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NORWOOD FINANCIAL CORP  
Form 10-K405  
March 25, 2002

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

(Mark One):

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 2001,

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File No. 0-28366

Norwood Financial Corp.

( Exact Name of Registrant as specified in Its Charter)

Pennsylvania 23-2828306

(State or Other Jurisdiction of Incorporation or Organization) I.R.S. Employer Identification No.

717 Main Street, Honesdale, Pennsylvania 18431

(Address of Principal Executive Offices) (Zip Code)

Issuer's Telephone Number, Including Area Code: (570) 253-1455

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

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

Common Stock, par value \$.10 per share

(Title of Class)

Check whether the issuer: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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  NO .

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained,

to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

As of March 16, 2002, there were 1,753,733 shares outstanding of the registrant's Common Stock.

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The Registrant's voting stock trades on the NASDAQ National Market under the symbol "NWFL." The aggregate market value of the voting stock held by non-affiliates of the registrant, based on the last price the registrant's Common Stock was sold on March 16, 2002, was \$36,968,385 (\$26.15 per share based on 1,413,702 shares of Common Stock outstanding).

### DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Annual Report to Stockholders for the Fiscal Year ended December 31, 2001. (Parts I, II, and IV)
2. Portions of the Proxy Statement for the Annual Meeting of Stockholders. (Part III)

### PART I

#### Forward Looking Statements

The Private Securities Litigation Reform Act of 1995 contains safe harbor provisions regarding forward-looking statements. When used in this discussion, the words "believes", "anticipates," "contemplates," "expects," and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties which could cause actual results to differ materially from those projected. Those risks and uncertainties include changes in interest rates, risks associated with the effect of opening a new branch, the ability to control costs and expenses, and general economic conditions. Norwood Financial Corp undertakes no obligation to publicly release the results of any revisions to those forward-looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

#### Item 1. Business.

##### General

Norwood Financial Corp. (the "Company") a Pennsylvania corporation is the holding company for Wayne Bank. On March 29, 1996, the Bank completed the Reorganization and became a wholly owned subsidiary of the Company. At December 31, 2001, the Company had total assets of \$346.0 million, deposits of \$274.9 million, and stockholders' equity of \$35.1 million.

Wayne Bank is a Pennsylvania chartered commercial bank located in Honesdale, Pennsylvania. The Bank was originally chartered on February 17, 1870 as Wayne County Savings Bank. Wayne County Savings Bank changed its name to Wayne County Bank and Trust in December 1943. In September 1993, the Bank adopted the name Wayne Bank. The Bank's deposits are currently insured by the Bank Insurance Fund ("BIF") as administered by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is regulated by the Pennsylvania Department of Banking ("PDB") and the FDIC.

The Bank is an independent community-oriented bank with six offices in Wayne County, three offices in Pike County and one office in Monroe County. The Bank offers a wide variety of personal, business credit services and trust and investment products to the consumers, businesses, nonprofit organizations, and municipalities in each of the communities that the Bank serves. The Bank primarily serves the Pennsylvania counties of Wayne, Pike and Monroe, and to a much lesser extent, the counties of Lackawanna and Susquehanna. In addition, the Bank operates eleven automated teller machines with ten in branch locations and one remote service facility.

#### Competition

The competition for deposit products comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, and multi-state regional banks in the Company's market area of Wayne, Pike and Monroe Counties, Pennsylvania. Deposit competition also includes a number of insurance products sold by local agents and investment products such as mutual funds and other securities sold by local and regional brokers. Loan competition varies depending upon market conditions and comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, multi-state regional banks, and mortgage bankers.

#### Personnel

As of December 31, 2001, the Bank had 119 full-time and 12 part-time employees. None of the Bank's employees are represented by a collective bargaining group.

#### Lending Activities

The Bank's loan products include loans for personal and business use. This includes mortgage lending to finance principal residences as well as "seasonal" or second home dwellings. The products include adjustable rate mortgages up to 30 years which are retained and serviced through the Bank, longer term fixed rate mortgage products which may be sold, servicing retained, in the secondary market through the Federal National Mortgage Association (Fannie Mae) or held in the Bank's portfolio subject to certain internal guidelines. Fixed rate home equity loans are originated on terms up to 180 months, as well as offering a home equity line of credit tied to prime rate. The Bank also offers indirect dealer financing of automobiles (new and used), boats, and recreational vehicles through a network of over 60 dealers in Northeast Pennsylvania.

