UNION BANKSHARES INC
Form 10-Q
November 14, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: September 30, 2007

Commission file number: 001-15985

UNION BANKSHARES, INC.

VERMONT 03-0283552

P.O. BOX 667
MAIN STREET
MORRISVILLE, VT 05661

Registrant's telephone number: 802-888-6600

Former name, former address and former fiscal year, if changed since last report: Not applicable

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 whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. (See definition of "accelerated filer and large accelerated filer", in Rule 12b-2 of the Exchange Act). (Check One):
Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [X]

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes _____ No __X__

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of

November 2, 2007:
Common Stock, $2 par value 4,507,308 shares

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Part l Financial Information
Item 1. Financial Statements

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2007	December 31, 2006
	(Dollars in thousands)	
Assets		
Cash and due from banks	$ 12,061	$ 11,694
Federal funds sold and overnight deposits	9,151	9,263
Cash and cash equivalents	21,212	20,957
Interest bearing deposits in banks	10,634	5,417
Investment securities available-for-sale	34,270	23,682
Loans held for sale	4,220	3,750
Loans	311,368	313,822
Allowance for loan losses	(3,396)	(3,338)
Unearned net loan fees	(105)	(120)
Net loans	307,867	310,364
Accrued interest receivable	1,918	2,001
Premises and equipment, net	6,293	6,080
Other assets	11,077	8,898

Total assets	$397,491	$381,149
	========	========
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Noninterest bearing	$ 54,890	$ 54,875
Interest bearing	278,532	264,947
	--------	--------
Total deposits	333,422	319,822
Borrowed funds	14,618	14,596
Liability for pension benefits	1,589	1,317
Accrued interest and other liabilities	5,941	3,491
	--------	--------
Total liabilities	355,570	339,226
	--------	--------
Commitments and Contingencies		
Stockholders' Equity		
Common stock, $2.00 par value; 7,500,00 shares authorized at 9/30/07 and 5,000,000 at 12/31/06; 4,918,611 shares issued at 9/30/07 and 12/31/06	9,837	9,837
Paid-in capital	157	150
Retained earnings	35,543	35,203
Treasury stock at cost; 404,395 shares at 9/30/07 and 386,634 at 12/31/06	(2,639)	(2,264)
Accumulated other comprehensive loss	(977)	(1,003)
	--------	--------
Total stockholders' equity	41,921	41,923
	--------	--------
Total liabilities and stockholders' equity	$397,491	$381,149
	========	========

See accompanying notes to the unaudited consolidated financial statements.

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UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended		Nine Mont
	------------------		---------
	September 30,		Septemb
	2007	2006	2007
	----	----	----
	(Dollars in thousands except Per Sha		
Interest income			
Interest and fees on loans	$ 6,115	$ 6,122	$ 17,959
Interest on debt securities			
Taxable	275	188	766
Tax exempt	59	47	155
Dividends	25	49	82

Interest on federal funds sold and overnight deposits	132	67	312
Interest on interest bearing deposits in banks	128	61	324
Total interest income	6,734	6,534	19,598
Interest expense			
Interest on deposits	1,941	1,532	5,606
Interest on borrowed funds	182	287	551
Total interest expense	2,123	1,819	6,157
Net interest income	4,611	4,715	13,441
Provision for loan losses	190	-	235
Net interest income after provision for loan losses	4,421	4,715	13,206
Noninterest income			
Trust income	94	74	261
Service fees	866	787	2,516
Net gains on sales of investment securities	30	5	67
Net gains on sales of loans held for sale	48	108	98
Other income	45	19	211
Total noninterest income	1,083	993	3,153
Noninterest expenses			
Salaries and wages	1,565	1,536	4,692
Pension and employee benefits	541	541	1,721
Occupancy expense, net	186	184	620
Equipment expense	278	269	821
Other expenses	1,004	893	2,941
Total noninterest expense	3,574	3,423	10,795
Income before provision for income taxes	1,930	2,285	5,564
Provision for income taxes	508	623	1,421
Net income	$ 1,422	$ 1,662	$ 4,143
Earnings per common share	$ 0.32	$ 0.37	$ 0.92
Weighted average number of common shares outstanding	4,518,204	4,540,740	4,526,243
Dividends per common share	$ 0.28	$ 0.26	$ 0.84

See accompanying notes to the unaudited consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)

	Common Stock				
	Shares, net of Treasury	Amount	Paid-in capital	Retained earnings	Treasury stock
				(Dollars in thousands)	
Balances, December 31, 2006	4,531,977	$9,837	$150	$35,203	$(2,264)
Comprehensive income:					
Net income	-	-	-	4,143	-
Change in net unrealized loss on investment securities available-for-sale, net of reclassification adjustment and tax effects	-	-	-	-	-
Net change in unfunded liability for pension benefits, net of tax	-	-	-	-	-
Total comprehensive income					
Cash dividends declared ($0.84 per share)	-	-	-	(3,803)	-
Issuance of stock options	-	-	7	-	-
Purchase of treasury stock	(17,761)	-	-	-	(375)
Balances, September 30, 2007	4,514,216	$9,837	$157	$35,543	$(2,639)

See accompanying notes to the unaudited consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended	
	September 30, 2007	September 2006
	(Dollars in thousands)	
Cash Flows From Operating Activities		

Net Income	$ 4,143	$ 4,6
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	570	5
Provision for loan losses	235	1
Credit for deferred income taxes	(236)	(1
Net amortization of investment securities	11	
Equity in losses of limited partnerships	199	2
Issuance of stock options	7	
Write-downs of other real estate owned	72	
Decrease in unamortized loan fees	(15)	(
Proceeds from sales of loans held for sale	13,405	15,4
Origination of loans held for sale	(13,777)	(11,1
Net gains on sales of loans held for sale	(98)	(2
Net gains on sales of investment securities	(67)	(
Net losses (gains) on disposals of premises and equipment	1	
Net gains on sales of repossessed property	(4)	
Net gains on sales of other real estate owned	(44)	
Decrease in accrued interest receivable	83	1
Increase in other assets	(778)	(3
Increase in income taxes	23	1
Increase in accrued interest payable	181	2
Increase in other liabilities	1,498	7
Net cash provided by operating activities	5,409	10,5
Cash Flows From Investing Activities		
Interest bearing deposits in banks		
Maturities and redemptions	1,183	2,7
Purchases	(6,400)	(2
Investment securities available-for-sale		
Sales	546	7,5
Maturities, calls and paydowns	1,811	3,3
Purchases	(12,870)	(9
Net redemption (purchase) of Federal Home Loan Bank stock	82	(4
Net decrease (increase) in loans	1,883	(15,1
Recoveries of loans charged off	33	1
Purchases of premises and equipment	(806)	(6
Investments in limited partnerships	(361)	(3

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	Nine Months Ended	
	September 30, 2007	September 2006
	(Dollars in thousands)	
Proceeds from sales of other real estate owned	255	
Proceeds from sales of premises and equipment	22	
Proceeds from sales of repossessed property	24	
Net cash used in investing activities	(14,598)	(4,0
Cash Flows From Financing Activities		
Net increase in borrowings outstanding	22	2,8
Net increase (decrease) in noninterest bearing deposits	15	(2,1

Net increase (decrease) in interest bearing deposits	13,585	(2,2
Purchase of treasury stock	(375)	(
Dividends paid	(3,803)	(3,5
Net cash provided by (used) in financing activities	9,444	(5,1
Increase in cash and cash equivalents	255	1,4
Cash and cash equivalents		
Beginning	20,957	14,2
Ending	$ 21,212	$ 15,6
Supplemental Disclosures of Cash Flow Information		
Interest paid	$ 5,976	$ 4,5
Income taxes paid	$ 1,635	$ 1,6
Supplemental Schedule of Noncash Investing and Financing Activities		
Change in net unrealized losses on investment securities available-for-sale	$ 20	$ (
Change in unfunded liability for pension benefits for amortization	$ 20	$
Other real estate acquired in settlement of loans	$ 547	$ 1
Repossessed property acquired in settlement of loans	$ 79	$
Investment in limited partnerships acquired by capital contributions payable	$ 1,397	$
Loans originated to finance the sale of other real estate owned	$ 115	$

See accompanying notes to the unaudited consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY

Note 1. Basis of Presentation

The accompanying interim unaudited consolidated financial statements of Union Bankshares, Inc. (the Company) as of September 30, 2007 and 2006, and for the three and nine months then ended have been prepared in conformity with U.S. generally accepted accounting principles (GAAP), general practices within the banking industry, and the accounting policies described in the Company's Annual Report to Shareholders and Annual Report on Form 10-K for the year ended December 31, 2006. In the opinion of Company's management, all adjustments,

consisting only of normal recurring adjustments and disclosures necessary for a fair presentation of the information contained herein have been made. This information should be read in conjunction with the Company's 2006 Annual Report to Shareholders, 2006 Annual Report on Form 10-K, and current reports on Form 8-K. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2007, or any other interim period.

Certain amounts in the 2006 consolidated financial statements have been reclassified to conform to the 2007 presentation.

Note 2. Commitments and Contingencies

In the normal course of business, the Company is involved in various legal proceedings. In the opinion of management, any liability resulting from such proceedings would not have a material adverse effect on the Company's financial condition or results of operations.

Note 3. Per Share Information

Earnings per common share amounts are computed based on the weighted average number of shares of common stock outstanding during the period and reduced for shares held in treasury. The assumed conversion of available stock options does not result in material dilution.

Note 4. New Accounting Pronouncements

In November, 2007, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 109, Written Loan Commitments Recorded at Fair Value Through Earnings ("SAB 109"), which supersedes Staff Accounting Bulletin No. 105, Application of Accounting Principles to Loan Commitments. SAB 109 expresses the current view of the SEC staff that the expected net future cash flows related to the servicing of loan commitments should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings, whether accounted for as derivatives under Statement of Financial Accounting Standard (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, or accounted for at fair value under SFAS No. 159. SAB 109 also expresses the SEC staff's view that internally-developed intangible assets, such as customer relationship intangibles, should not be recorded as part of the fair value of any written loan commitment accounted for at fair value through earnings, whether under SFAS 133 or SFAS 159. SAB 109 is effective for loan commitments issued or modified by the Company beginning on January 1, 2008. The Company is currently assessing the financial statement impact, if any, that SAB 109 may have on the Company.

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. This Statement permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This Statement does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. This Statement does not establish requirements for recognizing and measuring dividend income, interest income, or interest expense. This Statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS No. 157, Fair Value Measurements, and No. 107, Disclosures about Fair Value of Financial

Instruments. This Statement is effective prospectively for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of this new standard on the Company's consolidated financial statements but does not expect that such impact will be material.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact of this new standard to determine its effects on the Company's consolidated financial statements but does not expect that such impact will be material.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets, an amendment of SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities. The Statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations. It requires all separately recognized servicing assets and liabilities to be initially measured at fair value, if practicable. It permits an entity to choose either the amortization method or the fair value measurement method for each class of separately recognized servicing assets and liabilities and requires additional disclosures in the financial statements under the fair value measurement method. The Company adopted SFAS No.156 effective January 1, 2007 and will continue with the amortization method of accounting for servicing rights, which has no additional impact on the Company's financial position or results of operations.

Note 5. Defined Benefit Pension Plan
Union Bank (Union), the Company's bank subsidiary, sponsors a noncontributory defined benefit pension plan covering all eligible employees. The plan provides defined benefits based on years of service and final average salary.

