exercise of stock options		(20)		108				88
Purchase of common stock for treasury				(289)				(289)
Balance as of December 31, 1998	$6,790	$38,018	$32,998	$(6,065)	$ 1,583	$ (71)	$ (653)	$72,600

</TABLE>

The accompanying notes are an integral part of these statements.

Consolidated Statements of Cash Flows

<TABLE>
<CAPTION>

	Year Ended December 31,		
	1998	1997	1996
		(In Thousands)	
<S>	<C>	<C>	<C>
Increase (decrease) in cash and due from banks			
Cash flows from operating activities			
Net earnings	$ 9,557	$ 2,307	$ 7,201
Adjustments to reconcile net earnings to net cash provided by operating activities			
Provision for possible loan losses	1,125	2,425	1,372
Provision for depreciation and amortization	2,468	2,329	2,312
Net (accretion) amortization of security discounts and premiums	30	24	(107)
Provision for loss (recovery) on other real estate owned	53	25	(383)
Earned compensation-performance-based stock options		1,078	
Deferred income tax benefits	(43)	(1,243)	(133)
Realized gains on sales of securities available for sale, net	(4,185)	(2,187)	(650)
Writedown of premises and equipment	712	1,305	
Loans originated for sale	(40,082)	(26,435)	(27,205)
Proceeds from sale of loans originated for sale	40,047	26,807	28,719
(Increase) decrease in other assets	316	3,509	(2,647)
Decrease in other liabilities	(1,285)	(2,270)	(130)
Allocation of common stock by the ESOP	133	36	36
Decrease in unearned restricted stock	362		
Realized gains on sales of loans	(725)	(415)	(798)
Gains on sales of other assets	(465)		
Increase (decrease) in unearned income	74	(428)	(62)
Realized (gains) losses on sales of other real estate owned	54	(64)	(149)
Net cash provided by operating activities	8,146	6,803	7,376
Cash flows from investing activities			
Proceeds from sales of securities available for sale	5,462	116,531	71,485

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Proceeds from maturities and calls of securities available for sale	50,750	52,500	50,948
Principal payments received on securities available for sale	9,596	13,294	7,469
Purchase of securities available for sale	(109,586)	(147,266)	(146,853)
Purchase of securities held to maturity	(15,012)	(7,000)	(58,767)
Proceeds from maturities and calls of securities held to maturity	26,765	33,150	17,814
Principal payments received on securities held to maturity		2,129	4,525
Purchase of Federal Home Loan Bank of Boston stock		(836)	(150)
Redemption of Federal Home Loan Bank of Boston stock			1,343
Loan originations, net of repayments	(48,912)	(68,627)	(41,275)
Proceeds from sale of loans			17,638
Purchase of premises and equipment	(1,533)	(2,489)	(2,394)
Proceeds from sales of other assets	465		
Net (increase) decrease in interest-bearing deposits in other banks	7,920	(9,459)	6,246
Proceeds from sales of other real estate owned	921	2,376	4,752
Other	32	88	(199)
Net cash used in investing activities	(73,132)	(15,609)	(67,418)
Cash flows from financing activities			
Net increase in demand, NOW, money market deposit and savings accounts	24,779	19,865	6,217
Net increase (decrease) in time certificates	(23,275)	19,451	12,327
Net increase in securities sold under agreements to repurchase	4,880	1,064	15,003
Increase (decrease) in other borrowings	54,731	(33,313)	30,691
Repayment on liability relating to ESOP	(36)	(36)	(36)
Dividends paid on common stock	(2,824)	(1,285)	(1,083)
Proceeds from issuance of common stock	2,042	1,483	547
Reissuance of common stock from treasury	88		
Purchase of common stock for treasury	(289)	(305)	(1,876)
Purchase of common stock relating to restricted stock awards	(281)		
Net cash provided by financing activities	59,815	6,924	61,790
Net increase (decrease) in cash and due from banks	(5,171)	(1,882)	1,748
Cash and due from banks at beginning of year	28,677	30,559	28,811
Cash and due from banks at end of year	$ 23,506	$ 28,677	$ 30,559

</TABLE>

The accompanying notes are an integral part of these statements.

Notes to Consolidated Financial Statements

NOTE 1-Summary of Significant Accounting Policies

The accounting and reporting policies of Granite State Bankshares, Inc. (the "Company") and its wholly-owned subsidiary, Granite Bank (the "subsidiary bank") conform to generally accepted accounting principles and to general practices within the banking industry.

The subsidiary bank has been and continues to be a community oriented commercial bank offering a variety of financial services. The principal business of the subsidiary bank consists of attracting deposits from the general public and originating loans secured by residential and commercial real estate and other loans. The subsidiary bank also originates fixed rate residential real estate loans for sale in the secondary mortgage market. The subsidiary bank has nineteen full service offices and an additional twenty one remote automatic teller locations. The subsidiary bank is a full service community bank with a diversified lending operation that services Cheshire, Hillsborough, Merrimack, Strafford and Rockingham counties, New Hampshire.

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the balance 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 possible loan losses. In connection with the determination of the allowance for possible loan losses, management obtains independent appraisals for significant properties which collateralize loans.

A substantial portion of the Company's loans are secured by real estate in New Hampshire. Accordingly, the ultimate collectibility of a substantial portion of the Company's loan portfolio is susceptible to changing conditions in New Hampshire.

The following is a description of the significant accounting policies.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and the subsidiary bank. All significant intercompany transactions and balances have been eliminated in consolidation.

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Reclassifications

Certain amounts in the 1997 and 1996 consolidated financial statements have been reclassified to conform to the 1998 presentation.

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; debt and equity securities that are bought and held principally for the purpose of selling in the near term are 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 in accumulated other comprehensive income as a separate component of stockholders' equity, net of estimated income taxes. During 1998, 1997 and 1996, the Company had no securities classified as trading securities.

Premiums and discounts on securities are amortized or accreted into earnings on the straight-line method over the life of the investments. Income recognized by use of this method does not differ materially from that which would be recognized by use of the level-yield method. If a decline in fair value below the amortized cost basis of a security is judged to be other than temporary, the cost basis of the security is written down to fair value as a new cost basis and the amount of the write-down is included as a charge against net gains or losses on securities. Gains and losses on the sale of securities available for sale are recognized at the time of sale on a specific identification basis.

Loans

Real estate mortgage loans and other loans are stated at the amount of unpaid principal, less unearned income and the allowance for possible loan losses.

Interest on loans is included in income as earned based on rates applied to principal amounts outstanding. Accrual of interest on loans is discontinued either when reasonable doubt exists as to the full, timely collection of interest or principal, or when a loan becomes contractually past due by ninety days, unless the loan is well secured and in the process of collection. When a loan is placed on nonaccrual status, all interest previously accrued is reversed against current period interest income. Interest subsequently received on nonaccrual loans is either applied against

principal or recorded as income according to management's judgment as to the collectibility of principal.

The Company measures loan impairment on commercial and commercial real estate loans in excess of $75,000 based on the present value of expected future cash flows discounted at the loan's effective interest rate, or on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. When the Company determines that foreclosure is probable, it measures impairment based on the fair value of the collateral. Loans that experience insignificant payment delays and insignificant shortfalls in payment amounts generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Commercial and commercial real estate loans of $75,000 or less are collectively evaluated for impairment. Additionally, large groups of smaller balance homogeneous loans, such as residential real estate and consumer loans are collectively evaluated for impairment.

Loan origination and commitment fees, certain direct loan origination costs and discounts on acquired loans are being deferred and amortized as an adjustment of the related loan yield over the contractual life of the loans.

Allowance for Possible Loan Losses

The adequacy of the allowance for possible loan losses is evaluated on a regular basis by management. The methodology for determining the amount of the allowance for possible loan losses consists of several elements. Nonperforming, impaired and delinquent loans are reviewed individually and the value of any underlying collateral is considered in determining estimates of possible losses associated with those loans. Another element involves estimating losses inherent in categories of loans, based primarily on historical experience, industry trends and trends in the real estate market and the current economic environment in the Company's primary market

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areas. The last element is based on management's evaluation of various conditions, and involves a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments. The conditions evaluated in connection with this element include the following: industry and regional conditions; seasoning of the loan portfolio and changes in the composition of and growth in the loan portfolio; the strength and duration of the current business cycle; existing general economic and business conditions in the lending areas; credit quality trends, including trends in nonperforming loans expected to result from changes in existing conditions; historical loan charge-off experience; and the results of bank regulatory examinations.

The provision for possible loan losses charged to operations is based upon management's judgment of the amount necessary to maintain the allowance at a level adequate to absorb possible losses. Loan losses are charged against the allowance when management believes the collectibility of the principal is unlikely, and recoveries are credited to the allowance when received.

Management believes that the allowance for possible loan losses is adequate. While management evaluates the allowance for possible loan losses based upon available information, future additions to the allowance may be necessary. Additionally, regulatory agencies review the Company's allowance for possible loan losses as part of their examination process. Such agencies may require the Company to recognize additions to the allowance based on judgments which may be different from those of management.

Mortgage Loans Held For Sale

Mortgage loans held for sale into the secondary market and commitments to fund such loans are carried at the lower of cost or estimated market value as determined by outstanding investor and origination commitments or, in the absence of such commitments, current investor yield requirements. Valuation adjustments are charged against gain/loss on sales of mortgage loans. Gains or losses on sales of mortgage loans are recognized at the time of the sale.