Commercial loans and commercial mortgages are provided to local small and mid-sized businesses at a variety of terms and rate structures. Commercial lending activities include lines of credit, revolving credit, term loans, mortgages, various forms of secured lending and a limited amount of letter of credit facilities. The structure may be fixed, immediately repricing tied to the prime rate or adjustable at set intervals.

Adjustable-rate loans decrease the risks associated with changes in interest rates by periodically repricing, but involve other risks because as interest rates increase, the underlying payments by the borrower increase, thus increasing the potential for default. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Upward adjustment of the contractual interest rate may also be limited by the maximum periodic interest rate adjustment permitted in certain adjustable-rate mortgage loan documents, and, therefore is potentially limited in effectiveness during periods of rapidly rising interest rates. These risks have not had an adverse effect on the Bank.

Consumer lending, including indirect financing provides benefits to the Bank's asset/liability management program by reducing the Bank's exposure to interest rate changes, due to their generally shorter terms, and higher yields. Such loans may entail additional credit risks compared to owner-occupied

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residential mortgage lending. However, the Bank believes that the higher yields and shorter terms compensate the Bank for the increased credit risk associated with such loans.

Commercial lending including real-estate related loans entail significant additional risks when compared with residential real estate and consumer lending. For example, commercial loans typically involve larger loan balances to single borrowers or groups of related borrowers, the payment experience on such loans typically is dependent on the successful operation of the project and these risks can be significantly impacted by the cash flow of the borrowers and market conditions for commercial office, retail, and warehouse space. In periods of decreasing cash flows, the commercial borrower may permit a lapse in general maintenance of the property causing the value of the underlying collateral to deteriorate. The liquidation of commercial property is often more costly and may involve more time to sell than residential real estate.

Due to the type and nature of the collateral, consumer lending generally involves more credit risk when compared with residential real estate lending. Consumer lending collections are typically dependent on the borrower's continuing financial stability, and thus, are more likely to be adversely affected by job loss, divorce, illness and personal bankruptcy. In most cases, any repossessed collateral for a defaulted consumer loan will not provide an adequate source of repayment of the outstanding loan balance. The remaining deficiency is usually turned over to a collection agency.

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Types of Loans. Set forth below is selected data relating to the composition of the Bank's loan portfolio at the dates - indicated.

	As of December 31,					
	2001		2000		1999	
	\$	%	\$	%	\$	%
	(Dollars in Thousands)					
Type of Loans:	-----					
Commercial, Financial and						
Agricultural.....	\$17,442	8.1	\$17,102	7.9	\$15,672	7.6
Real Estate-Construction.....	4,642	2.2	2,425	1.1	3,339	1.6
Residential.....	64,635	30.1	59,517	27.5	56,967	27.7
Commercial.....	63,609	29.6	56,815	26.2	51,562	25.1
Lease financing, net of unearned						
income.....	6,126	2.9	13,644	6.3	23,974	11.7
Consumer Loans to Individuals.....	58,143	27.1	67,286	31.0	54,045	26.3
	-----	-----	-----	-----	-----	-----
	214,597	100.0	216,789	100.0	205,559	100.0
	=====	=====	=====	=====	=====	=====
Less:						
Unearned income and deferred fees....	(403)		(312)		(399)	
Allowance for loan losses.....	(3,216)		(3,300)		(3,344)	
	-----		-----		-----	
	\$210,978		\$213,177		\$201,816	
	=====		=====		=====	

Maturities and Sensitivities of Loans to Changes in Interest Rates. The following table sets forth maturities and interest rate sensitivity for selected categories of loans as of December 31, 2001. Scheduled repayments are reported in the maturity category in which payment is due.