Net periodic pension benefit cost for the three and nine months ended September 30, 2007 and 2006, consisted of the following components:

	Three Months Ended		Nine Months Ended	
	2007	2006	2007	2006
	(Dollars in thousands)			
Service cost	$ 130	$ 129	$ 389	$ 371
Interest cost on projected benefit obligation	150	131	452	406
Expected return on plan assets	(150)	(122)	(451)	(364)
Amortization of prior service cost	2	1	5	4
Amortization of net loss	6	21	16	63

Net periodic benefit cost	$ 138	$ 160	$ 411	$ 480

Note 6. Other Comprehensive Loss
The components of other comprehensive loss and related tax effects for the three and nine months ended September 30, 2007 and 2006, are as follows:

	Three Months Ended		Nine Months Ended	
	2007	2006	2007	2006
	(Dollars in thousands)			
Unrealized holding losses (gains) on investment securities available-for-sale	$311	$ 327	$ 87	$(69)
Reclassification adjustment for net gains realized in income	(30)	(5)	(67)	(22)
Net unrealized losses (gains)	281	322	20	(91)
Tax effect	(96)	(109)	(7)	31
Net of tax amount	$185	$ 213	$ 13	$(60)

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	Three Months Ended		Nine Months Ended	
	2007	2006	2007	2006
	(Dollars in thousands)			
Unfunded liability for pension benefits reclassification adjustment for amortization per FAS 158 recognized in income	$20	$ -	$20	$ -
Tax effect	(7)	-	(7)	-
Net of tax amount	$13	$ -	$13	$ -

Note 7. Income Taxes
The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of SFAS No. 109 (FIN 48), on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes, and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

Based on management's evaluation, management has concluded that there are no significant uncertain tax positions requiring recognition in the Company's financial statements. Although the Company is not currently the subject of a tax audit by the Internal Revenue Service (IRS), the Company's tax years ending

December 31, 2003 through 2006 are open to audit by the IRS under the applicable statute of limitations.

The Company may from time to time be assessed interest and/or penalties by federal or state tax jurisdictions, although any such assessments historically have been minimal and immaterial to the Company's financial results. In the event that the Company receives an assessment for interest and/or penalties, it will be classified in the financial statements as other expenses.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

The following discussion and analysis by management focuses on those factors that had a material effect on Union Bankshares, Inc.'s (Company's) financial position as of September 30, 2007, and as of December 31, 2006, and its results of operations for the three and nine months ended September 30, 2007 and 2006. This discussion is being presented to provide a narrative explanation of the financial statements and should be read in conjunction with the consolidated financial statements and related notes and with other financial data appearing elsewhere in this filing and with the Company's Annual Report on Form 10-K for the year ended December 31, 2006. In the opinion of Company's management, the interim unaudited data reflects all adjustments, consisting only of normal recurring adjustments, and disclosures necessary to fairly present the Company's consolidated financial position and results of operations for the interim period. Management is not aware of the occurrence of any events after September 30, 2007, which would materially affect the information presented.

CAUTIONARY ADVICE ABOUT FORWARD LOOKING STATEMENTS

The Company may from time to time make written or oral statements that are considered "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may include financial projections, statements of plans and objectives for future operations, estimates of future economic performance and assumptions relating thereto. The Company may include forward-looking statements in its filings with the Securities and Exchange Commission (SEC), in its reports to stockholders, including this Quarterly Report, in other written materials, and in statements made by senior management to analysts, rating agencies, institutional investors, representatives of the media and others.

Forward-looking statements reflect management's current expectations and are subject to uncertainties, both general and specific, and risk exists that those predictions, forecasts, projections and other estimates contained in forward-looking statements will not be achieved. When management uses any of the words "believes," "expects," "anticipates," "intends," "plans," "seeks," "estimates", or similar expressions, they are making forward-looking statements. Many possible events or factors, including those beyond the control of management, could affect the future financial results and performance of the Company. This could cause results or performance to differ materially from those expressed in forward-looking statements. The possible events or factors that might affect forward-looking statements include, but are not limited to, the following:

o uses of monetary, fiscal, and tax policy by various governments;

- political, legislative, or regulatory developments in Vermont, New Hampshire, or the United States including changes in laws concerning accounting, taxes, financial reporting, banking, and other aspects of the financial services industry;
- developments in general economic or business conditions nationally, in Vermont, or in northern New Hampshire, including interest rate fluctuations, market fluctuations and perceptions, job creation and unemployment rates, ability to attract new business, and inflation and their effects on the Company or its customers;
- changes in the competitive environment for financial services organizations, including increased competition from tax-advantaged credit unions and out-of-market competitors offering financial services over the internet;
- the Company's ability to attract and retain key personnel;
- changes in technology, including demands for greater automation which could present operational issues or significant capital outlays;
- acts or threats of terrorism or war, and actions taken by the United States or other governments that might adversely affect business or economic conditions for the Company or its customers;
- adverse changes in the securities market which could adversely affect the value of the Company's stock;
- any actual or alleged conduct which could harm the Company's reputation;
- natural or other disasters which could affect the ability of the Company to operate under normal conditions;
- the Company's ability to retain and attract deposits;
- illegal acts of theft or fraud perpetuated against the bank or its customers;
- unanticipated lower revenues or increased cost of funds, loss of customers or business, or higher operating expenses;
- the failure of assumptions underlying the establishment of the allowance for loan losses and estimations of values of collateral and various financial assets and liabilities;
- the amount invested in new business opportunities and the timing of these investments;
- the failure of actuarial, investment, work force, salary, and other assumptions underlying the establishment of reserves for future pension costs or changes in legislative or regulatory requirements;
- future cash requirements might be higher than anticipated due to loan commitments or unused lines of credit being drawn upon or depositors withdrawing their funds;
- assumptions made regarding interest rate movement and sensitivity could vary substantially if actual experience differs from historical experience which could adversely affect the Company's results of operations; and
- the creditworthiness of current loan customers is different from management's understanding or changes dramatically and therefore the allowance for loan losses becomes inadequate.

When evaluating forward-looking statements to make decisions with respect to the Company, investors and others are cautioned to consider these and other risks and uncertainties and are reminded not to place undue reliance on such statements. Forward-looking statements speak only as of the date they are made and the Company undertakes no obligation to update them to reflect new or changed information or events, except as may be required by federal securities laws.

CRITICAL ACCOUNTING POLICIES

The Company has established various accounting policies which govern the

application of accounting principles generally accepted in the United States of America in the preparation of the Company's financial statements. Certain accounting policies involve significant judgments and assumptions by management which have a material impact on the reported amount of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes. The SEC has defined a company's critical accounting policies as the ones that are most important to the portrayal of the company's financial condition and results of operations, and which require the company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, the Company has identified the accounting policies and judgments most critical to the Company. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and assumptions made by management, actual results could differ from estimates and have a material impact on the carrying value of assets, liabilities, or the results of operations of the Company.

The Company believes the allowance for loan losses is a critical accounting policy that requires the most significant judgments and estimates used in the preparation of its consolidated financial statements. In estimating the allowance for loan losses, management utilizes historical experience as well as other factors including the effect of changes in the local real estate market on collateral values, the effect on the loan portfolio of current economic indicators and their probable impact on borrowers and changes in delinquent, nonperforming or impaired loans. Changes in these factors may cause management's estimate of the allowance for loan losses to increase or decrease and result in adjustments to the Company's provision for loan losses in future periods. For additional information see, FINANCIAL CONDITION - Allowance for Loan Losses below.

The Company's pension benefit obligations and net periodic benefit cost are actuarially determined based on the following assumptions: discount rate, estimated future return on plan assets, wage base rate, anticipated mortality rates, Consumer Price Index rate, rate of increase in compensation levels, anticipated service periods and retirement dates. The determination of the pension benefit obligations and net periodic benefit cost is a critical accounting estimate as it requires the use of estimates and judgment related to the amount and timing of expected future cash out flows for benefit payments and cash in flows for maturities and returns on plan assets. Changes in estimates and assumptions could have a material impact to the Company's financial condition or results of operations.

The Company also has other key accounting policies, which involve the use of estimates, judgments and assumptions that are significant to understanding the Company's results of operation and financial condition, including the valuation of deferred tax assets and of investment securities. Although management believes that its estimates, assumptions and judgments are reasonable, they are based upon information presently available. Actual results may differ significantly from these estimates under different assumptions, judgments or conditions.

OVERVIEW

The Company's net income was $1.42 million for the quarter ended September 30, 2007, compared with net income of $1.66 million for the same period in 2006, or a 14.4% decrease between years. The Company faced a challenging interest rate environment, and although total interest income increased by $200 thousand, or 3.1% in 2007 versus the third quarter of 2006, this increase was more than offset by an increase in interest expense of $304 thousand, or 16.7% between periods. The interest rate environment throughout 2006 and 2007 has proved

challenging. The prime rate was 7.25% as of December 31, 2005, and during 2006 rose twice in the first quarter and twice in the second quarter, by 25 basis points each time, to reach 8.25% at June 29, 2006, where it remained until September 18, 2007, when it dropped to 7.75%. This decline was in response to the Federal Reserve's 50 basis point drop in both the target federal funds rate and the discount rate. Toward the end of the second quarter of 2007, the yield curve had started to trend toward a positive bias with short term interest rates being lower than long term rates for the first time since August, 2006, but it moved back to flat and slightly inverted during

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the third quarter of 2007. During the third quarter of 2007, the Company's net interest margin decreased 29 basis points to 5.16%, from 5.45% for the third quarter of 2006, and decreased 22 basis points to 5.18% for the first nine months of 2007 compared to 5.40% for the same period last year. The Company's net interest spread declined 34 basis points to 4.58% for the third quarter of 2007, compared to 4.92% for the 2006 comparison period, and declined 33 basis points to 4.60% for the first nine months of 2007, compared to 4.93% for the same period last year. The decline in the net interest spread was primarily the result of average interest rates paid on time and money market deposits rising as traditional and non-traditional financial institutions and tax exempt credit unions in the Company's market compete aggressively for core deposit dollars, resulting in pricing pressures. Further drops in the prime rate and/or increases in competitors deposit rates could be problematic going forward as the individual instruments re-price.

The Company's total assets increased from $381.1 million at December 31, 2006, to $397.5 million at September 30, 2007, an increase of $16.4 million, or 4.3%. Deposits increased from $319.8 million at December 31, 2006 to $333.4 million at September 30, 2007, an increase of $13.6 million, or 4.3%. Total loans including loans held for sale decreased $2.0 million, or 0.6% from $317.6 million at December 31, 2006 to $315.6 million at September 30, 2007.

Noninterest income is up $90 thousand, or 9.1%, to $1.1 million for the third quarter of 2007 versus $1.0 million for 2006, due to increases in numerous categories, but was partially offset by lower gains on sales of loans held for sale. Noninterest expenses are up $151 thousand, or 4.4% for the third quarter of 2007 to $3.57 million from $3.42 million for the third quarter of 2006, primarily due to the costs to bring or maintain properties in other real estate owned.