The Company recognizes as separate assets rights to service mortgage loans for others, however those servicing rights are acquired. When the Company acquires mortgage servicing rights either through the purchase or origination of mortgage loans and sells those loans with servicing rights retained, it allocates the total cost of the mortgage loans to the mortgage servicing rights and the loans (without the mortgage servicing rights) based on their relative fair values.

Purchased and originated loan servicing rights are amortized on a basis which results in approximately level rates of return in proportion to, and over the period of, estimated net servicing income.

On a quarterly basis, the Company assesses the carrying values of originated and purchased mortgage servicing rights for impairment based on the fair value of such rights. A valuation model that calculates the present value of future cash flows is used to estimate such fair value. This valuation model incorporates assumptions that market participants would use in estimating future net servicing income including estimates of the cost of servicing loans, discount rate, float value, ancillary income, prepayment speeds and default rates. Any impairment is recognized as a charge to earnings through a valuation allowance.

During 1997 the Company prospectively adopted Statement of Financial Accounting Standards ("SFAS") No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," as required by the Financial Accounting Standards Board ("FASB"). SFAS No. 125 superceded SFAS No. 122, "Accounting for Mortgage Servicing Rights," an Amendment of FASB Statement No. 65. The adoption of SFAS No. 125 had no significant impact on the Company's consolidated financial position or consolidated results of operations.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is computed using the straight-line method over the estimated useful lives of the assets or the remaining lease terms, if shorter. Useful lives are 15-50 years for bank buildings, 3-20 years for leasehold improvements and 2-10 years for furniture and equipment.

The Company reviews for impairment of long-lived assets, certain identifiable intangibles and goodwill, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Gains or losses on routine dispositions are credited or charged to earnings. Maintenance and repairs are charged to expense as incurred, and improvements are capitalized.

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Other Real Estate Owned

Other real estate owned is comprised of properties acquired through foreclosure proceedings or acceptance of a deed in lieu of foreclosure. Other real estate owned is recorded at the lower of the carrying value of the loan or the fair value of the property received less a valuation allowance for estimated costs to sell. Loan losses arising from the acquisition of such properties are charged against the allowance for possible loan losses. Provisions to reduce the carrying value to net realizable value are charged to current period earnings as realized and are reflected as an additional valuation allowance. Operating expenses and gains and losses upon disposition are reflected in earnings as realized.

Other Assets

Goodwill arising from acquisitions is included in other assets, net of accumulated amortization, and is amortized on the straight-line basis over 15 years.

Mortgage servicing rights are included in other assets, net of accumulated amortization, and are amortized on a basis which results in approximately level rates of return in proportion to, and over the period of, estimated net servicing income.

Fair Value of Financial Instruments

In accordance with SFAS No. 107, Disclosures about Fair Value of Financial Instruments, the Company is required to disclose estimated fair values of financial instruments. Fair value estimates, methods, and assumptions are set forth below in note 23 of Notes to Consolidated Financial Statements.

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 carryforwards. 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. Under the asset and liability method, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date.

Retirement and Benefit Plans

The Company and its subsidiary bank have a non-contributory defined benefit Pension Plan covering substantially all of the Company's employees. Contributions are intended to provide for benefits attributed to services rendered to date and for those expected to be earned in the future.

The Company adopted SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" an amendment of FASB Statements Nos. 87, 88 and 106, effective January 1, 1998. SFAS No. 132 revises employers' disclosures about pension and other postretirement benefit plans. It does not change the measurement or recognition of costs or obligations under those plans. SFAS No. 132 requires a reconciliation of both the fair values of plan assets and of benefit obligations. The Company has made the required disclosures under SFAS No. 132 for all years presented.

The Company sponsors a Supplemental Executive Retirement Plan ("SERP"). The SERP is a nonqualified plan designed to provide supplemental retirement benefits to certain key employees, whose benefits under the Company's other retirement plans are limited by Federal tax laws.

The Company has an Employee Stock Ownership Plan ("ESOP"), covering eligible employees with one year of service as defined by the ESOP. The Company records compensation expense in an amount equal to the fair value of shares committed to be released from the ESOP to employees.

Stock-Based Compensation

SFAS No. 123, "Accounting for Stock-Based Compensation", establishes a fair value based method of accounting for stock-based compensation arrangements with employees, rather than the intrinsic value based method that is contained in Accounting Principles Board Opinion No. 25 ("Opinion 25"). However, SFAS No. 123 did not require an entity to adopt the new fair value based method for purposes of preparing its basic financial statements. Entities are allowed (1) to continue to use the intrinsic value based method under Opinion 25 or (2) to adopt the SFAS No. 123 fair value based method. SFAS No. 123 applies to all transactions in which an entity acquires goods

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or services by issuing equity instruments or by incurring liabilities where the payment amounts are based on the entity's common stock price, except for employee stock ownership plans. For entities not adopting the SFAS No. 123 fair value based method, SFAS No. 123 requires the entity to display in the footnotes to the financial statements pro forma net earnings and earnings per share information as if the fair value based method had been adopted. The Company continues to account for stock-based compensation under the intrinsic value based method under Opinion 25, as allowed by SFAS No. 123, and includes presentation of the appropriate required pro forma disclosures in the notes to the consolidated financial statements.

Earnings Per Share

Basic earnings per share is computed by dividing net earnings by the weighted average number of common shares outstanding for the period. Diluted earnings per share 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 Company.

Derivative Financial Instruments

The Company utilizes interest rate cap agreements to manage exposure to interest rate risk. The Company does not purchase derivative financial instruments for trading purposes. The Company receives an interest payment if the three-month London Interbank Offered Rate ("LIBOR") increases above a predetermined rate. This payment would be based upon the rate difference between current LIBOR and the predetermined rate accrued on the notional value of the instrument. The amounts received on the interest rate cap agreements are accounted for as an adjustment to the yield or cost of the hedged financial instruments. The transaction fee paid on the interest rate cap is amortized over the life of the contract.

Comprehensive Income

The Company adopted SFAS No. 130, "Reporting Comprehensive Income", effective January 1, 1998. SFAS No. 130 establishes standards for reporting comprehensive income and its components (revenues, expenses, gains and losses). Components of comprehensive income are net earnings and all other non-owner changes in equity. SFAS No. 130 requires that an enterprise (a) classify items of other comprehensive income by their nature in a financial statement and (b) display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position. Reclassification of financial statements for earlier periods provided for comparative purposes is required. The Company's accumulated other comprehensive income included in stockholders' equity is comprised exclusively of net unrealized gains on securities available for sale, net of related tax effects.

The Company has chosen to disclose comprehensive income in a separate statement of comprehensive income.

Disclosure about Segments

The Company adopted SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information", effective January 1, 1998. SFAS No. 131 establishes standards for reporting information about segments in annual and interim financial statements. SFAS No. 131 introduces a new model for segment reporting called the "management approach". The management approach is based on the way the chief operating decision-makers organize segments within the company for making operating decisions and assessing performance. Reportable segments are based on products and services, geography, legal structure, management structure and any other manner in which management disaggregates a company. Based on the "management approach" model, the Company has determined that its business is comprised of a single operating segment and that SFAS No. 131 has no impact on its financial statements.

Recent Accounting Developments

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", which is effective for fiscal years beginning after June 15, 1999. SFAS No. 133 must be adopted prospectively and retroactive application is not permitted. SFAS No. 133 will require the Company to record all derivatives on the balance sheet at fair value. Changes in derivative fair values will either be recognized in earnings as offsets to the changes in fair value of related hedged assets, liabilities and firm commitments or for forecasted transactions, deferred and recorded as a component of accumulated other comprehensive

income in stockholders' equity until the hedged transactions occur and are

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recognized in earnings. The ineffective portion of a hedging derivative's change in fair value will be immediately recognized in earnings. The Company does not believe the effect of adopting SFAS No. 133 will have any material effect on its consolidated financial position or results of operations.

NOTE 2-Mergers and Acquisitions

Effective after the close of business October 31, 1997, the Company completed its merger with Primary Bank, which was accounted for under the pooling-of-interests method. Accordingly, the consolidated financial statements of the Company have been restated to reflect the acquistion at the beginning of each period presented. In connection with the merger, each share of Primary Bank's common stock was converted into 1.1483 shares of the Company's common stock, resulting in the issuance of 2,520,157 shares of the Company's common stock to Primary Bank stockholders.

Expenses directly attributable to the merger during the years ending December 31, 1998 and 1997 amounted to $34,000 and $5,917,000, respectively. The 1997 charges were recorded at the date of combination and were comprised of personnel costs of $1,462,000, data processing costs of $1,282,000, facilities and equipment costs of $1,305,000 and other costs of $1,868,000. Personnel costs related primarily to the costs of employee severance, data processing costs related primarily to the termination of data processing contracts with outside service bureaus, facilities and equipment costs related to the consolidation of certain back-office operations and consist of writedowns of properties owned and writedowns and disposition of equipment which was unusable. Other merger expenses include investment banking fees, legal and accounting fees, due diligence costs, proxy registration/filing fees and mailing costs. The 1998 charges were insignificant.