	Less than One Year -----	One to Five Years -----	Over Five Years -----	Total -----
	(Dollars in thousands)			
Commercial, Financial and Agricultural	\$ 5,932	\$ 6,446	\$ 5,064	\$17,442
Real Estate- Construction	4,642	--	--	4,642
Commercial	4,185	11,225	48,199	63,609
	-----	-----	-----	-----
Total	\$14,759	\$17,671	\$53,263	\$85,693
	=====	=====	=====	=====
Loans with fixed-rate	\$ 2,346	\$ 6,952	\$10,929	\$20,227
Loans with floating Rates	12,413	10,719	42,334	65,466
	-----	-----	-----	-----
Total	\$14,759	\$17,671	\$53,263	\$85,693
	=====	=====	=====	=====

Non-performing Assets. The following table sets forth information regarding non-accrual loans, foreclosed real estate owned and loans that are 90 days or more delinquent but on which the Bank was accruing interest at the dates indicated. For the year ended December 31, 2001, interest income that would have been recorded on loans accounted for on a non-accrual basis under the original terms of such loans was \$71,000 of which \$27,000 was collected.

	2001 -----	As of December 31, 2000 1999 1998 -----			1997 -----
	(Dollars In Thousands)				
Loans accounted for on a non-accrual basis:					
Commercial and all other	\$ 64	\$ 64	\$ 64	\$ 65	\$ 963
Real estate	597	518	513	503	1,112
Consumer	11	--	19	20	33
	-----	-----	-----	-----	-----
Total	672	582	596	588	2,108
Accruing loans which are contractually past-due 90 days or more:					
Commercial and all other	--	--	--	--	44
Real estate	--	34	--	--	--
Consumer	11	64	61	34	23

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Total	11	98	61	34	67
Total non-performing loans	683	680	657	622	2,175
Foreclosed real estate	54	27	110	204	537
Total non-performing assets	\$ 737	\$ 707	\$ 767	\$ 826	2,712
Total non-performing loans to total loans	.32%	.31%	.32%	.33%	1.17%
Total non-performing loans to total assets	.20%	.21%	.21%	.22%	.83%
Total non-performing assets to total assets	.21%	.22%	.24%	.30%	1.03%

The recorded investment in impaired loans, not requiring an allowance for loan losses was \$618,000 and \$354,000 at December 31, 2001 and 2000, respectively. The recorded investment in impaired loans requiring an allowance for loan losses was \$64,000 and \$-0- at December 31, 2001 and 2000, respectively. The related allowance for loan losses associated with these loans was \$7,000 and \$-0-, respectively, at December 31, 2001 and 2002. For the years, ended December 31, 2001, 2000 and 1999, the average recorded investment in these impaired loans was \$694,000, \$364,000 and \$365,000 and the interest income recognized on these impaired loans was \$22,000, \$-0- and \$-0-, respectively.

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Potential Problem Loans. As of December 31, 2001, there were no loans not previously disclosed, where known information about possible credit problems of borrowers causes management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms.

Analysis of the Allowance for Loan Losses. The following table sets forth information with respect to the Bank's allowance for loan losses for the years indicated:

	Years Ended December 31,			
	2001	2000	1999	1998
Total loans receivable net of unearned income .....	\$ 214,194	\$ 216,477	\$ 205,160	\$ 186,000
Average loans receivable .....	214,905	211,174	196,005	186,000
Allowance balance at beginning of period .....	\$ 3,300	\$ 3,344	\$ 3,333	\$ 3,333
Charge-offs:				
Commercial and all other .....	(12)	--	(12)	(12)
Real Estate .....	(11)	(9)	(17)	(17)
Consumer .....	(711)	(589)	(419)	(419)
Leases .....	(152)	(170)	(184)	(184)
Total .....	(886)	(768)	(632)	(632)

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Recoveries:				
Commercial and all other .....	8	54	74	
Real Estate .....	1	73	--	
Consumer .....	85	88	83	
Leasing .....	13	29	16	
	-----	-----	-----	-----
Total .....	107	244	173	
	-----	-----	-----	-----
Net Charge-offs .....	(779)	(524)	(459)	
Provision Expense .....	695	480	470	
	-----	-----	-----	-----
Allowance balance at end of period .....	\$ 3,216	\$ 3,300	\$ 3,344	\$ 3,300
	=====	=====	=====	=====
Allowance for loan losses as a percent of total				
Loans outstanding .....	1.50%	1.52%	1.63%	
	=====	=====	=====	=====
Net loans charged off as a percent of average				
Loans outstanding .....	.36%	.25%	.23%	
	=====	=====	=====	=====

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Allocation of the Allowance For Loan Losses. The following table sets forth the allocation of the Bank's allowance for loan losses by loan category and the percent of loans in each category to total loans at the date indicated.