The following unaudited per share information and key ratios depict several measurements of performance or financial condition for or at the three and nine months ended September 30, 2007 and 2006, respectively:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Return on average assets (ROA) (1)	1.46%	1.77%	1.45%	1.67%
Return on average equity (ROE) (1)	13.71%	15.83%	13.29%	14.93%
Net interest margin (1)(2)	5.16%	5.45%	5.18%	5.40%
Efficiency ratio (3)	62.01%	58.91%	64.15%	60.33%
Net interest spread (4)	4.58%	4.92%	4.60%	4.93%
Average loan to average deposit ratio	95.47%	102.85%	97.20%	100.88%

Net loan charge-offs (recoveries) to average loans not held for sale (1)	0.16%	(0.11%)	0.08%	(0.04%)
Allowance for loan losses to loans not held for sale	1.09%	1.05%	1.09%	1.05%
Non-performing assets to total assets	0.96%	1.22%	0.96%	1.22%
Equity to assets	10.55%	11.37%	10.55%	11.37%
Total capital to risk weighted assets	16.82%	17.54%	16.82%	17.54%
Book value per share	$9.29	$9.39	$9.29	$9.39
Earnings per share	$0.32	$0.37	$0.92	$1.03
Dividends paid per share	$0.28	$0.26	$0.84	$0.78
Dividend payout ratio (5)	87.50%	70.27%	91.30%	75.73%

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(1) Annualized
(2) The ratio of tax equivalent net interest income to average earning assets.
(3) The ratio of noninterest expense to net interest income plus noninterest income excluding securities gains and losses.
(4) The difference between the average rate earned on assets minus the average rate paid on liabilities.
(5) Cash dividends declared and paid per share divided by consolidated net income per share.

RESULTS OF OPERATIONS

Net Interest Income. The largest component of the Company's operating income is net interest income, which is the difference between interest and dividend income received from interest-earning assets and the interest expense paid on interest-bearing liabilities. The Company's net interest income decreased $104 thousand, or 2.2%, to $4.61 million for the three months ended September 30, 2007, from $4.72 million for the three months ended September 30, 2006. The net interest spread decreased 34 basis points to 4.58% for the three months ended September 30, 2007, from 4.92% for the three months ended September 30, 2006. As money market and time deposit "specials" abounded throughout the market place, interest rates paid to attract these deposits moved up more quickly than rates earned on loans and other earning assets. Also, the continuing inversion of the yield curve has contributed to the decrease as the majority of deposits are short term in nature compared to the longer duration of the majority of interest bearing assets. The net interest margin for the third quarter of 2007 decreased 29 basis points to 5.16% from the 2006 period at 5.45%. Another decrease in the prime rate would not necessarily be beneficial to the Company in the near term, see "OTHER FINANCIAL CONSIDERATIONS - Market Risk and Asset and Liability Management."

Yields Earned and Rates Paid. The following table shows, for the periods indicated, the total amount of income recorded from interest-earning assets and the related average yields, the interest expense associated with interest-bearing liabilities, the related average rates paid, and the relative net interest spread and net interest margin. Yield and rate information is calculated on an annualized tax equivalent basis. Yield and rate information for a period is average information for the period, and is calculated by dividing the annualized income or expense item for the period by the average balance of the appropriate balance sheet item during the period. Net interest margin is annualized tax equivalent net interest income divided by average interest-earning assets. Nonaccrual loans are included in asset balances for the appropriate periods, but recognition of interest on such loans is discontinued and any remaining accrued interest receivable is reversed in conformity with federal regulations.

	Three months ended September			
	2007			
	Average Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Balance
			(Dollars in thousands)	
Average Assets:				
Federal funds sold and overnight deposits	$ 10,261	$ 131	5.01%	$ 5,064
Interest bearing deposits in banks	10,521	128	4.82%	6,261
Investment securities (1), (2)	29,041	338	5.00%	22,949
Loans, net (1), (3)	311,071	6,115	7.89%	315,648
FHLB of Boston stock	1,385	22	6.34%	1,638
Total interest-earning assets (1)	362,279	6,734	7.48%	351,560
Cash and due from banks	10,468			10,555
Premises and equipment	6,179			6,070
Other assets	9,727			7,878
Total assets	$388,653			$376,063
Average Liabilities and Stockholders' Equity:				
NOW accounts	$ 56,034	$ 119	0.84%	$ 52,850
Savings/money market accounts	92,405	415	1.78%	99,872
Time deposits	126,931	1,407	4.40%	104,637
Borrowed funds	14,479	182	4.93%	22,668
Total interest bearing liabilities	289,849	2,123	2.90%	280,027
Noninterest bearing deposits	50,456			49,532
Other liabilities	6,874			4,507
Total liabilities	347,179			334,066
Stockholders' equity	41,474			41,997
Total liabilities and stockholders' equity	$388,653			$376,063
Net interest income		$4,611		
Net interest spread (1)			4.58%	
Net interest margin (1)			5.16%	

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(1) Average yields reported on a tax-equivalent basis.
(2) Average balances of investment securities are calculated on the amortized cost basis.

(3) Includes loans held for sale and is net of unearned income and allowance for loan losses.

	Nine months ended September			
	2007			
	Average Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Balance
	(Dollars in thousands)			
Average Assets:				
Federal funds sold and overnight deposits	$ 8,046	$ 312	5.10%	$ 2,952
Interest bearing deposits in banks	9,236	324	4.69%	7,157
Investment securities (1), (2)	26,948	931	4.94%	26,924
Loans, net (1), (3)	309,432	17,959	7.86%	310,815
FHLB of Boston stock	1,391	72	6.85%	1,508
Total interest earning assets (1)	355,053	19,598	7.49%	349,356
Cash and due from banks	10,280			10,229
Premises and equipment	6,122			6,100
Other assets	9,338			7,899
Total assets	$380,793			$373,584
Average Liabilities and Stockholders' Equity:				
NOW accounts	$ 53,100	$ 321	0.81%	$ 52,258
Savings/money market accounts	93,605	1,241	1.77%	103,734
Time deposits	123,161	4,044	4.39%	103,662
Borrowed funds	14,765	551	4.92%	19,529
Total interest bearing liabilities	284,631	6,157	2.89%	279,183
Non-interest bearing deposits	48,475			48,457
Other liabilities	6,115			4,252
Total liabilities	339,221			331,892
Stockholders' equity	41,572			41,692
Total liabilities and stockholders' equity	$380,793			$373,584
Net interest income		$13,441		
Net interest spread (1)			4.60%	
Net interest margin (1)			5.18%	

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(1) Average yields reported on a tax-equivalent basis.
(2) Average balances of investment securities are calculated on the amortized cost basis.
(3) Includes loans held for sale and is net of unearned income and allowance for loan losses.

Rate/Volume Analysis. The following tables describe the extent to which changes in interest rates and changes in volume of interest-earning assets and interest-bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. For each category of interest-earning assets and interest-bearing liabilities information is provided on changes attributable to:

- changes in volume (change in volume multiplied by prior rate);
- changes in rate (change in rate multiplied by prior volume); and
- total change in rate and volume.

Changes attributable to both rate and volume have been allocated proportionately to the change due to volume and the change due to rate.

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	Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006 Increase/(Decrease) Due to Change In		
	Volume	Rate	Net
	(Dollars in thousands)		
Interest earning assets:			
Federal funds sold and overnight deposits	$ 66	$ (2)	$ 64
Interest bearing deposits in banks	49	18	67
Investment securities	73	22	95
Loans, net	(86)	79	(7)
FHLB of Boston stock	(5)	(14)	(19)
Total interest earning assets	$ 97	$ 103	$ 200
Interest bearing liabilities:			
NOW accounts	$ 6	$ 19	$ 25
Savings/money market accounts	(32)	27	(5)
Time deposits	235	154	389
Borrowed funds	(104)	(1)	(105)
Total interest bearing liabilities	$ 105	$ 199	$ 304
Net change in net interest income	$ (8)	$ (96)	$(104)

	Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006 Increase/(Decrease) Due to Change In		
	Volume	Rate	Net
	(Dollars in thousands)		
Interest earning assets:			
Federal funds sold and overnight deposits	$ 198	$ 4	$ 202

Interest bearing deposits in banks	68	48	116
Investment securities	1	44	45
Loans, net	(81)	613	532
FHLB of Boston stock	(6)	4	(2)
Total interest earning assets	$ 180	$ 713	$ 893
Interest bearing liabilities:			
NOW accounts	$ 4	$ 50	$ 54
Savings/money market accounts	(127)	126	(1)
Time deposits	558	819	1,377
Borrowed funds	(176)	27	(149)
Total interest bearing liabilities	$ 259	$1,022	$1,281
Net change in net interest income	$ (79)	$ (309)	$ (388)

Three months Ended September 30, 2007, compared to Three months Ended September 30, 2006.

Interest and Dividend Income. The Company's interest and dividend income increased $200 thousand, or 3.1%, to $6.73 million for the three months ended September 30, 2007, from $6.53 million for the three months ended September 30, 2006, with average earning assets increasing $10.7 million, or 3.0%, to $362.3 million for the three months ended September 30, 2007, from $351.6 million for the three months ended September 30, 2006. The increase in interest income resulting from the rise in average earning assets was augmented by the higher rates earned on loans, investments, and interest bearing deposits in banks in 2007 versus 2006. Interest income increased during the third quarter of 2007 versus the 2006 comparison period despite a decline in average loan volume between periods. Average loans approximated $311.1 million at an average yield of 7.89% for the three months ended September 30, 2007, down $4.6 million from $315.6 million at an average yield of 7.80% for the three months ended

September 30, 2006, or a 1.4% decrease in average volume. The decrease in volume was partially offset by a 9 basis point increase in yield. Loan demand has slowed during 2007 especially for residential mortgages and construction loans.

The 50 basis point drop in the discount rate by the Federal Reserve in August of 2007, followed by a 50 basis point decrease in the target Federal Funds rate in September, precipitated a 50 basis point drop in the Prime rate which impacted variable rate loans with monthly repricing, while continued competition for deposits minimized reductions in deposit rates from this rate drop.

The average balance of investments (including mortgage-backed securities) increased $6.1 million or 26.6%, to $29.0 million for the three months ended September 30, 2007, from $22.9 million for the three months ended September 30, 2006. The average level of interest bearing deposits in banks for the quarter was $10.5 million up $4.3 million or 68.0% from the 2006 average level of $6.3 million, as FDIC insured certificates of deposit in other financial institutions was one of the highest yielding investment options available. The increase in the investment portfolio and interest bearing deposits in banks from the third quarter of 2006 reflects slower loan demand. The average level of federal funds sold and overnight deposits increased $5.2 million, to $10.3 million at 5.01% for the three months ended September 30, 2007, from $5.1 million at 5.16% for the three months ended September 30, 2006. The yield curve

through the majority of the quarter was flat or inverted with Federal Funds yielding as much or more than available investment options. Interest income from nonloan instruments increased $207 thousand or 50.2% between periods, with $619 thousand for the third quarter of 2007 and $412 thousand for the same period of 2006, reflecting the overall increases in yields on interest bearing deposits and investment securities and volume increases on all instruments except the Federal Home Loan Bank (FHLB) of Boston stock.

Interest Expense. The Company's interest expense increased $304 thousand, or 16.7%, to $2.12 million for the three months ended September 30, 2007, from $1.82 million for the three months ended September 30, 2006, of which $105 thousand was a result of the increase in volume while the remaining $199 thousand increase was due to rate increases fueled by strong competition for deposit dollars.