The following table presents a summary of activity in 1998 and 1997 with respect to the merger accrual:

	December 31, 1998	December 31, 1997
	(In Thousands)	
Balance at beginning of year	$1,613	$ 0
Provision charged against earnings	34	5,917
Cash outlays	1,647	2,999
Non-cash writedowns		1,305
Balance at end of year	$ 0	$1,613

NOTE 3-Earnings Per Share

Information regarding the computations of earnings per share is as follows:

	Year Ended December 31, 1998	1997	1996
	($ in Thousands, except per share data)		
Net earnings	$ 9,557	$ 2,307	$ 7,201
Weighted average common shares outstanding-Basic	5,818,856	5,444,350	5,323,480
Dilutive effect of stock options computed using the treasury stock method	171,889	306,912	291,074
Weighted average common shares outstanding-Diluted	5,990,745	5,751,262	5,614,554
Net earnings per share-basic	$1.64	$.42	$1.35
Net earnings per share-diluted	$1.60	$.40	$1.28

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Weighted average options to purchase 37,808 and 109,363 shares of common stock were outstanding at December 31, 1998 and 1996, respectively, but were not included in the computation of weighted average common shares outstanding for purposes of computing diluted earnings per share, because the effect would have been antidilutive. All options to purchase shares of common stock outstanding at December 31, 1997 were included in the computation of weighted average common shares outstanding for purposes of computing diluted earnings per share.

NOTE 4-Supplemental Cash Flow Disclosures

Supplemental Disclosures of Cash Flow Information

	Year Ended December 31,		
	1998	1997	1996
	(In Thousands)		
Cash paid for			
Interest	$27,400	$29,010	$27,143
Income taxes	3,924	2,500	1,650

Supplemental Schedule of Noncash Investing and Financing Activities

The subsidiary bank acquired other real estate owned through foreclosure in settlement of loans or accepted deeds in lieu of foreclosures on real estate loans in the amount of $724,000, $732,000 and $2,933,000 during the years ended December 31, 1998, 1997 and 1996, respectively.

Dividends declared and unpaid on common stock at December 31, 1998, 1997 and 1996 were $737,000, $613,000 and $277,000, respectively.

NOTE 5-Cash and Due From Banks

The Federal Reserve Bank requires the subsidiary bank to maintain average reserve balances. The average amount of these reserve balances for the year ended December 31, 1998 was approximately $9,678,000.

NOTE 6-Securities

The amortized cost and estimated market values of securities at December 31, were as follows:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Market Value
	(In Thousands)			
Securities held to maturity				
At December 31, 1998				
US Government agency obligations	$ 17,265	$ 230		$ 17,495
Other corporate obligations	5,012	41		5,053
Total securities held to maturity	$ 22,277	$ 271	$ 0	$ 22,548
Securities available for sale				
At December 31, 1998				
US Treasury obligations	$ 82,521	$1,195		$ 83,716
US Government agency obligations	55,961	112	$ 75	55,998
Other corporate obligations	46,593	150	286	46,457
Mortgage-backed securities:				
FNMA	7,045	35	49	7,031
FHLMC	2,876	2	25	2,853
GNMA	1,190	59	3	1,246
SBA	552	16		568
Total mortgage-backed securities	11,663	112	77	11,698
Mutual Funds	6,326	105	29	6,402

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Marketable equity securities	14,122	2,785	1,413	15,494
Total securities available for sale	$217,186	$4,459	$1,880	$219,765
Securities held to maturity				
At December 31, 1997				
US Government agency obligations	$ 33,910	$ 285	$ 25	$ 34,170
Total securities held to maturity	$ 33,910	$ 285	$ 25	$ 34,170
Securities available for sale				
At December 31, 1997				
US Treasury obligations	$ 82,470	$ 499		$ 82,969
US Government agency obligations	44,218	31	$ 50	44,199
Other corporate obligations	8,493	16	1	8,508
Mortgage-backed securities:				
FNMA	11,723	49	95	11,677
FHLMC	6,562	26	41	6,547
GNMA	2,418	84		2,502
SBA	765	17		782
Total mortgage-backed securities	21,468	176	136	21,508
Mutual Funds	6,005	130	22	6,113
Marketable equity securities	6,719	8,664		15,383
Total securities available for sale	$169,373	$9,516	$ 209	$178,680

</TABLE>

In the fourth quarter of 1997, the acquisition of Primary Bank (see Note 2-"Mergers and Acquisitions") necessitated a transfer of securities held to maturity with an amortized cost of $22,226,000 and a net unrealized loss of $156,000 to securities available for sale in order to maintain the Company's existing interest rate risk profile.

As a member of the Federal Home Loan Bank of Boston ("FHLBB"), the subsidiary bank is required to invest in $100 par value stock of the FHLBB in the amount of 1% of its outstanding loans secured by residential housing, or 1% of 30% of total assets, or 5% of its outstanding advances from the FHLBB, whichever is higher. When such stock is redeemed, the subsidiary bank would receive from the FHLBB an amount equal to the par value of the stock. As of December 31, 1998 and 1997, the subsidiary bank had investments in FHLBB stock of $7,201,000. Such investments are reflected separately in the Consolidated Statements of Financial Condition.

Gross realized gains and gross realized losses on sales of securities available for sale for the years ended December 31 were as follows:

<TABLE>
<CAPTION>

	1998		1997		1996	
	Realized Gain	Realized Loss	Realized Gain	Realized Loss	Realized Gain	Realized Loss
	(In Thousands)					
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Securities						
Debt securities	$ 23		$ 166	$1,018	$212	$324
Marketable equity securities	4,162		3,039		767	5
	$4,185	$ 0	$3,205	$1,018	$979	$329

</TABLE>

At December 31, 1998, U. S. Treasury and U. S. Government Agency Obligations with carrying values of $89,873,000 and estimated market values of $90,033,000 were pledged as collateral for securities sold under agreements to repurchase and for government deposit accounts.

The following table sets forth the maturity distribution of debt securities held to maturity and available for sale at amortized cost and estimated market value at December 31, 1998. Actual maturities may differ from contractual maturities because certain issuers have the right to call or prepay obligations without penalties.

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	Within 1 Year	Over 1 Year Through 5 Years	Over 5 Years Through 10 Years	Over 10 Years	Totals
			(In Thousands)		
Amortized Cost					
At December 31, 1998					
Securities held to maturity					
US Government agency obligations			$17,265		$ 17,265
Other corporate obligations			5,012		5,012
Total debt securities held to maturity	$ 0	$ 0	$22,277	$ 0	$ 22,277
Securities available for sale					
US Treasury obligations	$49,980	$ 32,541			$ 82,521
US Government agency obligations		54,961	$ 1,000		55,961
Other corporate obligations		28,087	13,135	$ 5,371	46,593
Mortgage-backed securities	16	143	1,179	10,325	11,663
Total debt securities available for sale	$49,996	$115,732	$15,314	$15,696	$196,738
Estimated Market Value					
At December 31, 1998					
Securities held to maturity					
US Government agency obligations			$17,495		$ 17,495
Other corporate obligations			5,053		5,053
Total debt securities held to maturity	$ 0	$ 0	$22,548	$ 0	$ 22,548
Securities available for sale					
US Treasury obligations	$50,312	$ 33,404			$ 83,716
US Government agency obligations		55,000	$ 998		55,998
Other corporate obligations		28,092	12,969	$ 5,396	46,457
Mortgage-backed securities	16	145	1,195	10,342	11,698
Total debt securities available for sale	$50,328	$116,641	$15,162	$15,738	$197,869

NOTE 7-Loans

Loans consist of the following at:

	December 31, 1998	December 31, 1997
	(In Thousands)	
Commercial, financial and agricultural	$ 48,418	$ 68,513
Real estate-residential	328,243	245,577
Real estate-commercial	146,093	151,474
Real estate-construction and land development	2,281	6,000
Installment	7,809	11,588
Other	22,855	26,013
Total loans	555,699	509,165
Less:		
Unearned income	(1,506)	(1,432)
Allowance for possible loan losses	(7,122)	(7,651)
Net loans	$547,071	$500,082

At December 31, 1998 and 1997, loans which were on nonaccrual status were $3,013,000 and $7,145,000, respectively. Interest income which would

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have been accrued on nonaccrual loans, had they performed in accordance with the terms of their contracts, for the years ended December 31, 1998, 1997 and 1996, was $441,000, $767,000 and $679,000, respectively. Interest income recognized on nonaccrual loans in 1998, 1997 and 1996 amounted to $145,000, $413,000 and $188,000, respectively.

The Company has identified loans as impaired in accordance with SFAS No. 114, when it is probable that interest and principal will not be collected according to the terms of the loan agreements. The balance of impaired loans was $1,556,000 and $4,559,000, respectively, at December 31, 1998 and 1997. The average recorded investment in impaired loans was $3,502,000, $3,001,000 and $3,933,000, respectively, in 1998, 1997 and 1996. No income was recognized on impaired loans during 1998 and 1997 and $4,000 of income was recognized during 1996. Total cash collected on impaired loans during 1998, 1997 and 1996 was $710,000, $779,000 and $2,427,000, respectively, of which $710,000, $779,000 and $2,423,000, respectively, was credited to the principal balance outstanding on such loans.

Changes in the allowance for possible loan losses allocated to impaired loans, which is included in the allowance for possible loan losses (see Note 8), are as follows:

	Year Ended December 31, (In Thousands)		
	1998	1997	1996
Balance at beginning of year	$ 1,054	$ 457	$ 1,114
Provision for possible loan losses	201	983	499
Loans charged off	(1,022)	(386)	(1,156)
Balance at end of year	$ 233	$1,054	$ 457

At December 31, 1998 and 1997, there were no impaired loans which did not have an allowance for possible loan losses determined in accordance with SFAS No. 114.

The Company's policy for interest income recognition on impaired loans is to recognize income on nonaccrual loans under the cash basis when the loans are both current and the collateral on the loan is sufficient to cover the outstanding obligation to the Company; if these factors do not exist, the Company does not recognize income.