	At December 31,					
	2001		2000		1999	
	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans
	(Dollars in thousands)					
Commercial, financial and agricultural	\$426	8.1%	\$ 345	7.9%	\$376	7.6%
Real estate - construction	70	2.2	40	1.1	31	1.6
Real estate - mortgage	1,421	59.7	1,314	53.7	1,171	52.8
Consumer loans to individuals	715	27.1	719	31.0	551	26.3
Lease Financing	92	2.9	118	6.3	180	11.7
Unallocated	492	--	764	--	1,035	--
	-----	-----	-----	-----	-----	-----
Total	\$3,216	100.0%	\$3,300	100.0%	\$3,344	100.0%
	=====	=====	=====	=====	=====	=====

(1) Includes specific reserves for assets classified as loss.

Investment Activities

General. The Company maintains a portfolio of investment securities consisting principally of obligations of the U.S. Government and its agencies and obligations of state, counties and municipalities including school districts. The Company considers its investment portfolio a source of earnings and liquidity.

Securities Portfolio. Carrying values of securities at the dates indicated are as follows:

(Dollars in thousands)	As of December 31,		
	2001 ----	2000 ----	1999 ----
Securities: (carrying value)			
U.S. Treasury Securities.....	\$ --	\$ --	\$3,988
U.S. Government Agencies.....	15,647	20,879	18,170
State and political Subdivisions.....	18,866	15,993	12,151
Corporate Notes and bonds.....	14,244	7,953	2,307
Mortgage-backed Securities.....	51,459	38,152	45,523
Equity Securities.....	1,803	1,572	1,632
	-----	-----	-----
Total Securities	\$102,019	\$84,549	\$83,771
	=====	=====	=====
Fair value of Securities.....	\$102,257	\$84,851	\$83,705
	=====	=====	=====

Maturity Distribution of Securities. The following table sets forth certain information regarding carrying values, weighted average yields, and maturities of the Company's securities portfolio at December 31, 2001. Yields on tax-exempt securities are stated on a fully taxable equivalent basis using a Federal tax rate of 34%. Actual maturities may differ from contractual maturities as certain instruments have call features which allow prepayment of obligations. Maturity on mortgage backed securities is based upon expected average lives rather than contractual terms. Equity securities with no stated maturity are classified as "one year or less."

Investment Portfolio Maturities  (Dollars in thousands)	One year or Less		After one through five years		After five through ten years		After
	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carry Valu
	-----	-----	-----	-----	-----	-----	-----

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Obligations of U.S.							
Government Agencies	\$ --	--	\$ 7,058	5.70%	\$ 7,590	6.19%	\$ 9
Obligations of state and							
political subdivisions	254	6.36%	1,965	8.38%	796	7.21%	15,8
Mortgage-backed Securities (1)	12,147	5.83%	23,510	5.78%	10,542	5.66%	5,2
Corporate Securities	2,081	7.10%	11,334	5.59%	--	--	8
Equity Securities (2)	1,803	4.35%	--	--	--	--	--
	-----	----	-----	----	-----	----	-----
Total Investment							
Securities	\$16,285	5.95%	\$43,867	5.84%	\$18,928	5.94%	\$22,9
	=====	=====	=====	=====	=====	=====	=====

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Deposit Activities.

General. The Bank provides a full range of deposit products to its retail and business customers. These include interest-bearing and noninterest bearing transaction accounts, statement savings and money market accounts. Certificate of deposit terms range up to 5 years for retail instruments. The Bank participates in Jumbo CD (\$100,000 and over) markets with local municipalities and school districts which are typically priced on a competitive bid basis. Other services the Bank offers its customers on a limited basis include cash management, direct deposit and Automated Clearing House (ACH) activity. The Bank operates ten automated teller machines and is affiliated with the STAR ATM network.

The following table sets forth information regarding deposit categories of the Company.