Interest expense on deposits increased $409 thousand or 26.7% to $1.94 million for the quarter ended, September 30, 2007, from $1.53 million for the quarter ended September 30, 2006. Competition for deposits has remained strong. Management believes consumers have become more rate sensitive over the last two years due to advertised "specials" and the proliferation of nonlocal financial institutions trying to gather deposits throughout the Company's market area reflecting this rate sensitivity. Average time deposits rose to $126.9 million for the three months ended September 30, 2007, from $104.6 million for the three months ended September 30, 2006, or an increase of $22.3 million or 21.3%. While the majority of these deposits are new funds for the Company, there has been movement of deposits from lower yielding savings and NOW accounts to higher paying certificates of deposit within its account base. The average rate paid on time deposits increased 54 basis points, to 4.40% from 3.86% for the three months ended September 30, 2007 and 2006, respectively. The average balances for money market and savings accounts decreased $7.5 million, or 7.5%, to $92.4 million for the three months ended September 30, 2007, from $99.9 million for the three months ended September 30, 2006 as the interest rates on time deposits continued to be higher which appeared to motivate customers to move funds into certificates of deposit and lock in the higher rates. A $3.2 million or 6.0% increase in NOW accounts brought the average balance up to $56.0 million from $52.9 million between the two years.

Interest expense on borrowed funds dropped from $287 thousand for the quarter ended September 30, 2006 to $182 thousand for the quarter ended September 30, 2007, as the average funds borrowed from the FHLB of Boston dropped from $22.2 million to $14.4 million between years. The softening of loan demand, the $18.0 million growth in deposits on average between the quarters ended September 30, 2006 and September 30, 2007, and the continuing yield curve shape led the Company to reduce its reliance on borrowed funds.

Provision for Loan Losses. There was an $190 thousand loan loss provision for the quarter ended September 30, 2007 and no provision for the quarter ended September 30, 2006. The provision was deemed necessary for the third quarter of 2007 as the net charge-offs for the quarter ended September 30, 2007 were $120 thousand and there had been an upward trend over the quarter in the dollar amount

of loans with higher risk characteristics. For further details see, FINANCIAL CONDITION -"Allowance for Loan Losses" below.

Noninterest income. The following table sets forth changes from the third quarter of 2006 to the third quarter of 2007 for components of noninterest income:

	For The Three Months Ended September 30,			
	2007	2006	$ Variance	% Variance
	(Dollars in thousands)			
Trust income	$ 94	$ 74	$ 20	27.0
Service fees	866	787	79	10.0
Net gains on sales of investment securities	30	5	25	500.0
Net gains on sales of loans held for sale	48	108	(60)	(55.6)
Other	45	19	26	136.8
Total noninterest income	$1,083	$993	$ 90	9.1

Trust income. The increase resulted primarily from increases in regular fee income, which is based on the market value of assets managed and the addition of new customers.

Service fees. The increase resulted primarily from increases in overdraft fees of $23 thousand, or 7.8%; merchant program income increase of $24 thousand, or 23.1%; foreign exchange fee increase of $15 thousand, or 271.2% as Canadian and British traffic to our market area has picked up substantially due to the weakened U.S. dollar, and ATM/Debit Card usage fees of $11 thousand, or 5.9%. These increases were partially offset by a decline in deposit service charges of $5.8 thousand, or 12.0%.

Net gains on sales of investment securities. The Company took advantage of an issuer's buyback offer during the third quarter of 2007 and sold a position in one equity investment resulting in a gain of $30 thousand.

Net gains on sales of loans held for sale. Residential real estate loans of $4.1 million were sold for a net gain of $48 thousand during the third quarter of 2007, versus sales of $2.8 million for a net gain of $31 thousand during the third quarter of 2006. There were no sales of commercial loans during the third quarter of 2007, compared to sales of $1.6 million of commercial real estate loans were sold for a net gain of $77 thousand.

Other. The increase between periods is primarily due to the increase in net mortgage servicing rights of $4 thousand from 2006 to 2007, a $16 thousand net gain on the sale of other real estate owned, and a $4 thousand gain from the purchase of Vermont State Tax credits.

Noninterest expense. The following table sets forth changes from the third quarter of 2006 to the third quarter of 2007 for components of noninterest expense:

	For The Three Months Ended September 30,			
	2007	2006	$ Variance	% Variance
	(Dollars in thousands)			
Salaries and wages	$1,565	$1,536	$ 29	1.9
Pension and employee benefits	541	541	-	-
Occupancy expense, net	186	184	2	1.1
Equipment expense	278	269	9	3.3
Equity in losses of affordable housing investments	66	66	-	-

Other	938	827	111	13.4
Total noninterest expense	$3,574	$3,423	$151	4.4

Salaries and wages and related expenses. The increase in 2007 over 2006 was due primarily to regular salary activity offset partially by increased efficiency in operations which allowed the Company to grow while reducing a few staff positions. A decrease in the accrual for pension plan expense of $23 thousand or 14.4% and a decrease of $5 thousand or 42.4% in the Company's dental insurance costs were offset by a $31 thousand or 16.2% increase in the Company's medical costs.

Equipment Expense. The increase between years is primarily due to the purchase of a Microsoft open license by the Company which will allow the Company to increase the number of personal computers on its network and to migrate to future software upgrades, partially offset by a decrease in depreciation expense.

Other. The net change between years has many components; the largest being an increase for the costs to bring or maintain properties in Other Real Estate Owned which accounts for $37 thousand or 33% of the increase. The expiration of state tax credits and the growth in deposits led to an increase in Vermont franchise taxes of $20 thousand. A $12 thousand increase from the $3 thousand 2006 invoice for the Company's share of the Vermont Banking Department's division expenses was an unexpected expense in the third quarter. An increase in Trust and Asset Management's expenses of $12 thousand for the quarter also added to the higher other expenses.

Income Tax Expense. The Company has provided for current and deferred federal income taxes for the current and all prior periods presented. The Company's provision for income taxes was $508 thousand for the three months ended September 30, 2007 compared to $623 thousand for the same period in 2006, reflecting the decrease in taxable net income and the reduction in nontaxable deductions between periods. The Company's effective tax rate decreased to 26.3% for the three months ended September 30, 2007, from 27.3% for the same period in 2006, reflecting the reduction in nontaxable deductions.

Nine Months Ended September 30, 2007, compared to Nine Months Ended September 30, 2006.

Interest and Dividend Income. The Company's interest and dividend income increased $893 thousand, or 4.8% to $19.60 million for the nine months ended September 30, 2007, from $18.70 million for the nine months ended September 30, 2006, with average earning assets increasing $5.7 million, or 1.6%, to $355.1 million for the nine months ended September 30, 2007, from $349.4 million for the nine months ended September 30, 2006. The increase in interest income resulting from the rise in average earning assets was augmented by the higher rates earned on all categories of earning assets in 2007 versus 2006. Average loans approximated $309.4 million at an average yield of 7.86% for the nine months ended September 30, 2007, down $1.4 million or 0.5% from $310.8 million at an average yield of 7.59% for the nine months ended September 30, 2006. The slowing of loan demand especially for residential construction and mortgage loans, is now being felt in the Northeast sector of the United States. This is the main reason for the slight decrease in volume but there was a 27 basis point increase in yield.

The average balance of investments (including mortgage-backed securities) was $26.9 million for the nine months ended September 30, 2007 and 2006. The

average level of federal funds sold and overnight deposits increased $5.1 million to $8.0 million for the nine months ended September 30, 2007, from $2.9 million for the nine months ended September 30, 2006 as the yield curve was inverted for the majority of the first nine months of 2007, making short term funds an attractive investment vehicle. The average level of interest bearing deposits in banks for the first nine months of 2007 was $9.2 million, up $2.1 million, or 29.0% from the 2006 average level of $7.2 million. Interest income from non-loan instruments was $1.64 million year to date for 2007 and $1.28 million for the same period of 2006, reflecting the overall increases in yields and volume.

Interest Expense. The Company's interest expense increased $1.28 million, or 26.3%, to $6.16 million for the nine months ended September 30, 2007, from $4.88 million for the nine months ended September 30, 2006, of which $259 thousand was a result of the increase in volume and $1.02 million was due to increases in rates, fueled by competition for funds from both local and out-of-market competitors. This competition has been most evident for the money market and certificate of deposit accounts, but higher paying interest-bearing checking accounts are appearing in our market as well which puts more pressure

on the historical demand deposit and NOW account balances. Average interest-bearing liabilities increased $5.4 million, or 2.0%, to $284.6 million for the nine months ended September 30, 2007, from $279.2 million for the nine months ended September 30, 2006, and the average rate paid increased 56 basis points to 2.89%, from 2.33% for the nine months ended September 30, 2007 and 2006, respectively. Average time deposits were $123.2 million for the nine months ended September 30, 2007, and $103.7 million for the nine months ended September 30, 2006, or an increase of $19.5 million, or 18.8%. The average rate paid on time deposits increased 95 basis points, to 4.39% from 3.44% for the nine months ended September 30, 2007 and 2006, respectively. The average balances for money market and savings accounts decreased $10.1 million, or 9.8%, to $93.6 million for the nine months ended September 30, 2007, from $103.7 million for the nine months ended September 30, 2006. NOW accounts grew modestly with the average balance of $53.1 million for 2007 compared to $52.3 million for 2006.

The average balance of funds borrowed decreased $4.8 million or 24.4% from $19.5 million for the nine months ended September 30, 2006, to $14.8 million for the nine months ended September 30, 2007, while the average rate paid on those funds rose from 4.73% to 4.92% between years. The reduction in borrowings were funded from the increase in customer deposits between years and reflected slowing loan demand.

Provision for Loan Losses. The loan loss provision year to date as of September 30, 2007 was $235 thousand compared to $150 thousand for the same period in 2006. Net chargeoffs for 2007 year to date were $177 thousand compared to net recoveries in 2006 of $103 thousand. While the composition of the loans within the portfolio has remained fairly constant; the third quarter 2007 provision reflects the net chargeoff activity and the upward trend of loans with higher risk characteristics. The net change resulted in the continuing improvement in both the ratios of allowance for loan losses to loans not held for sale and of allowance for loan losses to nonperforming loans. For further details see, FINANCIAL CONDITION - "Allowance for Loan Losses" below.

Noninterest income. The following table sets forth changes from year to date 2006 to year to date 2007 for components of noninterest income:

	For The Nine Months Ended September 30,			
	2007	2006	$ Variance	% Variance
	(Dollars in thousands)			
Trust income	$ 261	$ 219	$ 42	19.2
Service fees	2,516	2,280	236	10.4
Net gains on sales of investment securities	67	22	45	204.5
Net gains on sales of loans held for sale	98	227	(129)	(56.8)
Other	211	194	17	8.8
Total noninterest income	$3,153	$2,942	$ 211	7.2

Trust income. The increase resulted from increases in regular fee income, which is based on the market value of assets managed and the addition of new customers.

Service fees. The increase resulted primarily from increases in overdraft fees of $92 thousand, or 10.9%; increase in loan servicing fee income of $18 thousand, or 7.1%; increase in merchant services income of $53 thousand, or 18.7%; foreign exchange fee increase of $32 thousand, or 181.5%; as Canadian and British traffic to our market area has picked up substantially due to the weakened US dollar, and ATM/Debit Card usage fees of $44 thousand, or 8.7%. These increases were partially offset by a decline in deposit service charges of $21 thousand, or 12.6%, which resulted from the introduction, during the first and second quarters of 2006, of a group of retail deposit products that generally are not charged monthly service fees.