The Company's lending activities are conducted principally in New Hampshire and to a lesser extent in selected areas in other New England states. The Company grants single family and multi-family residential loans, commercial real estate loans, commercial loans, and a variety of consumer loans. In addition, the Company grants loans for the construction of residential homes, multi-family properties and commercial real estate properties. Most loans granted by the Company are collateralized by real estate. The ability and willingness of the single family residential and consumer borrowers to honor their repayment commitments is generally dependent on the level of overall economic activity within the borrowers' geographic areas, and real estate values. The ability and willingness of commercial real estate, commercial and construction loan borrowers to honor their repayment commitments is generally dependent on the health of the real estate economic sector in the borrowers' geographic areas, and the general economy.

At December 31, 1998 and 1997, the subsidiary bank serviced real estate loans sold to others in the amounts of $148,024,000 and $163,943,000, respectively.

NOTE 8-Allowance for Possible Loan Losses

Changes in the allowance for possible loan losses are as follows:

	Year Ended December 31, (In Thousands)		
	1998	1997	1996

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Balance at beginning of year	$ 7,651	$ 6,253	$ 7,151
Provision for possible loan losses	1,125	2,425	1,372
Loans charged off	(2,113)	(1,205)	(3,020)
Recoveries of loans previously charged off	459	178	750
Balance at end of year	$ 7,122	$ 7,651	$ 6,253

</TABLE>

NOTE 9-Loans to Related Parties

The Company's banking subsidiary has granted loans to its officers and directors, and those of the Company and to their associates. The aggregate amount of these loans was $9,622,000 and $6,864,000 at December 31, 1998 and 1997, respectively. During 1998, $6,436,000 of new loans were made and repayments totaled $3,678,000.

NOTE 10-Premises and Equipment

The following is a summary of premises and equipment:

<TABLE>
<CAPTION>

	December 31,	
	1998	1997
	(In Thousands)	
<S>	<C>	<C>
Bank buildings	$15,496	$16,082
Leasehold improvements	1,697	1,808
Furniture and equipment	11,077	10,155
	28,270	28,045
Less: Accumulated depreciation and amortization	13,528	11,972
	14,742	16,073
Land	2,791	2,785
Construction in progress	167	5
	$17,700	$18,863

</TABLE>

Depreciation and amortization expense for the years ended December 31, 1998, 1997 and 1996 was $1,994,000, $1,911,000 and $1,889,000, respectively.

For the year ended December 31, 1998, the Company recorded a $712,000 writedown on bank buildings based upon an appraisal performed on property used as a branch office which is being closed. The charge to earnings is reflected in occupancy and equipment expense.

NOTE 11-Other Real Estate Owned

A summary of other real estate owned follows:

<TABLE>
<CAPTION>

	December 31,	
	1998	1997
	(In Thousands)	
<S>	<C>	<C>
Condominiums and apartment projects	$ 131	$ 371
Single family housing projects	739	792
Non-retail commercial	756	773
Residential	451	437
	2,077	2,373
Less:Valuation allowance	476	468
	$1,601	$1,905

</TABLE>

An analysis of other real estate owned follows:

<TABLE>

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<CAPTION>

	Year Ended December 31,		
	1998	1997	1996
	(In Thousands)		
<S>	<C>	<C>	<C>
Balance at beginning of year	$1,905	$ 3,492	$ 4,779
Other real estate owned acquired	724	732	2,933
Advances for construction and other		18	
Sales proceeds	(921)	(2,376)	(4,752)
Gains (losses) on sales, net	(54)	64	149
Provisions for (loss) recovery subsequent to foreclosure	(53)	(25)	383
Balance at end of year	$1,601	$1,905	$3,492

</TABLE>

An analysis of other real estate owned expense follows:

<TABLE>
<CAPTION>

	Year Ended December 31,		
	1998	1997	1996
	(In Thousands)		
<S>	<C>	<C>	<C>
Foreclosure and holding costs, net	$250	$102	$ 480
Provision for loss (recovery) subsequent to foreclosure	53	25	(383)
(Gains) losses on sales, net	54	(64)	(149)
	$357	$ 63	$ (52)

</TABLE>

Changes in the valuation allowance for other real estate owned were as follows:

<TABLE>
<CAPTION>

	Year Ended December 31,		
	1998	1997	1996
	(In Thousands)		
<S>	<C>	<C>	<C>
Balance at beginning of year	$468	$528	$1,605
Provision for loss (recovery)	53	25	(383)
Charge offs, net	(45)	(85)	(694)
Balance at end of year	$476	$468	$ 528

</TABLE>

NOTE 12-Other Assets

Goodwill and mortgage servicing rights included in other assets at December 31, consisted of the following:

<TABLE>
<CAPTION>

	1998		
	Original Amount	Accumulated Amortization	Net Book Value
	(In Thousands)		
<S>	<C>	<C>	<C>
Goodwill	$3,682	$2,044	$1,638

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	Original Amount	Accumulated Amortization	Net Book Value
Mortgage servicing rights	$1,377	$ 987	$ 390

1997

	Original Amount	Accumulated Amortization	Net Book Value
	(In Thousands)		
Goodwill	$3,682	$1,799	$1,883
Mortgage servicing rights	$1,115	$ 784	$ 331

Mortgage servicing rights of $262,000, $114,000 and $257,000, were capitalized during 1998, 1997 and 1996.

Amortization expense for the years ended December 31, 1998, 1997 and 1996 was $474,000, $418,000 and $423,000, respectively and included amortization on mortgage servicing rights of $203,000, $118,000 and $109,000 in 1998, 1997 and 1996, respectively.

NOTE 13-Interest Bearing Deposits

Interest bearing deposits consisted of the following:

	December 31, 1998	December 31, 1997
	(In Thousands)	
NOW accounts	$203,068	$166,773
Savings accounts	87,150	89,278
Money market deposit accounts	19,659	31,486
Time certificates	266,901	290,176
	$576,778	$577,713

Maturities of time certificates after December 31, 1998 are $226,150,000 in 1999, $25,272,000 in 2000, $8,949,000 in 2001, $3,751,000 in 2002, $2,467,000 in 2003 and $312,000 in years thereafter.

Time certificates with balances of $100,000 or more at December 31, 1998 and 1997 totaled $33,545,000 and $37,360,000, respectively.

NOTE 14-Borrowings

Securities Sold Under Agreements to Repurchase

Short-term borrowings in the form of securities sold under agreements to repurchase at December 31, 1998 and 1997, totaled $70,905,000 and $66,025,000, respectively. Such borrowings were collateralized at December 31, 1998 by a portion of the Company's U.S. Treasury and U.S. Government agency securities with a carrying value of $87,348,000 and estimated market value of $87,467,000 (see note 6). The collateral is maintained under the control of the Company in a separate custodial account at the Federal Home Loan Bank of Boston. The weighted average interest rate on those borrowings was 4.29% and 5.07%, respectively, at December 31, 1998 and 1997.

The maximum amount of securities sold under agreements to repurchase at any month end during 1998, 1997 and 1996, were $73,392,000, $67,693,000 and $64,961,000, respectively. The average amount of securities sold under agreements to repurchase in 1998, 1997 and 1996 were $67,562,000, $59,826,000 and $51,220,000, respectively. The average cost of securities sold under agreements to repurchase was 4.36%, 4.76% and 4.76% during 1998, 1997 and 1996, respectively.

Other Borrowings

The Company's subsidiary bank maintains a line of credit with the FHLBB to meet short or long-term financing needs that

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may arise. Short and long-term borrowings from the FHLBB are secured by a blanket lien on substantially all unencumbered interest-earning assets and FHLBB stock held. The Company's subsidiary bank is able to commingle, encumber or dispose of any collateral held subject to its ability to maintain specific "qualifying" collateral levels in excess of collateral maintenance requirements and meet minimum capital ratios, both of which were met as of December 31, 1998 and 1997.

Based upon "qualifying" collateral held, the Company's subsidiary bank had a total borrowing capacity with the FHLBB as of December 31, 1998 of approximately $332,456,000, of which approximately $251,848,000 was still available.

Other borrowings, all of which were with the FHLBB, consisted of the following:

	December 31, 1998	
	Amount	Range of Rates (%)
	($ In Thousands)	
Due within one year	$ 45	5.00-6.17
Due from one to three years	99	5.00-6.17
Due over three years	80,464	4.18-6.17
	$80,608	

	December 31, 1997	
	Amount	Range of Rates (%)
	($ In Thousands)	
Due within one year	$25,269	4.69-7.05
Due from one to three years	93	5.00-6.17
Due over three years	515	5.00-6.17
	$25,877	

Principal payments due on other borrowings after December 31, 1998 are $45,000 in 1999, $48,000 in 2000, $51,000 in 2001, $55,000 in 2002, $30,057,000 in 2003 and $50,352,000 in years thereafter. The FHLBB has the right to call and require the repayment of $20,000,000 of borrowings at an interest rate of 4.49% due in 2008 during 2001. Additionally, the FHLBB has the right to call and require the repayment of $20,000,000 of borrowings at an interest rate of 4.18% due in 2013 during 2000.

NOTE 15-Commitments and Contingencies

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. 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 statement of financial condition. The contract or notional amount of those instruments reflects 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, standby letters of credit and recourse arrangements 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, 1998 and 1997 were as follows:

	Contract or Notional Amount

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	1998	1997
	(In Thousands)	
Financial instruments whose contract amounts represent credit risk		
Commitments to originate loans	$18,886	$16,673
Unused lines and standby letters of credit	38,490	46,263
Unadvanced portions of construction loans	1,767	1,110

Commitments to originate 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 being 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 upon management's credit evaluation of the borrower.