Net gains on sales of loans held for sale. Residential real estate loans of $13.3 million were sold for a net gain of $98 thousand during the first nine months of 2007, compared to sales of $15.2 million with a net gain of $227 thousand during the first nine months of 2006. There were no sales of Commercial loans during the first nine months of 2007, compared to sales of $1.6 million during the first nine months of 2006, resulting in a gain of $76 thousand. As the yield curve moved from inverted to flat to slightly positive

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and then back to inverted during the first nine months of 2007, premiums paid on loans sold declined.

Other. The increase mainly resulted from a net gain of $46 thousand on the sale of other real estate owned partially offset by a $22 thousand decrease in mortgage servicing rights between years and a $7 thousand reduction in net gains on disposals of premises and equipment.

Noninterest expense. The following table sets forth changes from year to date 2006 to year to date 2007 for components of noninterest expense:

	For The Nine Months Ended September 30,			
	2007	2006	$ Variance	% Variance
	(Dollars in thousands)			
Salaries and wages	$ 4,692	$ 4,541	$151	3.3
Pension and employee benefits	1,721	1,670	51	3.1
Occupancy expense, net	620	585	35	6.0

Equipment expense	821	786	35	4.5
Equity in losses of affordable housing investments	199	231	(32)	(13.9)
Other	2,742	2,458	284	11.5
Total noninterest expense	$10,795	$10,271	$524	5.1

Salaries and wages and related expenses. The increase in 2007 over 2006 was due primarily to regular salary activity. Increases in the Company's medical insurance costs of $112 thousand or 19.2% during the first nine months of 2007 was the main factor in the increase in pension and employee benefits. This increase was partially offset by a $69 thousand or 14.4% drop in pension expense due to rising long term interest rates and the performance of the market.

Occupancy Expense. The increase for 2007 over 2006 was due primarily to the increased square footage of the organization with the addition of the Littleton, New Hampshire branch opened in March of 2006 and the purchase of an additional office building in Morrisville, Vermont in December 2006. The increased costs of fuel throughout the offices also contributed to the increase.

Equipment Expense. The increase between years is primarily due to the purchase of a Microsoft open license by the Company which will allow us to increase the number of personal computers on our network and to migrate to future software upgrades. This increase was partially offset by a $23 thousand or 5.2% decrease in depreciation expense.

Amortization of investments in affordable housing projects. The expense for 2006 was higher than the current year as it included a $32 thousand adjustment related to new partnerships investments for 2005 that was not known until the partnership's 2005 financial statements were received in April of 2006.

Other. The increase between years is primarily due to the costs to bring or maintain properties in other real estate owned which is $123 thousand higher in 2007 or $151 thousand in total. Other expenses also rose due to increases in ATM/debit card expenses of $26 thousand, contributions of $17 thousand, directors fees of $8 thousand, legal fees of $29 thousand, trust department expenses of $50 thousand, bad checks and charged off accounts of $16 thousand and Vermont franchise taxes of $57 thousand due to the expiration of state tax credits and growth in deposits. These increases are somewhat offset by the reduction in other costs of employment of $15 thousand, training of $19 thousand and checkbook expenses of $15 thousand as well as the nonrecurrence of the one time robbery loss in June of 2006.

Income Tax Expense. The Company has provided for current and deferred federal income taxes for the current and all prior periods presented. The Company's provision for income taxes decreased $260 thousand, or 15.5%, to $1.42 million for the nine months ended September 30, 2007, from $1.68 million for the same period in 2006, reflecting a decrease in net income compared to the 2006 period and an increase in nontaxable municipal income between periods. The Company's effective tax rate decreased to 25.5% for the nine months ended September 30, 2007, from 26.5% for the same period in 2006.

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FINANCIAL CONDITION

At September 30, 2007 the Company had total consolidated assets of $397.5 million, including gross loans and loans held for sale ("total loans") of

$315.6 million, deposits of $333.4 million and stockholders' equity of $41.9 million. The Company's total assets increased $16.3 million or 4.3% to $397.5 million at September 30, 2007, from $381.1 million at December 31, 2006. Net loans and loans held for sale were $312.1 million, or 78.5% of total assets at September 30, 2007, as compared to $314.1 million, or 82.4% of total assets at December 31, 2006.

Cash and cash equivalents, including federal funds sold and overnight deposits, increased $255 thousand, or 1.2%, to $21.2 million at September 30, 2007, from $21.0 million at December 31, 2006. Interest bearing deposits in banks increased $5.2 million or 96.3% from $5.4 million at December 31, 2006 to $10.6 million at September 30, 2007 as these FDIC insured deposits were one of the most attractive investment alternatives during the first nine months of 2007.

Investment securities available-for-sale increased from $23.7 million at December 31, 2006, to $34.3 million at September 30, 2007, a $10.6 million, or 44.7%, increase. As loan demand was not as strong during the first nine months of 2007, the opportunity was taken to rebuild the investment portfolio to a more normal level. The securities available-for-sale and interest bearing deposits in banks increased from 7.6% of total assets at December 31, 2006 to 11.3% at September 30, 2007.

Deposits increased $13.6 million, or 4.3%, to $333.4 million at September 30, 2007, from $319.8 million at December 31, 2006. Noninterest bearing deposits stayed stable at $54.9 million at December 31, 2006 and September 30, 2007, while interest bearing deposits increased $13.6 million, or 5.1%, from $264.9 million at December 31, 2006, to $278.5 million at September 30, 2007. (See average balances and rates in the Yields Earned and Rates Paid tables on Page 15 and 16.) With the rise in interest rates being paid on deposits of all types over the past two years and aggressive rate competition from in-market and out-of-market financial institutions, noninterest bearing deposit accounts are harder to attract and retain.

Total borrowings remained level at $14.6 million at September 30, 2007, and at December 31, 2006.

Total stockholders' equity remained level at $41.9 million at December 31, 2006 and September 30, 2007, reflecting net income of $4.1 million for the first nine months of 2007, less the regular cash dividends paid of $3.8 million, the purchase of Treasury stock totaling $375 thousand, and a decrease of $26 thousand in accumulated other comprehensive loss. (See Capital Resources section on Page 35)

Loans Held for Sale and Loan Portfolios. The Company's total loans primarily consist of adjustable-rate and fixed-rate mortgage loans secured by one-to-four family, multi-family residential or commercial real estate. As of September 30, 2007, the Company's total loan portfolio was $315.6 million, or 79.4% of assets, down from $317.6 million, or 83.3% of assets as of December 31, 2006, and from $318.0 million or 84.8% of assets as of September 30, 2006. Total loans (including loans held for sale) have decreased $2.0 million since December 31, 2006. Average net loans (including loans held for sale) were $310.8 million for the 2006 comparison period and have decreased to $309.4 million for the first nine months of 2007. The Company sold $13.3 million of loans held for sale during the first nine months of 2007 resulting in a gain on sale of loans of $98 thousand, compared with loan sales of $15.2 million and related gain on sale of loans of $227 thousand for the first nine months of 2006. The Company recognizes that competition for good loans is strong and has placed continued emphasis on calling on both current and prospective customers while maintaining credit quality.

The following table shows information on the composition of the Company's total loan portfolio as of September 30, 2007 and December 31, 2006:

Loan Type	September 30, 2007		December 31, 2006	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Residential real estate	$110,852	35.1	$114,139	35.9
Construction real estate	21,137	6.7	22,568	7.1
Commercial real estate	134,546	42.7	130,848	41.2
Commercial	16,734	5.3	19,253	6.1
Consumer	7,264	2.3	7,717	2.4
Municipal loans	16,835	5.3	19,297	6.1
Term Federal Funds Sold	4,000	1.3	-	-
Loans Held for Sale	4,220	1.3	3,750	1.2
Total loans	315,588	100.0	317,572	100.0
Deduct:				
Allowance for loan losses	3,396		3,338	
Unearned net loan fees	105		120	
Net loans and loans held for sale	$312,087		$314,114	

The Company originates and sells some residential mortgages into the secondary market, with most such sales made to the Federal Home Loan Mortgage Corporation (FHLMC/"Freddie Mac") and the Vermont Housing Finance Agency (VHFA). At September 30, 2007, the Company serviced a $201.3 million residential real estate mortgage portfolio, approximately $90.5 million of which was serviced for unaffiliated third parties. Additionally, the Company originates commercial real estate and commercial loans under various SBA, U.S. Development Authority and Vermont Economic Development Authority programs which provide an agency guarantee for a portion of the loan amount. The Company occasionally sells the guaranteed portion of the loan to other financial concerns and will retain servicing rights, which generates fee income. The Company serviced $6.1 million of commercial and commercial real estate loans for unaffiliated third parties as of September 30, 2007. The Company capitalizes servicing rights on these fees and recognizes gains and losses on the sale of the principal portion of these loans as they occur. The unamortized balance of servicing rights on loans sold with servicing retained was $310 thousand at September 30, 2007, with an estimated market value in excess of their carrying value.

In the ordinary course of business, the Company occasionally participates out, on a non-recourse basis, a portion of commercial or real estate loans to other financial institutions for liquidity or credit concentration management purposes. The total of loans participated out as of September 30, 2007 was $10.5 million.

Asset Quality. The Company, like all financial institutions, is exposed to certain credit risks including those related to the value of the collateral that secures its loans and the ability of borrowers to repay their loans. Management closely monitors the Company's loan and investment portfolios and other real estate owned for potential problems and reports to the Company's and the subsidiary's Boards of Directors at regularly scheduled meetings.

The Company's loan review procedures include a credit quality assurance process that begins with approval of lending policies and underwriting guidelines by the Board of Directors and includes a loan review department supervised by an experienced, former regulatory examiner, conservative individual lending limits

for officers, Board approval for large credit relationships and a quality control process for loan documentation that includes post-closing reviews. The Company also maintains a monitoring process for credit extensions. The Company performs periodic concentration analyses based on various factors such as industries, collateral types, large credit sizes, and officer portfolio loads. The Company has established underwriting guidelines to be followed by its officers, and exceptions are required to be approved by a senior loan officer or the Board of Directors. The Company monitors its delinquency levels for any negative or adverse trends. There can be no assurance, however, that the Company's loan

portfolio will not become subject to increasing pressures from deteriorating borrower credit due to general or local economic conditions.

Restructured loans include the Company's troubled debt restructurings that involved forgiving a portion of interest or principal on any loans, refinancing loans at a rate materially less than the market rate, rescheduling loan payments, or granting other concessions to a borrower due to financial or economic reasons related to the debtor's financial difficulties. Restructured loans do not include qualifying restructured loans that have complied with the terms of their restructure agreement for a satisfactory period of time. Restructured loans in compliance with modified terms totaled $214 thousand at September 30, 2007 and $1.3 million at December 31, 2006. At September 30, 2007 the Company was not committed to lend any additional funds to borrowers whose terms have been restructured.

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Loans are designated as nonaccrual when reasonable doubt exists as to the full collection of interest and principal. Normally, when a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of interest and principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

The Company had loans in nonaccrual status totaling $2.3 million, or 0.74% of gross loans at September 30, 2007, $2.5 million, or 0.80%, at December 31, 2006, and $1.7 million, or 0.55%, at September 30, 2006. Certain loans in non-accrual status are covered by guarantees of U.S. Government or state agencies. Approximately $316 thousand of the balances in this category were covered by such guarantees at September 30, 2007. The aggregate interest income not recognized on such nonaccrual loans amounted to approximately $438 thousand and $327 thousand as of September 30, 2007 and 2006, respectively and $371 thousand as of December 31, 2006.