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 facilities to customers.

Derivative Financial Instruments

In 1997, the Company began using interest rate cap agreements in managing the interest rate risk included in the consolidated statement of financial condition.

With respect to interest rate caps, the Company is not exposed to loss beyond its initial cash outlay to enter into the agreements. The cash paid to enter into these agreements is amortized over the terms of the agreements. The unamortized cost related to these agreements was $325,000 and $384,000 at December 31, 1998 and 1997, respectively. The Company enters into these agreements with AAA-rated counterparties.

Interest rate cap agreements provide for the receipt of interest to the extent that the three-month LIBOR is greater than the strike rate. No interest was received under these agreements during 1998 and 1997.

At December 31, 1998 and 1997 the Company had the following interest rate cap agreements in effect:

Notional Amount (In Thousands)	Strike Rate	Maturity Date
$ 5,000	7.50%	2/7/04
5,000	7.8125%	6/4/04
10,000	7.875%	11/15/04

There were no interest rate cap agreements in effect at December 31, 1996.

Investment in Limited Partnerships

At December 31, 1998, the subsidiary bank was committed to invest an additional $1,254,000 in two real estate development limited partnerships related to low income housing. The investments will be $219,000 in 1999, $208,000 in 2000, $198,000 in 2001, $187,000 in 2002, $177,000 in 2003 and $265,000 thereafter. At December 31, 1998 and 1997, the Company had $400,000 and $85,000, respectively, invested in such partnerships, which are included in other assets in the consolidated statements of financial condition.

Lease Commitments

As of December 31, 1998, the Company was obligated under noncancelable operating leases for premises. Minimum future rentals under leases are as follows:

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	Amount (In Thousands)
Year Ending December 31,	
1999	$ 469
2000	388
2001	243
2002	197
2003	190
Thereafter	1,060
	$2,547

Rent expense amounted to $537,000, $510,000 and $519,000 for the years ended December 31, 1998, 1997 and 1996, respectively.

Employment and Special Termination Agreements

The subsidiary bank and the Company have entered into an employment agreement with a senior officer, which provides for a specified minimum annual compensation, certain lump sum severance payments following a "change in control" as defined in the agreement and for the reimbursement by the Company for any excise taxes relating to a change in control. However, such employment may be terminated for cause without incurring any continuing obligations. The Company has also entered into Special Termination Agreements with four other senior officers which generally provide for certain lump sum severance payments following a "change in control" as defined in the agreements.

Legal Proceedings

The Company is a defendant in ordinary and routine pending legal actions incident to its business, none of which is believed by management to be material to the financial condition of the Company.

NOTE 16-Income Taxes

The Company and its subsidiary file a consolidated Federal income tax return on the accrual basis for taxable years ending December 31.

Income tax expense (benefit) reflected in the consolidated statements of earnings for years ended December 31, are as follows:

	1998	1997	1996
	(In Thousands)		
Federal:			
Current	$4,476	$ 1,947	$ 1,693
Deferred	341	34	1,296
Effect of change in valuation allowance		(1,277)	(1,429)
State:			
Current	703		145
Deferred	(384)		
	$5,136	$ 704	$ 1,705

The above amounts include a tax provision on securities transactions of $1,616,000, $845,000 and $237,000, in 1998, 1997 and 1996, respectively.
The income tax benefit related to the exercise of stock options reduces taxes currently payable and is credited to additional paid-in capital. Such amounts were $1,152,000 in 1998, $290,000 in 1997 and $126,000 in 1996.
The difference between the total expected income tax expense computed by applying the Federal income tax rate to earnings before income tax expense and the reported income tax expense for years ended December 31, is

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as follows:

<TABLE>
<CAPTION>

	1998	1997	1996
		(In Thousands)	
Computed "expected" Federal income tax expense at statutory rate	$4,996	$ 1,024	$ 3,028
Increase (decrease) resulting from:			
State income tax, net of Federal tax benefit	211		96
Performance based stock options		367	
Nondeductible merger-related charges		611	
Change in valuation allowance		(1,277)	(1,429)
Change in base year reserve			(43)
Other	(71)	(21)	53
	$5,136	$ 704	$ 1,705

</TABLE>

Significant components of the Company's deferred tax assets and liabilities are as follows:

<TABLE>
<CAPTION>

	December 31,	
	1998	1997
	(In Thousands)	
Deferred tax assets:		
Allowance for possible loan losses	$2,428	$1,649
Other real estate owned	74	55
Federal and state net operating loss carryforwards	580	1,509
Tax credit carryforwards		218
Accrued interest	132	62
Core deposit intangibles	101	109
Deferred compensation	65	159
Marketable equity securities	49	101
Other	153	
	3,582	3,862
Less: Valuation allowance	0	0
Total deferred tax assets	3,582	3,862
Deferred tax liabilities:		
Unearned income	674	570
Premises and equipment		260
Deferred loan fees	140	185
Unrealized gains on securities available for sale	996	3,594
Other	71	193
Total deferred tax liabilities	1,881	4,802
Net deferred tax asset (liability)	$1,701	$ (940)

</TABLE>

At December 31, 1998 and 1997, net deferred tax assets (liabilities) includes $996,000 and $3,594,000, respectively, in deferred tax liabilities which are attributable to the tax effects of net unrealized gains on securities available for sale. Pursuant to SFAS No. 115 and SFAS No. 109, the corresponding charge has been made directly to stockholders' equity.

As of December 31, 1998 the Company has net operating loss carryforwards available for tax purposes of approximately $1,707,000, which expire at various dates from the year 2006 through 2010. The subsequent realization of net operating loss carryforwards is subject to limitation as defined in Internal Revenue Code Section 382 due to changes in ownership relating to acquisitions. Approximately $426,000 of these net operating loss carryforwards are available for use by the Company in 1999.

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SFAS No. 109 requires a valuation allowance against deferred tax assets, if based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. In 1996 and prior years, management believed that uncertainty existed with respect to future realization of a portion of its net operating loss carryforwards and had estab-

lished a valuation allowance. In view of taxable income generated during 1996 and 1997, and upon management's evaluation of the likelihood of realization, a portion of the valuation allowance was reversed in 1996, with the remainder being reversed in 1997. There was no valuation allowance on deferred tax assets at December 31, 1998 or 1997.

NOTE 17-Pension Plans

Defined Benefit Pension Plan

The following table sets forth the funded status of the Company's defined benefit pension plan as of September 30, 1998 and 1997 (the most recent actuarial valuations):

	1998	1997
	(In Thousands)	
Actuarial present value of benefit obligations:		
Accumulated benefit obligation, including vested benefits of $2,425,000 and $2,074,000, respectively	$2,502	$2,178
Projected benefit obligation, beginning of period	$2,800	$2,458
Service costs - benefits earned during the period	176	151
Interest cost on projected benefit obligation	194	184
Actuarial loss recognized during the period	187	88
Annuity payments made during the period	(76)	(74)
Settlements occurring during the period	(64)	(7)
Projected benefit obligation, end of period	$3,217	$2,800
Plan assets at fair value, beginning of period, primarily fixed income and equity securities	$3,221	$2,662
Return on plan assets during the period	44	515
Employer contributions during the period	42	125
Annuity payments made during the period	(76)	(74)
Settlements occurring during the period	(64)	(7)
Plan assets at fair value, end of period, primarily fixed income and equity securities	$3,167	$3,221
Plan assets in excess of (less than) projected benefit obligation	$ (50)	$ 421
Unrecognized net gain from past experience different from that assumed and effects of changes in assumptions	(389)	(841)
Unrecognized net liability being recognized over approximately 12 years	134	190
Accrued pension cost	$ (305)	$ (230)

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</TABLE>

Net periodic pension expense included the following components:

	Year Ended December 31,		
	1998	1997	1996
	(In Thousands)		
Service cost-benefits earned during the period	$ 176	$ 151	$ 144
Interest cost on projected benefit obligation	194	184	171
Expected return on plan assets	(254)	(217)	(186)
Net amortization and deferral	2	18	32
Net periodic pension expense	$ 118	$ 136	$ 161

</TABLE>

The weighted average discount rate of 6.50% in 1998, 7.25% in 1997 and 7.75% in 1996, and the rate of increase in future compensation levels of 4.50% in 1998, 5.00% in 1997 and 5.50% in 1996, were used in determining the actuarial present value of the projected benefit obligation. The expected long-term rate of return on assets was 8.00% for each year.

Supplemental Executive Retirement Plan

Effective January 1, 1993, the Company established a SERP. In August of 1996, the Company established a Rabbi Trust, which purchased life insurance policies to satisfy its benefit obligations thereunder. The cash surrender value of these life insurance policies was $1,430,000 and $1,360,000 at December 31, 1998 and 1997, respectively, and is carried in Other Assets in the Consolidated Statements of Financial Condition. Annual accruals for expense are paid to trusts for the benefit of the participants. The present value of future benefits is being accrued over the term of employment. SERP expense for the years ended December 31, 1998, 1997 and 1996 amounted to $257,000, $257,000 and $176,000, respectively.

NOTE 18-Employee Stock Ownership Plan (ESOP)

On October 13, 1993, the Company's ESOP purchased 39,562 shares of common stock for $250,000. These funds were obtained by the ESOP through a loan from a third party lender and repayment of the loan is guaranteed by the Company. Annual principal payments are approximately $36,000 with interest at approximately the prime rate. Company contributions are the primary source of funds for the ESOP's repayment of the loan.

Interest expense incurred on ESOP debt was $9,000, $17,000 and $19,000, respectively, for the years ended December 31, 1998, 1997 and 1996.

Compensation expense related to the ESOP amounted to $308,000, $321,000 and $251,000, respectively, for the years ended December 31, 1998, 1997 and 1996 and included additional contributions in excess of amounts required to service the ESOP debt of $175,000 in each of those years.

Dividends on unallocated shares were insignificant during 1998, 1997 and 1996.

The total shares held by the ESOP were as follows:

	December 31,	
	1998	1997
Allocated shares	322,448	308,807
Unallocated shares	11,314	16,961
Total ESOP shares	333,762	325,768

</TABLE>

The fair value of unallocated shares at December 31, 1998 and 1997 was $266,000 and $454,000, respectively. Unallocated shares are allocated to

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employees as the ESOP debt is repaid.

NOTE 19-Stock Compensation Plans

The Company maintains the 1997 Long-Term Incentive Stock Benefit Plan. Under this plan, stock options have been granted to certain officers of the Company and its subsidiary bank. Under this plan, stock options have also been granted to each member of the Board of Directors who is not an officer or employee of the Company or the subsidiary bank. Options have been granted to certain officers and still remain outstanding under the Company's 1986 stock option plan and stock options are still outstanding that relate to plans adopted by Primary Bank in 1993 and 1995, which plans were assumed by the Company in connection with the acquisition of Primary Bank. Additionally, stock options granted to members of the Board of Directors of Primary Bank, are still outstanding under plans adopted by Primary Bank in 1993 and 1995, which plans were assumed by the Company in connection with the acquisition of Primary Bank. Each option entitles the holder to purchase one share of the Company's common stock at an exercise price equal to the fair market value of the stock at the date of grant. Options will be exercisable in whole or in part over the vesting period and expire 10 years following the date of grant. However, all options become 100% exercisable in the event that the employee or Director terminates their employment or service due to death, disability, normal retirement, or in the event of a change in control.

The following is a description of activity in the stock compensation plans for the years ended December 31, 1998, 1997 and 1996:

Fixed Stock Option Plans

<TABLE>
<CAPTION>

	1998		1997		1996	
	Number of Options	Weighted Average Option Price	Number of Options	Weighted Average Option Price	Number of Options	Weighted Average Option Price
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Options at beginning of year	584,600	$11.39	490,331	$ 5.80	576,049	$5.52
Granted	195,250	19.64	283,918	16.93	9,118	7.48
Exercised	(257,880)	6.26	(189,024)	5.20	(93,909)	4.25
Canceled	(1,502)	8.91	(625)	9.90	(927)	8.09
Options at end of year	520,468	$17.06	584,600	$11.39	490,331	$5.80
Options exercisable at year end	82,861	$11.13	305,600	$ 6.28	426,225	$5.30

<CAPTION>

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
<S>	<C>	<C>	<C>	<C>	<C>
$3.33	16,500	3.3	$ 3.33	16,500	$ 3.33
$6.33 to $7.52	17,578	5.0	6.72	17,578	6.72
$8.12 to $9.10	6,160	6.5	8.82	6,160	8.82
$11.09 to $11.41	4,498	6.8	11.40	4,498	11.40
$13.93	1,482	8.0	13.93	1,482	13.93
$17.00	399,250	8.8	17.00	36,643	17.00
$23.88	75,000	9.0	23.88		
$3.33 to $23.88	520,468	8.4	$17.06	82,861	$11.13

</TABLE>

Performance-Based Stock Option Plans

<TABLE>
<CAPTION>

	1998		1997		1996	
		Weighted		Weighted		Weighted

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	Number of Options	Average Option Price	Number of Options	Average Option Price	Number of Options	Average Option Price
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Options at beginning of year	66,787	$11.09	103,616	$11.06	47,023	$11.40
Granted					56,593	10.78
Exercised	(46,809)	11.02	(36,331)	11.01		
Canceled	(472)	10.82	(498)	10.78		
Options at end of year	19,506	$11.23	66,787	$11.09	103,616	$11.06
Options exercisable at year end	19,506	$11.23	66,787	$11.09	0	N/A

</TABLE>

The range of exercise prices for the performance-based stock option plans are $10.78-$11.40, with a remaining weighted average life of 7.1 years at December 31, 1998.

Under the 1995 Stock Option Plan for Outside Directors and the 1995 Stock Option Plan for Officers, which options were assumed by the Company in connection with the acquisition of Primary Bank (the "Performance-Based Stock Options"), options vest in increments when the fair value of the stock exceeds certain target prices, as defined, at the date of grant. During 1997 the fair market value of the stock exceeded the target prices and all such options fully vested. In connection with the Performance-Based Stock Options, the Company recorded compensation expense of $1,078,000 in 1997. The offsetting entry relating to this expense was credited to additional paid-in capital.

The weighted average fair values of options at their grant date during 1998, 1997 and 1996, were $8.64, $6.55 and $5.00 per option share, respectively. The fair values of the share grants were estimated on the date of grant using the Black-Scholes option-pricing model using the following assumptions:

<TABLE>
<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Expected option lives	7 years	7.5 years	7 years
Expected volatility	37 - 48%	39%	40%
Risk free interest rate	4.99 - 5.49%	6.96%	6.10%
Expected dividend yield	2.10%	1.74%	N/A

</TABLE>

Had compensation cost for the Company's stock-based compensation plans been determined consistent with SFAS No. 123 for awards made after July 1, 1995, the Company's net earnings and net earnings per share would have been reduced to the pro forma amounts indicated below for the years ended December 31:

<TABLE>
<CAPTION>

		1998	1997	1996
		($ In Thousands, except per share data)		
<S>	<S>	<C>	<C>	<C>
Net Earnings	As Reported	$9,557	$2,307	$7,201
	Pro forma	$8,370	$2,070	$6,888
Net Earnings Per Share:				
Basic	As Reported	$ 1.64	$ .42	$ 1.35
	Pro forma	$ 1.44	$ .38	$ 1.29
Diluted	As Reported	$ 1.60	$ .40	$ 1.28
	Pro forma	$ 1.40	$ .36	$ 1.23

</TABLE>

In 1998, 46,500 shares of restricted stock were awarded to certain officers under the 1997 Long-Term Incentive Stock Benefit Plan with a weighted average fair value at the dates of grant of $21.83 per share. At December 31, 1998, restricted stock awards totaled 46,500 shares of which 6,500 shares were vested. Shares vest ratably over a period of five years. Compensation expense applicable to the stock awards was $362,000 in 1998.

NOTE 20-Stockholders' Equity

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Capital Requirements

The Company and the subsidiary bank are subject to various regulatory capital requirements administered by 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 consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the subsidiary 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 classification 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 subsidiary bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). As of December 31, 1998, the Company and the subsidiary bank meet all capital adequacy requirements to which they are subject.

As of December 31, 1998, the most recent notification from the Federal Deposit Insurance Corporation ("FDIC") categorized the Company's wholly-owned subsidiary bank as "well-capitalized" under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the subsidiary bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There have been no conditions or events since that notification that management believes would cause a change in the subsidiary bank's categorization.

The Company's and the subsidiary bank's actual capital amounts and ratios as of December 31, 1998 and 1997 are presented in the following table.

<TABLE>
<CAPTION>

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	($ In Thousands)					
<S>	<C>	<C>	<C>	<C>	<C>	<C>
As of December 31, 1998:						
Total Capital (to Risk Weighted Assets):						
Consolidated	$75,971	14.42%	$42,145	>/=8.00%	N/A	
Subsidiary Bank	$72,961	13.85%	$42,145	>/=8.00%	$52,681	>/=10.00%
Tier I Capital (to Risk Weighted Assets):						
Consolidated	$69,379	13.17%	$21,072	>/=4.00%	N/A	
Subsidiary Bank	$66,369	12.60%	$21,072	>/=4.00%	$31,609	>/=6.00%
Tier I Capital (to Average Assets):						
Consolidated	$69,379	8.18%	$33,944	>/=4.00%	N/A	
Subsidiary Bank	$66,369	7.82%	$33,944	>/=4.00%	$42,430	>/=5.00%
As of December 31, 1997:						
Total Capital (to Risk Weighted Assets):						
Consolidated	$65,688	12.87%	$40,836	>/=8.00%	N/A	
Subsidiary Bank	$63,737	12.49%	$40,830	>/=8.00%	$51,038	>/=10.00%
Tier I Capital (to Risk Weighted Assets):						
Consolidated	$59,292	11.62%	$20,418	>/=4.00%	N/A	
Subsidiary Bank	$57,342	11.24%	$20,415	>/=4.00%	$30,623	>/=6.00%
Tier I Capital (to Average Assets):						
Consolidated	$59,292	7.47%	$31,730	>/=4.00%	N/A	
Subsidiary Bank	$57,342	7.23%	$31,723	>/=4.00%	$39,654	>/=5.00%

</TABLE>

Stock Repurchase Program

On August 13, 1996, the Company announced a Stock Repurchase Program ("1996 Program"), whereby the Company's Board of Directors authorized the repurchase of up to 10% of its outstanding common shares from time to time.

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Shares repurchased under the 1996 Program may be held in treasury, retired or used for general corporate purposes. The Company had repurchased 72,549 shares under the 1996 Program. No shares were repurchased under the 1996 Program after March of 1997, and, as a result of the merger agreement entered into with Primary Bank in April of 1997 (see note 2 of notes to consolidated financial statements), the Stock Repurchase Program was terminated.