The Company had $1.1 million in loans past due 90 days or more and still accruing at September 30, 2007 and $2.2 million at December 31, 2006. The decrease between periods was mainly due to the improvement in the number of days past due of several loans under $200 thousand each. Certain loans past due 90 days or more and still accruing interest are covered by guarantees of U.S. Government or state agencies. Approximately $144 thousand of the balances in this category were covered by such guarantees at September 30, 2007.

At September 30, 2007, and December 31, 2006, respectively, the Company had internally classified certain loans totaling $48 thousand and $319 thousand, respectively. In management's view, such loans represent a higher degree of risk and could become nonperforming loans in the future. While still on a

performing status, in accordance with the Company's credit policy, loans are internally classified when a review indicates one or more of the following conditions makes the likelihood of collection uncertain:

- the financial condition of the borrower is unsatisfactory;
- repayment terms have not been met;
- the borrower has sustained losses that are sizable, either in absolute terms or relative to net worth;
- confidence is diminished;
- loan covenants have been violated;
- collateral is inadequate; or
- other unfavorable factors are present.

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On occasion real estate properties are acquired through or in lieu of loan foreclosure. These properties are to be sold and are initially recorded at the lesser of the recorded loan or fair value via an appraisal for more significant properties and an evaluation for minor properties at the date of acquisition establishing a new carrying basis. The Company had $237 thousand in residential real estate and $212 thousand of commercial real estate property classified as OREO at September 30, 2007 compared to $3 thousand of land, $98 thousand of residential real estate and $298 thousand of commercial real estate property at December 31, 2006. The other real estate owned was included in Other Assets on the Consolidated Balance Sheet at both time periods.

Allowance for Loan Losses. Some of the Company's loan customers ultimately do not make all of their contractually scheduled payments, requiring the Company to charge off a portion or all of the remaining principal balance due. The Company maintains an allowance for loan losses to absorb such losses. The allowance is maintained at a level which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio; however, actual loan losses may vary from current estimates.

Adequacy of the allowance for loan losses is determined using a consistent, systematic methodology, which analyzes the risk inherent in the loan portfolio. In addition to evaluating the collectibility of specific loans when determining the adequacy of the allowance, management also takes into consideration other factors such as changes in the mix and size of the loan portfolio, historic loss experience, the amount of delinquencies and loans adversely classified, industry trends, and the impact of the local and regional economy on the Company's borrowers. The adequacy of the allowance for loan losses is assessed by an allocation process whereby specific loss allocations are made against certain adversely classified loans and general loss allocations are made against segments of the loan portfolio which have similar attributes. While for internal analytical purposes the Company allocates the allowance for loan losses based on a percentage by category, the portion of the allowance for loan losses allocated to each category does not represent the total available for future losses which may occur within the loan category since the total allowance for possible loan losses is a valuation reserve available to cover losses in the entire portfolio.

The allowance for loan losses is increased by a provision for loan losses, which is charged to earnings, and reduced by charge-offs, net of recoveries. The provision for loan losses represents the current period credit cost associated with maintaining an appropriate allowance for loan losses. Based on an evaluation of the loan portfolio, management presents a quarterly analysis of the allowance for loan losses to the Board of Directors, indicating any changes since the last review and any recommendations as to adjustments. Additionally, various regulatory agencies periodically review the Company's allowance for loan losses as an integral part of their examination process.

For the quarter ended September 30, 2007, the methodology used to determine the provision for loan losses was unchanged from the prior quarter or year. The Company's loan portfolio balance decreased $2.5 million, or 0.8% from December 31, 2006. There was a reduction in the balance of all loan types except commercial real estate and term federal funds sold between December 31, 2006 and September 30, 2007. In considering the adequacy of the allowance for loan losses and establishing the amount of the provision, the overall reduction in the loan portfolio was more than offset by an upward trend over the last few months in the dollar amount of loans with higher risk characteristics resulting in an increase in the estimated allowance for loan losses. As a result of the combined changes and the net charge-offs for the third quarter of $120 thousand, the Company designated $190 thousand loan loss provision for the quarter ended September 30, 2007 which left the allowance for loan losses at $3.4 million at September 30, 2007. With the third quarter provision for loan losses, there was an improvement in the ratio of allowance for loan losses to nonperforming loans from 70.3% at December 31, 2006 to 101.1% at September 30, 2007. The charge-offs for the quarter were primarily on two loan relationships for which the collateral has been moved to Other Real Estate Owned and Other Assets Owned and plans to dispose of the assets are in process. There were no material changes in the lending programs or terms during the quarter.

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The following table reflects activity in the allowance for loan losses for the three and nine months ended September 30, 2007 and 2006:

	Three Months Ended, September 30,		Nine Months Ended, Septemb	
	2007	2006	2007	2006
	(Dollars in thousands)			
Balance at beginning of period	$3,326	$3,235	$3,338	$3,071
Charge-offs				
Real Estate	69	-	99	-
Commercial	48	3	48	3
Consumer and other	9	11	63	46
Total charge-offs	126	14	210	49
Recoveries				
Real Estate	1	1	9	25
Commercial	-	1	2	13
Consumer and other	5	101	22	114
Total recoveries	6	103	33	152
Net (charge-offs) recoveries	(120)	89	(177)	10
Provision for loan losses	190	-	235	150
Balance at end of period	$3,396	$3,324	$3,396	$3,324

The following table shows the internal breakdown of the Company's allowance for loan losses by category of loan (net of loans held for sale) and the percentage of loans in each category to total loans in the respective portfolios at the

dates indicated:

	September 30, 2007		December 31, 2006	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Real Estate				
Residential	$ 714	34.3	$ 640	34.8
Commercial	2,031	43.2	1,901	41.7
Construction	211	6.8	296	7.2
Other Loans				
Commercial	283	5.4	312	6.1
Consumer installment	114	2.3	125	2.5
Municipal, Other and Unallocated	43	8.0	64	7.7
Total	$3,396	100.0	$3,338	100.0
Ratio of Net Charge Offs (Recoveries) to Average Loans not held for sale (1)		0.08		(0.03)
Ratio of Allowance for Loan Losses to Loans not held for sale		1.09		1.06
Ratio of Allowance for Loan Losses to nonperforming loans (2)		101.1		70.26

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(1) Annualized

(2) Non-performing loans include loans in non-accrual status and loans past due 90 days or more and still accruing.

Not withstanding the categories shown in the table above, all funds in the allowance for loan losses are available to absorb loan losses in the portfolio, regardless of loan category.

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Management of the Company believes that the allowance for loan losses at September 30, 2007, was appropriate to cover losses inherent in the Company's loan portfolio as of such date. There can be no assurance that the Company will not sustain losses in future periods, which could be greater than the size of the allowance for loan losses at September 30, 2007. See CRITICAL ACCOUNTING POLICIES. While the Company recognizes that an economic slowdown may adversely impact its borrowers' financial performance and ultimately their ability to repay their loans, management continues to be cautiously optimistic about the key credit indicators from the Company's loan portfolio.

Investment Activities. At September 30, 2007, the reported value of investment securities available-for-sale was $34.3 million or 8.6% of assets. The amount in investment securities available-for-sale increased from $23.7 million, or 6.2% of assets at December 31, 2006, as the Company rebuilt the investment portfolio in light of decreased loan demand.

The Company had no securities classified as held-to-maturity or trading. The reported value of investment securities available-for-sale at September 30,

2007 reflects a negative valuation adjustment of $214 thousand. The offset of this adjustment, net of income tax effect, was a $141 thousand loss reflected in the Company's accumulated other comprehensive loss component of stockholders' equity at September 30, 2007.

At September 30, 2007, thirty-seven securities with a fair value of $13.5 million or 39.3% of the portfolio have been in an unrealized loss position for more than twelve months totaling $254 thousand. These unrealized losses are mainly attributed to the interest rate environment. Of the twenty-eight bonds in the corporate bond portfolio, twelve of the bonds are in the financial services arena with four of the bond issuers identified with problems in the "so-called" sub-prime mortgage market. Only two of the bonds have been in a loss position for more than twelve months. While we have concluded, due to actions taken by the issuer's management and the improvement in the fair market value of these bonds in September, that they are not other than temporarily impaired, we are monitoring them closely. The Company has the ability to hold all of these securities, classified as available-for-sale, for the foreseeable future. Management deems the unrealized losses on the Company's securities not to be other than temporary.

At December 31, 2006, the Company had thirty-eight debt securities with a fair value of $15.0 million with an unrealized loss of $400 thousand, or 63.3% of the value of the amortized cost of the entire investment portfolio, that had existed for more than 12 months.

Deposits. The following table shows information concerning the Company's average deposits by account type and weighted average nominal rates at which interest was paid on such deposits for the periods ended September 30, 2007, and December 31, 2006:

	Nine Months Ended September 30, 2007			Year Ended December 31, 200		
	Average Amount	Percent of Total Deposits	Average Rate	Average Amount	Percent of Total Deposits	Avera Rat
	(Dollars in thousands)					
Non-time deposits:						
Demand deposits	$ 48,475	15.2	-	$ 49,328	15.9	-
NOW accounts	53,100	16.7	0.81%	52,937	17.1	0.74
Money Market accounts	51,492	16.2	2.72%	56,286	18.1	2.48
Savings accounts	42,113	13.2	0.61%	46,061	14.8	0.60
Total non-time deposits	195,180	61.3	1.07%	204,612	65.9	1.01
Time deposits:						
Less than $100,000	77,521	24.4	4.08%	66,982	21.6	3.34
$100,000 and over	45,640	14.3	4.91%	38,706	12.5	4.14
Total time deposits	123,161	38.7	4.39%	105,688	34.1	3.64
Total deposits	$318,341	100.0	2.35%	$310,300	100.0	1.90

The Company's customers have been opening certificates of deposit to take

advantage of increasing time deposit rates as evidenced by the $6.9 million, or 17.9% increase in average time deposits of $100,000 and over and the $10.5 million, or 15.7% increase in time deposits less than $100,000 in 2007 year to date versus 2006.

As a participant in the Certificate of Deposit Account Registry Service (CDARS) of Promontory Interfinancial Network, LLC, there were $6.7 million of time deposits less than $100,000 on the balance sheet at September 30, 2007 which are considered to be "brokered" deposits. The deposits are matched dollar for dollar with Union's customer deposits which have been placed in other financial institutions in order to provide those customers with full FDIC insurance coverage.

The following table sets forth information regarding the Company's time deposits in amounts of $100,000 and over at September 30, 2007, and December 31, 2006, that mature during the periods indicated:

	September 30, 2007	December 31, 2006
	(Dollars in thousands)	
Within 3 months	$17,119	$13,466
3 to 6 months	7,926	17,254
6 to 12 months	19,078	11,299
Over 12 months	2,379	2,219
	$46,502	$44,238

Borrowings. Borrowings from the FHLB were $14.6 million at September 30, 2007, at a weighted average rate of 4.93%, and $14.6 million at December 31, 2006, at a weighted average rate of 4.82%.