On August 11, 1998, the Company announced a new Stock Repurchase Program ("1998 Program"), whereby the Company's Board of Directors authorized the repurchase of up to 5% of its outstanding common shares from time to time. Any shares repurchased may be held in treasury, retired or used for general corporate purposes. As of December 31, 1998, 14,700 shares had been repurchased under the 1998 Program.

Liquidation Account

Pursuant to certain bank conversion regulations, the subsidiary bank established a liquidation account for the benefit of eligible account holders who maintain their savings accounts in the subsidiary bank after conversion. In the event of a complete liquidation of the subsidiary bank, and only in such event, eligible account holders would be entitled to their interest in the liquidation account before any liquidation distribution may be made to stockholders. Their interest as to each savings account will be in the same proportion of the total liquidation amount as the balance of their savings account at the date of conversion was to the balance in all savings accounts in the subsidiary bank on that date. However, if the amount in the savings account on any annual closing date of the subsidiary bank is less than the amount

in such account at the date of conversion, then their interest in the liquidation account will be reduced by an amount proportionate to any such reduction and their interest will cease to exist if such savings accounts are closed. Their interest in the liquidation account will never be increased despite any increase in the related savings account after conversion. The balance in the liquidation account at December 31, 1998 was approximately $1,958,000 (unaudited).

NOTE 21-Restrictions on Subsidiary's Loans, Advances and Dividends

Bank regulatory authorities restrict the amounts available for the payment of dividends by the subsidiary bank to the Company if the effect thereof would cause the capital of the subsidiary bank to be reduced below applicable capital requirements. These restrictions indirectly restrict the Company's ability to pay common stock dividends.

Federal laws and regulations prohibit the Company from borrowing from the subsidiary bank unless the loans are secured by specified amounts of collateral. In addition, such secured loans to the Company from the subsidiary bank generally are limited to 10 percent of the subsidiary bank's capital surplus. At December 31, 1998 and 1997, no such transactions existed between the Company and the subsidiary bank.

NOTE 22-Other Noninterest Expense

Components of other noninterest expense were as follows:

<TABLE>
<CAPTION>

	Year Ended December 31,		
	1998	1997	1996
	(In Thousands)		
<S>	<C>	<C>	<C>
Advertising and marketing	$ 567	$1,210	$1,026
Amortization	474	418	423
Data processing	487	1,101	1,438
FDIC deposit insurance assessments	93	82	118
FDIC special assessment to recapitalize Savings Association Insurance Fund			187
Postage and freight	576	552	542
Professional fees	856	817	791
Printing and supplies	640	726	570
Telephone	552	433	383
Other	2,167	2,436	2,251

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$6,412	$7,775	$7,729

</TABLE>

NOTE 23-Fair Values of Financial Instruments

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 subsidiary bank's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the subsidiary bank's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, 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 could significantly affect the estimates.

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial assets or liabilities and therefore, are not valued pursuant to SFAS No. 107, include premises and equipment, other real estate owned, core deposit intangibles and goodwill. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in many of the estimates.

The following methods and assumptions were used by the Company in estimating fair values of its financial instruments:

Cash and due from banks and interest bearing deposits in other banks

For cash and due from banks and short term investments in interest bearing deposits in other banks, having maturities of 90 days or less, the carrying amounts reported in the consolidated statements of financial condition approximate fair values.

Securities held to maturity, securities available for sale and stock in Federal Home Loan Bank of Boston

The fair value of securities held to maturity and securities available for sale is estimated based on bid prices published in financial newspapers or bid quotations received from securities dealers. Ownership of stock in FHLBB is restricted to member banks; therefore, the stock is not traded. The estimated fair value of stock in FHLBB, which approximates carrying value, represents the price at which the subsidiary bank could liquidate its holdings.

Loans held for sale

Loans actively traded in the secondary mortgage market have been valued using current investor yield requirements.

Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, commercial real estate, residential mortgage, construction, and other consumer. Each loan category is further segmented into fixed and adjustable rate interest terms and by performing and nonperforming categories.

The fair value of performing loans, except residential mortgage loans, is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the subsidiary bank's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions. For performing residential mortgage loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using discount rates based on secondary market sources adjusted to reflect differences in servicing and credit costs.

Fair value for significant nonperforming loans is based on recent external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows, and discount rates are judgmentally determined using available market information and specific borrower information.

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Mortgage Servicing Rights

A valuation model that calculates the present value of future cash flows is used to estimate such fair values. This valuation model incorporates assumptions that market participants would use in estimating future net servicing income including estimates of the cost of servicing loans, discount rate, float value, ancillary income, prepayment speeds and default rates.

Accrued interest receivable

The carrying value of accrued interest receivable on securities and loans, included in other assets, approximates its fair value.

Deposits

Under SFAS No. 107, the fair value of deposits with no stated maturity, such as non-interest bearing deposits, NOW, regular savings and money market deposit accounts, is equal to the amount payable on demand. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market. The fair value estimate of time certificates is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

Securities sold under agreements to repurchase

The fair value estimate of securities sold under agreements to repurchase approximates carrying value because they generally mature within ninety days and bear market interest rates.

Other Borrowings

The fair value of other borrowings is based upon the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for borrowings of similar maturities.

Accrued interest payable

The carrying value of accrued interest payable on deposits and borrowings, included in other liabilities, approximates its fair value.

Off-balance sheet instruments

The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed rate loan commitments, excluding those committed for sale to the secondary market, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of financial guarantees written and letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties. It is management's belief that the fair value estimate of commitments to extend credit are not material, at December 31, 1998 and 1997, because most mature within one year, do not present any unanticipated credit concerns and bear market interest rates.

The fair values of the interest rate cap agreements are based on dealer quotes.

The following presents the carrying value and estimated fair value of the Company's financial instruments at December 31, 1998 and 1997.

<TABLE>
<CAPTION>

	December 31,			
	1998		1997	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
	(In Thousands)			
<S>	<C>	<C>	<C>	<C>
Financial Assets				

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Cash and due from banks	$ 23,506	$ 23,506	$ 28,677	$ 28,677
Interest bearing deposits in other banks	19,532	19,532	27,452	27,452
Securities held to maturity	22,277	22,548	33,910	34,170
Stock in Federal Home Loan Bank of Boston	7,201	7,201	7,201	7,201
Securities available for sale	219,765	219,765	178,680	178,680
Net loans	547,071	554,886	500,082	506,317
Loans held for sale	1,828	1,828	1,068	1,068
Mortgage servicing rights	390	643	331	679
Accrued interest receivable	5,722	5,722	5,627	5,627
Financial Liabilities				
Deposits (with no stated maturity)	383,586	383,586	358,807	358,807
Time deposits	266,901	269,129	290,176	290,772
Securities sold under agreements to repurchase	70,905	70,905	66,025	66,025
Other borrowings	80,608	80,579	25,877	25,883
Accrued interest payable	1,288	1,288	1,032	1,032

<CAPTION>

	Contractual or Notional Amount	Estimated Fair Value	Contractual or Notional Amount	Estimated Fair Value
	(In Thousands)			
Off-balance sheet instruments				
Commitments to extend credit	$ 59,143	$ 0	$ 64,046	$ 0
Interest rate cap agreements	20,000	122	20,000	242

</TABLE>

NOTE 24-Condensed Parent Company Only Financial Information

Condensed financial statements of Granite State Bankshares, Inc. (the "Parent Company"), as of December 31, 1998 and 1997, and for the years ended December 31, 1998, 1997 and 1996, are as follows:

Balance Sheets

<TABLE>
<CAPTION>

	December 31, 1998	December 31, 1997
	(In Thousands)	
Assets		
Interest bearing deposits in subsidiary bank	$ 3,948	$ 2,500
Investment in subsidiary bank, at equity	69,590	65,070
Other assets	3	70
	$73,541	$67,640
Liabilities	$ 941	$ 726
Stockholders' equity	72,600	66,914
	$73,541	$67,640

</TABLE>

<TABLE>
<CAPTION>
Statements of Earnings

	Year Ended December 31, 1998	1997	1996
	(In Thousands)		
Revenues			
Interest income from subsidiary bank	$ 83	$ 29	$ 20
Dividend income from subsidiary bank	2,250	3,000	2,000
Other revenues	465		
Total revenues	2,798	3,029	2,020

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Operating expenses	83	254	20
Earnings before income taxes and equity in undistributed earnings (loss) of subsidiary bank	2,715	2,775	2,000
Income tax expense (benefit)	161	(68)	
Earnings before equity in undistributed earnings (loss) of subsidiary bank	2,554	2,843	2,000
Equity in undistributed earnings (loss) of subsidiary bank	7,003	(536)	5,201
Net earnings	$9,557	$ 2,307	$ 7,201

</TABLE>

<TABLE>
<CAPTION>
Statements of Cash Flows

	Year Ended December 31, (In Thousands)		
	1998	1997	1996
<S>	<C>	<C>	<C>
Cash flows from operating activities:			
Net earnings	$ 9,557	$ 2,307	$ 7,201
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Equity in undistributed (earnings) loss of subsidiary bank	(7,003)	536	(5,201)
Gains on sales of other assets	(465)		
(Increase) decrease in other assets	(1)	228	1
Increase (decrease) in other liabilities	127	(22)	(7)
Deferred income tax expense (benefit)	68	(68)	
Net cash provided by operating activities	2,283	2,981	1,994
Cash flows from investing activities:			
(Increase) decrease in interest bearing deposits with subsidiary bank	(1,448)	(1,781)	748
Proceeds from sales of other assets	465		
Net cash provided by (used in) investing activities	(983)	(1,781)	748
Cash flows from financing activities:			
Dividends paid on common stock	(2,824)	(1,285)	(1,083)
Proceeds from issuance of common stock	2,042	426	253
Reissuance of common stock from treasury	88		
Purchase of common stock for treasury	(289)	(305)	(1,876)
Repayment on liability relating to ESOP	(36)	(36)	(36)
Purchase of common stock relating to restricted stock awards	(281)		
Net cash used in financing activities	(1,300)	(1,200)	(2,742)
Net increase (decrease) in cash	0	0	0
Cash at beginning of year	0	0	0
Cash at end of year	$ 0	$ 0	$ 0

</TABLE>

The Parent Company's Statements of Stockholders' Equity are identical to the Consolidated Statements of Stockholders' Equity and therefore, are not reprinted here.

The Company has no material contingencies, commitments or long-term obligations other than those disclosed elsewhere in the accompanying Notes to Consolidated Financial Statements.

NOTE 25-Summary of Quarterly Results (Unaudited)

The following is a summary of the quarterly results of operations for the years ended December 31, 1998 and 1997.

<TABLE>
<CAPTION>

	1998				1997			
	Fourth	Third	Second	First	Fourth	Third	Second	First

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	Quarter	Quarter	Quarter	Quarter	Quarter	Quarter	Quarter	Quarter
	($ In Thousands, except per share data)							
Interest and dividend income								
Loans	$11,447	$11,515	$11,595	$11,275	$11,233	$10,913	$10,370	$ 9,791
Securities available for sale	2,739	2,542	2,099	2,455	2,337	2,389	2,907	2,724
Securities held to maturity	380	321	248	520	896	1,313	1,415	1,486
Interest bearing deposits in other banks	373	349	226	81	302	162	140	177
Dividends on Federal Home Loan Bank of Boston stock	116	115	114	116	119	117	116	104
Total interest and dividend income	15,055	14,842	14,282	14,447	14,887	14,894	14,948	14,282
Interest expense								
Deposits	5,589	5,664	5,533	5,768	6,038	5,918	5,797	5,569
Other borrowed funds	1,588	1,497	1,096	918	1,010	1,350	1,624	1,594
Total interest expense	7,177	7,161	6,629	6,686	7,048	7,268	7,421	7,163
Net interest and dividend income	7,878	7,681	7,653	7,761	7,839	7,626	7,527	7,119
Provision for possible loan losses	350	250	225	300	800	700	700	225
Net interest and dividend income after provision for possible loan losses	7,528	7,431	7,428	7,461	7,039	6,926	6,827	6,894
Net gains (losses) on sales of securities available for sale	1,805	481	800	1,099	(1)	115	13	2,060
Other noninterest income	1,290	1,254	1,173	1,148	1,025	1,385	1,319	1,183
Noninterest expense[F1][F2]	7,221	5,560	5,565	5,859	12,681	6,163	6,803	6,127
Earnings (loss) before income taxes	3,402	3,606	3,836	3,849	(4,618)	2,263	1,356	4,010
Income tax expense (benefit)	1,193	1,276	1,325	1,342	(1,592)	587	536	1,173
NET EARNINGS (LOSS)[F1][F2]	$ 2,209	$ 2,330	$ 2,511	$ 2,507	$(3,026)	$1,676	$ 820	$ 2,837
Net earnings (loss) per share-basic[F3]	$ .38	$ .40	$ .43	$ .44	$ (.55)	$ .31	$ .15	$ .52
Net earnings (loss) per share-diluted[F3]	$ .37	$ .39	$ .42	$ .42	$ (.55)	$ .29	$ .14	$ .50
Annualized Returns								
Return on average assets	1.03%	1.12%	1.27%	1.29%	(1.50)%	.82%	.40%	1.44%
Return on average stockholders' equity	11.93%	12.74%	14.02%	14.63%	(18.02)%	10.18%	5.29%	18.97%

<FN>

<F1> Included in noninterest expense during the fourth quarter of 1998 were costs relating to the termination of certain officers. Additionally, a writedown of premises in connection with a branch closing occured during the fourth quarter of 1998. Noninterest expense associated with these items amounted to $1,472,000 in the fourth quarter of 1998.
<F2> The Company recorded $5,917,000 in merger-related charges in the fourth quarter of 1997 in connection with the acquisition of Primary Bank. The after-tax amount of these costs were $4,325,000.
<F3> Net earnings (loss) per share is calculated by dividing net earnings (loss) by the average common shares outstanding for each quarter. Therefore, the sum of net earnings (loss) per share for the quarters may not equal net earnings per share for the year.
</FN>
</TABLE>

SELECTED CONSOLIDATED FINANCIAL DATA

Balance Sheet Data:

<TABLE>
<CAPTION>

	At or for Years Ended December 31,				
	1998	1997	1996	1995	1994
	($ In Thousands, except per share data)				
Total assets	$878,147	$813,670	$797,840	$728,724	$668,310
Net loans	547,071	500,082	434,184	416,979	400,742

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Loans held for sale	1,828	1,068	1,025	1,985	834
Investments<F1>	249,243	219,791	273,230	218,229	205,792
Deposits	650,487	648,983	609,667	591,123	520,099
Securities sold under agreements to repurchase	70,905	66,025	64,961	49,958	39,113
Other borrowings	80,608	25,877	59,190	28,499	56,143
Stockholders' equity	72,600	66,914	59,429	54,755	48,636
Operating Data:					
Interest and dividend income	$ 58,626	$ 59,011	$ 54,430	$ 51,798	$ 43,583
Interest expense	27,653	28,900	27,243	25,018	18,721
Net interest and dividend income	30,973	30,111	27,187	26,780	24,862
Provision for possible loan losses	1,125	2,425	1,372	3,337	1,032
Net gains (losses) on securities	4,185	2,187	650	338	(127)
Other noninterest income	4,865	4,912	5,081	4,703	4,561
Noninterest expense<F2>	24,205	31,774	22,640	24,364	22,633
Earnings before income taxes	14,693	3,011	8,906	4,120	5,631
Applicable income taxes	5,136	704	1,705	1,638	562
Net earnings<F2>	$ 9,557	$ 2,307	$ 7,201	$ 2,482	$ 5,069
Per share data:					
Net earnings per share-basic	$ 1.64	$ .42	$ 1.35	$ .46	$ .93
Net earnings per share-diluted	$ 1.60	$ .40	$ 1.28	$ .44	$ .88
Cash dividends declared on common stock	$ .50	$ .29	$ .20	$ .18	$ .14
Financial Ratios:					
Return on average assets	1.17%	.29%	.95%	.35%	.76%
Return on average stockholders' equity	13.30%	3.57%	12.88%	4.56%	10.06%

<FN>

<F1> Investments include securities held to maturity, securities available for sale and stock in the Federal Home Loan Bank of Boston.

<F2> The Company recorded $5,917,000 in merger-related charges in 1997 associated with the acquisition of Primary Bank. The after-tax amount of these costs was $4,325,000.

</FN>

</TABLE>

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EXHIBIT 23.1

CONSENT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT-GRANT THORNTON LLP

Consent of Independent Certified Public Accountants

We have issued our report dated January 11, 1999 accompanying the consolidated financial statements incorporated by reference in the Annual Report of Granite State Bankshares, Inc. and Subsidiary on Form 10-K for the year ended December 31, 1998. We hereby consent to the incorporation by reference of said report in the Registration Statements of Granite State Bankshares, Inc. and Subsidiary on Form S-8 (File No. 33-57720, effective February 1, 1993) and on Form S-8 (File No. 333-42287, effective December 15, 1997).

/s/ Grant Thornton LLP

Boston, Massachusetts
March 26, 1999

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EXHIBIT 23.2

CONSENT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT-KPMG PEAT MARWICK LLP

Consent of Independent Certified Public Accountants

We consent to the incorporation by reference of our report, included herein, in the Registration Statement of Granite State Bankshares, Inc. and Subsidiary on Form S-8 (Nos. 33-57720 and 333-42287).

/s/ KPMG Peat Marwick LLP

Boston, Massachusetts
March 26, 1999

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<TABLE> <S> <C>

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This schedule contains summary financial information extracted from the Form 10-K and is qualified in its entirety by reference to such financial statements.
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<ALLOWANCE-FOREIGN>	0
<ALLOWANCE-UNALLOCATED>	1,308

<FN>
<F1>Securities available for sale, at market value
<F2>Loans net of unearned income, gross of allowance for possible loan losses and excluding loans held for sale
<F3>Securities sold under agreements to repurchase of $70,905
<F4>Includes other borrowings with the Federal Home Loan Bank of Boston of $80,608

</FN>

</TABLE>

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EXHIBIT 99

INDEPENDENT AUDITORS' REPORT OF PRIMARY BANK

Independent Auditors' Report

The Board of Directors
Primary Bank

We have audited the accompanying statements of operations, changes in stockholders' equity, and cash flows for the year ended December 31, 1996 for Primary Bank. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements for Primary Bank referred to above present fairly, in all material respects, the results of its operations and its cash flows for the year ended December 31, 1996, in conformity with generally accepted accounting principles.

/s/ KPMG Peat Marwick LLP

Boston, Massachusetts
January 23, 1997

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