OTHER FINANCIAL CONSIDERATIONS

Market Risk and Asset and Liability Management. Market risk is the potential of loss in a financial instrument arising from adverse changes in market prices, interest rates, foreign currency exchange rates, commodity prices, and equity prices. The Company's market risk arises primarily from interest rate risk inherent in its lending, investing, deposit taking and borrowing activities as yields on assets change in a different time period or in a different amount from that of interest costs on liabilities. Many other factors also affect the Company's exposure to changes in interest rates, such as general and local economic and financial conditions, competitive pressures, customer preferences, and historical pricing relationships.

The earnings of the Company and its subsidiary are affected not only by general economic conditions, but also by the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve System. The monetary policies of the Federal Reserve System influence to a significant extent the overall growth of loans, investments, deposits and borrowings; the level of interest rates earned on assets and paid for liabilities including interest rates charged on loans and paid on deposits. The nature and impact of future changes in monetary policies are often not predictable.

A key element in the process of managing market risk involves direct involvement by senior management and oversight by the Board of Directors as to the level of risk assumed by the Company in its balance sheet. The Board of Directors reviews and approves risk management policies, including risk limits and guidelines and reviews quarterly the current position in relationship to those limits and guidelines. Daily oversight functions are delegated to the Asset Liability Management Committee ("ALCO"). The ALCO, consisting of senior

business and finance officers, actively measures, monitors, controls and manages the interest rate risk exposure that can significantly impact the Company's financial position and operating results. The ALCO sets liquidity targets based on the Company's financial position and existing and projected economic and market conditions. The Company does not have any market risk sensitive instruments acquired for trading purposes. The Company attempts to structure its balance sheet to maximize net interest income and shareholder value while controlling its exposure to interest rate risk and strategies might include selling or participating out loans held for sale or investments available-for-sale. The ALCO formulates strategies to manage interest rate risk by evaluating the impact on earnings and capital of such factors as current interest rate forecasts and economic indicators, potential changes in such forecasts and indicators, liquidity, and various business strategies. The ALCO's methods for

evaluating interest rate risk include an analysis of the Company's interest rate sensitivity "gap", which provides a static analysis of the maturity and repricing characteristics of the Company's entire balance sheet, and a simulation analysis, which calculates projected net interest income based on alternative balance sheet and interest rate scenarios, including "rate shock" scenarios involving immediate substantial increases or decreases in market rates of interest.

Members of ALCO meet informally at least weekly to set loan and deposit rates, make investment decisions, monitor liquidity and evaluate the loan demand pipeline. Deposit runoff is monitored daily and loan prepayments evaluated monthly. The Company historically has maintained a substantial portion of its loan portfolio on a variable-rate basis and plans to continue this Asset/Liability Management (ALM) strategy in the future. Portions of the variable-rate loan portfolio have interest rate floors and caps which are taken into account by the Company's ALM modeling software to predict interest rate sensitivity, including prepayment risk. As of September 30, 2007, the investment portfolio was all classified as available-for-sale and the modified duration was relatively short. The Company does not utilize any derivative products or invest in any "high risk" instruments.

The Company's interest rate sensitivity analysis (simulation) as of December 2006 for a flat rate environment (Prime at December 31, 2006 was 8.25% and dropped to 7.75% on September 18, 2007) projected the following for the nine months ended September 30, 2007, compared to the actual results:

	September 30, 2007		
	Projected	Actual	Percentage Difference
	(Dollars in thousands)		
Net Interest Income	$13,236	$13,441	1.55%
Net Income	$3,994	$4,143	3.73%
Return on Assets	1.43%	1.45%	1.40%
Return on Equity	12.80%	13.29%	3.83%

Actual net income is higher than projected mainly due to the higher actual net interest income than projected, and the gain on sales of securities and other real estate owned that had not been projected partially offset by the higher actual loan loss provision and other real estate owned expenses.

Commitments, Contingent Liabilities, and Off-Balance Sheet Arrangements. The Company is a party to financial instruments with off-balance-sheet risk in the

normal course of business to meet the financing needs of its customers, to reduce its own exposure to fluctuations in interest rates, and to implement its strategic objectives. These financial instruments include commitments to extend credit, standby letters of credit, interest rate caps and floors written on adjustable-rate loans, commitments to participate in or sell loans, and commitments to buy or sell securities, certificates of deposit or other investment instruments. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet. The contract or notional amounts of these instruments reflect the extent of involvement the Company has in a particular class of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Company uses the same credit and investment policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. For interest rate caps and floors written on adjustable-rate loans, the contract or notional amounts do not represent management's estimate of the actual exposure to credit loss. The Company controls the risk of interest rate cap agreements through credit approvals, limits, and monitoring procedures.

The Company generally requires collateral or other security to support financial instruments with credit risk. As of September 30, 2007 and December 31, 2006, the contract or notional amount of financial instruments that represent credit risk was as follows:

	September 30, 2007	December 31, 2006
	(Dollars in thousands)	
Commitments to originate loans	$10,379	$12,176
Commitments to purchase investment securities	1,657	-
Unused lines of credit	37,688	36,574
Standby letters of credit	963	1,046
Credit Card arrangements	1,515	1,457
Equity investment commitment to housing limited partnership	-	917
Total	$52,202	$52,170

Commitments to originate loans are agreements to lend to a customer as long as 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 loan commitments are expected to expire without being drawn upon and not all credit lines will be utilized, the total commitment amounts do not necessarily represent future cash requirements.

The Company's significant fixed and determinable contractual obligations to third parties at September 30, 2007, and December 31, 2006, were as follows:

	September 30, 2007	December 31, 2006
	(Dollars in thousands)	
Operating lease commitments	$ 328	$ 316

Maturities on borrowed funds	14,618	14,596
Deposits without stated maturity (1)	206,233	202,997
Certificates of deposit (1)	127,189	116,825
Pension plan contributions (2)	581	700
Deferred compensation payouts (3)	489	551
Equity in housing limited partnerships	1,397	356
Real estate and construction contracts (4)	395	28
Total	$351,230	$336,369

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(1) While Union has a contractual obligation to depositors should they wish to withdraw all or some of the funds on deposit, management believes, based on historical analysis, that the majority of these deposits will remain on deposit for the foreseeable future. The amounts exclude interest accrued.

(2) Funding requirements for pension benefits after 2007 are excluded due to the significant variability in the assumptions required to project the amount and timing of future cash contributions.

(3) The Company owns life insurance on the lives of the payees, in an amount estimated by management to be sufficient to reimburse the Company for the deferred compensation payments should the Company desire to utilize the death benefit proceeds for that purpose. The policies have a current cash surrender value of $2.0 million which is reflected in the balance sheet under Other Assets. The Company also owns mutual funds.

(4) Contracts to purchase a new branch site and to complete renovation on one of the Morrisville administrative buildings.

The Company's subsidiary bank is required (as are all banks) to maintain vault cash or a noninterest bearing reserve balance as established by Federal Reserve regulations. The Bank's daily total reserve for the 14 day maintenance period including September 30, 2007 was $418 thousand and for December 31, 2006 was $2.3 million, both of which were satisfied by vault cash. For the purpose of reporting deposits subject to reserves to the Federal Reserve Bank of Boston, the Bank classifies transaction deposit accounts that meet certain criteria as savings accounts, in accordance with Federal Reserve banking regulations. Fluctuations in the number and balances of transaction deposit accounts classified for Federal Reserve reporting purposes as savings accounts impact the total reserve requirement for each 14 day maintenance period. The Company has also committed to maintain a noninterest bearing contracted clearing balance of $1.0 million at September 30, 2007 with the Federal Reserve Bank of Boston.

Interest Rate Sensitivity "Gap" Analysis. An interest rate sensitivity "gap" is defined as the difference between interest earning assets and interest bearing liabilities maturing or repricing within a given time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in overall market interest rates or conditions, changes in interest rates may affect net interest income positively or negatively even if an institution were perfectly

matched in each maturity category.

The Company prepares its interest rate sensitivity "gap" analysis by scheduling interest earning assets and interest bearing liabilities into periods based upon the next date on which such assets and liabilities could mature or reprice. The amounts of assets and liabilities shown within a particular period were determined in accordance with the contractual terms of the assets and liabilities, except that:

- adjustable-rate loans, investment securities, variable-rate time deposits, and FHLB advances are included in the period when they are first scheduled to adjust and not in the period in which they mature;
- fixed-rate mortgage-related securities and loans reflect estimated prepayments, which were estimated based on analyses of broker estimates, the results of a prepayment model utilized by the Company, and empirical data;
- other nonmortgage related fixed-rate loans reflect scheduled contractual amortization, with no estimated prepayments; and
- NOW, money markets, and savings deposits, which do not have contractual maturities, reflect estimated levels of attrition, which are based on detailed studies by the Company of the sensitivity of each such category of deposit to changes in interest rates.

Management believes that these assumptions approximate actual experience and considers them reasonable. However, the interest rate sensitivity of the Company's assets and liabilities in the tables could vary substantially if different assumptions were used or actual experience differs from the historical experience on which the assumptions are based.

The following table shows the Company's rate sensitivity analysis as of September 30, 2007:

	Cumulative repriced			
	3 Months or Less	4 to 12 Months	1 to 3 Years	3 to Yea
	(Dollars in thousands, by r			
Interest sensitive assets:				
Federal funds sold and overnight deposits	$ 9,151	$ -	$ -	$
Interest bearing deposits in banks	1,479	3,952	3,349	1,
Investment securities available-for-sale (1)(3)	2,597	6,078	8,068	5,
FHLB Stock	-	-	-	
Loans and loans held for sale (2)(3)	92,756	61,051	74,833	60,
Total interest sensitive assets	$105,983	$71,081	$ 86,250	$ 67,
Interest sensitive liabilities:				
Time deposits	$ 46,795	$64,749	$ 15,310	$
Money markets	6,903	-	-	
Regular savings	5,491	-	-	
NOW accounts	19,487	-	-	
Borrowed funds	214	587	1,310	2,
Total interest sensitive liabilities	$ 78,890	$65,336	$ 16,620	$ 3,

Net interest rate sensitivity gap	$ 27,093	$ 5,745	$ 69,630	$ 64,
Cumulative net interest rate sensitivity gap	$ 27,093	$32,838	$102,468	$166,
Cumulative net interest rate sensitivity gap as a percentage of total assets	6.8%	8.3%	25.8%	42
Cumulative net interest rate sensitivity gap as a percentage of total Interest sensitive assets	7.3%	8.9%	27.6%	45
Cumulative net interest rate sensitivity gap as a percentage of total Interest sensitive liabilities	9.2%	11.2%	35.0%	57

(1) Investment securities available-for-sale exclude marketable equity securities with a fair v mutual funds with a value of $18 thousand that may be sold by the Company at any time.
(2) Balances shown net of unearned income of $105 thousand.
(3) Estimated repayment assumptions considered in Asset/Liability model.

Simulation Analysis. In its simulation analysis, the Company uses computer software to simulate the estimated impact on net interest income and capital (Net Fair Value) under various interest rate scenarios, balance sheet trends, and strategies over a relatively short time horizon. These simulations incorporate assumptions about balance sheet dynamics such as loan and deposit growth, product pricing, prepayment speeds on mortgage related assets, principal maturities on other financial instruments, and changes in funding mix. While such assumptions are inherently uncertain as actual rate changes rarely follow any given forecast and asset-liability pricing and other model inputs usually do not remain constant in their historical relationships, management believes that these assumptions are reasonable. Based on the results of these simulations, the Company is able to quantify its estimate of interest rate risk and develop and implement appropriate strategies.

The following chart reflects the cumulative results of the Company's latest simulation analysis for the next twelve months on net interest income, net income, return on assets, return on equity and net fair value ratio. Shocks are intended to capture interest rate risk under extreme conditions by immediately shifting to the new level. The projection utilizes a rate shock, applied proportionately, of up and down 300 basis points from the September 30, 2007 prime rate of 7.75%, this is the highest and lowest internal slopes monitored. This slope range was determined to be the most relevant during this economic cycle.

INTEREST RATE SENSITIVITY ANALYSIS MATRIX
(Dollars in thousands)

12 Months Ending	Prime Rate	Net Interest Income	Change %	Net Income	Return on Assets %	Return on Equity %	Net Fair Value Ratio
September-08	10.75%	$20,022	10.82	$7,018	1.78	16.51	8.19%
	7.75%	$18,067	0.00	$5,703	1.42	13.40	10.57%
	4.75%	$15,964	(11.64)	$4,290	1.03	9.88	13.02%

The resulting projected cumulative effect of these estimates on net interest income and the net fair value ratio for the twelve month period ending September 30, 2008, are within approved ALCO guidelines for interest rate risk. The simulations of earnings do not incorporate any management actions, which might moderate the negative consequences of interest rate deviations. Therefore, they do not reflect likely actual results, but serve as conservative estimates of interest rate risk under different rate scenarios.

Liquidity. Managing liquidity risk is essential to maintaining both depositor confidence and stability in earnings. Liquidity is a measurement of the Company's ability to meet potential cash requirements, including ongoing commitments to fund deposit withdrawals, repay borrowings, fund investment and lending activities, and for other general business purposes. The Company's principal sources of funds are deposits, amortization and prepayment of loans and securities, maturities of investment securities and other short-term investments, sales of securities and loans available-for-sale, earnings and funds provided from operations. Maintaining a relatively stable funding base, which is achieved by diversifying funding sources, competitively pricing deposit products, and extending the contractual maturity of liabilities, reduces the Company's exposure to rollover risk on deposits and limits reliance on volatile short-term purchased funds. Short-term funding needs arise from declines in deposits or other funding sources, funding of loan commitments, draws on unused lines of credit and requests for new loans. The Company's strategy is to fund assets, to the maximum extent possible, with core deposits that provide a sizable source of relatively stable and low-cost funds. For the quarter ended, September 30, 2007, the Company's ratio of average loans to average deposits was 95.5% compared to the prior year of 102.9%.

In addition, as Union Bank is a member of the FHLB of Boston, it had access to an unused line of credit up to $5.3 million at September 30, 2007 over and above the term advances already drawn on the line based on FHLB estimate as of that date; with the purchase of required FHLB of Boston capital stock that amount would rise to $25.2 million. This line of credit could be used for either short or long term liquidity or other needs. In addition to its borrowing arrangements with the FHLB of Boston, Union Bank maintains a $7.5 million pre-approved Federal Funds line of credit with an upstream correspondent bank and a repurchase agreement line with a selected brokerage house. There were no balances outstanding on either line at September 30, 2007. Union is a member of the Certificate of Deposit Account Registry Service ("CDARS") of Promontory Interfinancial Network which allows Union to provide higher FDIC deposit insurance to customers by exchanging deposits with other members and allows Union to purchase deposits from other members as another source of funding. There were no purchased deposits at either September 30, 2007 or December 31, 2006, although Union had exchanged $6.7 million and $2.5 million, respectively, with other CDARS members as of those dates.

While scheduled loan and securities payments and FHLB advances are relatively predictable sources of funds, deposit flows and prepayments on loans and mortgage-backed securities are greatly influenced by general interest rates, economic conditions, and competition. The Company's liquidity is actively managed on a daily basis, monitored by the ALCO, and reviewed periodically with the subsidiary's Board of Directors. The Company's ALCO sets liquidity targets based on the Company's financial condition and existing and projected economic and market conditions. The ALCO measures the Company's marketable assets and credit available to fund liquidity requirements and compares the adequacy of that aggregate amount against the aggregate amount of the Company's interest sensitive or volatile liabilities, such as core deposits and time deposits in excess of $100,000, borrowings and term deposits with short maturities, and credit commitments outstanding. The primary objective is to manage the

Company's liquidity position and funding sources in order to ensure that it has the ability to meet its ongoing commitment to its depositors, to fund loan commitments and unused lines of credit, and to maintain a portfolio of investment securities.

The Company's management monitors current and projected cash flows and adjusts positions as necessary to maintain adequate levels of liquidity. Although approximately 88% of the Company's time deposits will mature within twelve months, management believes, based upon past experience, (percentage of time deposits to mature within twelve months has ranged from 72% to 85% over the preceding eight years) the relationships developed with local municipalities, and the introduction of new deposit products in 2005, that Union Bank will retain a substantial portion of these deposits. Management will continue to offer a competitive but prudent pricing strategy to facilitate retention of such deposits. The inverted yield curve for the last year and the proliferation of certificate of deposit specials have contributed to the shortening of the maturities in time deposits. A reduction in total deposits could be offset by purchases of federal funds, purchases of deposits, short-or-long-term FHLB borrowings, utilization of the repurchase agreement line, or liquidation of investment securities, purchased brokerage certificates of deposit or loans held for sale. Such steps could result in an increase in the Company's cost of funds or a decrease in the yield earned on assets and therefore adversely impact the net interest spread and margin. Management believes the Company has sufficient liquidity to meet all reasonable borrower, depositor, and creditor needs in the present economic environment. However, any projections of future cash needs and flows are subject to substantial uncertainty. Management continually evaluates opportunities to buy/sell securities and loans available-for-sale, obtain credit facilities from lenders, or restructure debt for strategic reasons or to further strengthen the Company's financial position.

Capital Resources. Capital management is designed to maintain an optimum level of capital in a cost-effective structure that meets target regulatory ratios; supports management's internal assessment of economic capital; funds the Company's business strategies; and builds long-term stockholder value. Dividends are generally increased in line with long-term trends in earnings per share growth and conservative earnings projections, while sufficient profits are retained to support anticipated business growth, fund strategic investments and provide continued support for deposits.

The total dollar value of the Company's stockholders' equity at September 30, 2007 was unchanged from September 30, 2006 at $41.9 million, reflecting net income of $4.1 million for the first nine months of 2007, less cash dividends paid of $3.8 million, the purchase of 17,761 shares of Treasury stock totaling $375 thousand, and a decrease of $26 thousand in accumulated other comprehensive loss.

Union Bankshares, Inc. has 7.5 million shares of $2.00 par value common stock authorized. As of September 30, 2007, the Company had 4,918,611 shares issued, of which 4,514,216 were outstanding and 404,395 were held in Treasury.

The Board of Directors has authorized the repurchase of up to 100,000 shares of common stock, or approximately 2.2% of the Company's outstanding shares at the authorization date, for an aggregate repurchase cost not to exceed $2.15 million. Shares can be repurchased in the open market or in negotiated transactions. The repurchase program is open for an unspecified period of time. As of September 30, 2007 the Company had repurchased 17,761 shares under this program, for a total cost of $375 thousand year-to-date, and 43,447shares at a total cost of $900 thousand since the inception of the program in November, 2005.

As of September 30, 2007, there were outstanding employee incentive stock options with respect to shares of the Company's common stock, granted pursuant to Union Bankshares' 1998 Incentive Stock Option Plan. As of such date, 12,825 options were currently exercisable but only 3,325 of those options were "in the money". Of the 75,000 shares authorized for issuance under the 1998 Plan, 45,450 shares remain available for future option grants. During the third quarter of 2007, no incentive stock options were granted or exercised pursuant to the 1998 plan.

Union Bankshares, Inc. and Union Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Management believes, as of September 30, 2007, that both companies meet all capital adequacy requirements to which they are subject. As of September 30, 2007, the most recent calculation categorizes Union Bank as well capitalized under the regulatory framework for prompt corrective action. The prompt corrective action capital category framework applies to FDIC insured depository institutions such as Union but does not apply directly to bank holding companies such as the Company. To be categorized as well capitalized, Union Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table below. There are no conditions or events since September 30, 2007, that management believes have changed either company's category.

Union Bank's and the Company's actual capital amounts and ratios as of September 30, 2007, are presented in the following table:

	Actual		Minimums For Capital Requirements		Minim To Be Capitaliz Prompt Co Action Pr
	Amount	Ratio	Amount	Ratio	Amount
	(Dollars in thousands)				
Total capital to risk weighted assets					
Union Bank	$46,190	16.8%	$21,969	8.0%	$27,461
Company	$46,325	16.8%	$22,020	8.0%	N/A
Tier I capital to risk weighted assets					
Union Bank	$42,763	15.6%	$10,986	4.0%	$16,479
Company	$42,898	15.6%	$11,014	4.0%	N/A
Tier I capital to average assets					
Union Bank	$42,763	11.0%	$15,522	4.0%	$19,402
Company	$42,898	11.1%	$15,529	4.0%	N/A

Regulatory Matters. The Company and Union are subject to periodic examinations by the various regulatory agencies. These examinations include, but are not limited to, procedures designed to review lending practices, risk management, credit quality, liquidity, compliance and capital adequacy. During 2006 the Securities and Exchange Commission, the Vermont State Department of Banking, the Federal Deposit Insurance Corporation, and the Federal Reserve Bank of Boston performed various examinations of the Company and Union pursuant to their regular, periodic regulatory reviews. No comments were received from these various bodies that would have a material adverse effect on the Company's liquidity, financial position, capital resources, or results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Information called for by this item is incorporated by reference in Management's Discussion and Analysis of Financial Condition and Results of Operations under the caption "OTHER FINANCIAL CONSIDERATIONS" on pages 29 through 36 in this Form 10-Q.

Item 4. Controls and Procedures.

The Company's chief executive officer and chief financial officer, with the assistance of the Disclosure Control Committee, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this report and concluded that those disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files with the Commission is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

There are no known pending legal proceedings to which the Company or its subsidiary is a party, or to which any of their properties is subject, other than ordinary litigation arising in the normal course of business activities. Although the amount of any ultimate liability with respect to such proceedings cannot be determined, in the opinion of management, any such liability would not have a material effect on the consolidated financial position of the Company and its subsidiary.

Item 1A. Risk Factors.

There have been no material changes in the Company's risk factors from those previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Numbers of Shares Purchased as Part of Publicly Announced Plans or Programs (1)
July 2007	800	$21.39	800
August 2007	2,700	$20.42	2,700
September 2007	2,931	$20.47	2,931

(1) Since November 18, 2005, the Company has maintained an informal stock repurchase program pu Company may repurchase up to $2.15 million or 100,000 shares of common stock, or approximat Company's outstanding shares as of the authorization date. Shares can be repurchased in the negotiated transactions. The repurchase program is open for an unspecified period of time. the Company had repurchased 17,761 shares under this program for a total cost of $375 thous inception of the program, the Company has repurchased 43,447 shares at a total cost of $900

Item 6. Exhibits.

3.1 Amended and Restated By-laws of Union Bankshares, Inc. as of October 12, 2007.

31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

November 14, 2007 Union Bankshares, Inc.

/s/ Kenneth D. Gibbons

Kenneth D. Gibbons
Director, President and
Chief Executive Officer

/s/ Marsha A. Mongeon

Marsha A. Mongeon
Chief Financial Officer and Treasurer
(Principal Financial Officer)

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