(in thousands)	2001		2000		1999	
	-----		-----		-----	
	Average		Average		Average	
	Balance	Rate Paid	Balance	Rate Paid	Balance	Rate Paid
	-----	-----	-----	-----	-----	-----
Non-interest bearing						
demand	\$ 31,407		\$ 29,525		\$ 28,059	
Interest-bearing demand	31,889	1.22%	28,789	1.80%	25,336	1.68%
Savings	42,631	1.86%	42,492	2.20%	42,676	2.19%
Time	122,161	5.18%	111,778	5.45%	107,152	5.15%

Maturities of Time Deposits. The following table indicates the amount of the Bank's certificates of deposit in amounts of \$100,000 or more and other time deposits of \$100,000 or more by time remaining until maturity as of December 31, 2001.

(Dollars in thousands)	Certificates
	of Deposit
	-----
Maturity Period	
-----	
Within three months.....	\$8,936

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Over three through six months.....	9,350
Over six through twelve months.....	1,998
Over twelve months.....	7,140
	-----
	\$27,424
	=====

### Short-Term Borrowings

The following table sets forth information concerning only short-term borrowings (those maturing within one year) which consist principally of federal funds purchased, securities sold under agreements to repurchase, Federal Home Loan Bank advances and U.S. Treasury demand notes, that the Company had during the periods indicated.

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(Dollars in thousands)	Years ended December 31,		
	2001	2000	1999
	----	----	----
Short term borrowings:			
Average balance during the year.....	\$7,781	\$6,914	\$8,187
Maximum month-end during the year.....	9,411	9,347	8,600
Average interest rate during the year .....	3.80%	4.38%	3.66%
Total short-term borrowings at end of the year.....	\$6,641	\$7,860	\$8,600

### Trust Activities

The Bank operates a Trust Department which provides estate planning, investment management and financial planning to customers. At December 31, 2001, the Bank acted as trustee for \$57.5 million of assets of which \$28.6 million is non-discretionary with no investment authority.

### Subsidiary Activities

The Bank, a Pennsylvania chartered bank, is the only wholly owned subsidiary of the Company. Norwood Investment Corp. (NIC), incorporated in 1996, a Pennsylvania licensed insurance agency, is a wholly-owned subsidiary of the Bank. NIC's business is annuity and mutual fund sales and discount brokerage activities primarily to customers of the Bank. The annuities, mutual funds and other investment products are not insured by the FDIC or any other government agency. They are not deposits, obligations of or guaranteed by any bank. The securities are offered through Futureshare Financial a registered broker/dealer. NIC had sales volume of \$9.2 million in 2001, generating revenues for the Company of \$267,000.

WCB Realty Corp. is a wholly-owned real estate subsidiary of the Bank whose principal asset is the administrative offices of the Company.

WTRO Properties Inc. is a wholly-owned real estate subsidiary of the Bank established to hold title to certain real estate upon which the Bank through WTRO foreclosed upon in 1998. The majority of the foreclosed real estate was sold in the third quarter of 1998. The Company had little activity in 2001.

### Regulation

Set forth below is a brief description of certain laws which relate to the regulation of the Registrant and the Bank. The description does not purport

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to be complete and is qualified in its entirety by reference to applicable laws and regulations.

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### Regulation of the Company

General. The Company, as a bank holding company under the Bank Holding Company Act of 1956, as amended ("BHCA"), is subject to regulation and supervision by the Board of Governors of the Federal Reserve System ("Federal Reserve") and by the Pennsylvania Department of Banking (the "Department"). The Company is required to file annually a report of its operations with, and is subject to examination by, the Federal Reserve and the Department. This regulation and oversight is generally intended to ensure that the Company limits its activities to those allowed by law and that it operates in a safe and sound manner without endangering the financial health of its subsidiary banks.

Under the BHCA, the Company must obtain the prior approval of the Federal Reserve before it may acquire control of another bank or bank holding company, merge or consolidate with another bank holding company, acquire all or substantially all of the assets of another bank or bank holding company, or acquire direct or indirect ownership or control of any voting shares of any bank or bank holding company if, after such acquisition, the bank holding company would directly or indirectly own or control more than 5% of such shares.

Federal statutes impose restrictions on the ability of a bank holding company and its nonbank subsidiaries to obtain extensions of credit from its subsidiary bank, on the subsidiary bank's investments in the stock or securities of the holding company, and on the subsidiary bank's taking of the holding company's stock or securities as collateral for loans to any borrower. A bank holding company and its subsidiaries are also prevented from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property, or furnishing of services by the subsidiary bank.

A bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the policy of the Federal Reserve that a bank holding company should stand ready to use available resources to provide adequate capital to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice or a violation of the Federal Reserve regulations, or both.

Non-Banking Activities. The business activities of the Company, as a bank holding company, are restricted by the BHCA. Under the BHCA and the Federal Reserve's bank holding company regulations, the Company may only engage in, or acquire or control voting securities or assets of a company engaged in, (1) banking or managing or controlling banks and other subsidiaries authorized under the BHCA and (2) any BHCA activity the Federal Reserve has determined to be so closely related to banking or managing or controlling banks to be a proper incident thereto. These include any incidental activities necessary to carry on those activities, as well as a lengthy list of activities that the Federal Reserve has determined to be so closely related to the business of banking as to be a proper incident thereto.

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Financial Modernization. The Gramm-Leach-Bliley Act, permits greater affiliation among banks, securities firms, insurance companies, and other companies under a new type of financial services company known as a "financial holding company." A financial holding company essentially is a bank holding company with significantly expanded powers. Financial holding companies are authorized by statute to engage in a number of financial activities previously impermissible for bank holding companies, including securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; and merchant banking activities. The Act also permits the Federal Reserve and the Treasury Department to authorize additional activities for financial holding companies if they are "financial in nature" or "incidental" to financial activities. A bank holding company may become a financial holding company ("FHC") if each of its subsidiary banks is well capitalized, well managed, and has at least a "satisfactory" CRA rating. A financial holding company must provide notice to the Federal Reserve within 30 days after commencing activities previously determined by statute or by the Federal Reserve and Department of the Treasury to be permissible. The Company has not submitted notice to the Federal Reserve of its intent to be deemed a financial holding company.

Regulatory Capital Requirements. The Federal Reserve has adopted capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the Bank Holding Company Act. The Federal Reserve's capital adequacy guidelines are similar to those imposed on the Bank by the Federal Deposit Insurance Corporation. See "Regulation of the Bank-Regulatory Capital Requirements."

### Regulation of the Bank

General. As a Pennsylvania chartered, insured commercial bank, the Bank is subject to extensive regulation and examination by the Department and by the FDIC, which insures its deposits to the maximum extent permitted by law. The federal and state laws and regulations applicable to banks regulate, among other things, the scope of their business, their investments, the reserves required to be kept against deposits, the timing of the availability of deposited funds and the nature and amount of collateral for certain loans. The laws and regulations governing the Bank generally have been promulgated to protect depositors and not for the purpose of protecting stockholders. This regulatory structure also gives the federal and state banking agencies extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the Department, the FDIC or the United States Congress, could have a material impact on the Company, the Bank and their operations.

Pennsylvania Banking Law. The Pennsylvania Banking Code ("Banking Code") contains detailed provisions governing the organization, location of offices, rights and responsibilities of directors, officers, and employees, as well as corporate powers, savings and investment operations and other aspects of the Bank and its affairs. The Banking Code delegates extensive rule-making power and administrative discretion to the Department so that the supervision and regulation of state chartered banks may be flexible and readily responsive to changes in economic conditions and in savings and lending practices.

The Federal Deposit Insurance Corporation Act ("FDIA"), however, prohibits state chartered banks from making new investments, loans, or becoming

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involved in activities as principal and equity investments which are not permitted for national banks unless (1) the FDIC determines the activity or investment does not pose a significant risk of loss to the BIF and (2) the bank meets all applicable capital requirements. Accordingly, the additional operating authority provided to the Bank by the Banking Code is significantly restricted by the FDIA.

**Federal Deposit Insurance.** The FDIC is an independent federal agency that insures the deposits, up to prescribed statutory limits, of federally insured banks and savings institutions and safeguards the safety and soundness of the banking and savings industries. The FDIC administers two separate insurance funds, the BIF, which generally insures commercial bank and state savings bank deposits, and the Savings Insurance Fund ("SAIF"), which generally insures savings association deposits. The Bank is a member of the BIF and its deposit accounts are insured by the FDIC, up to prescribed limits.

The FDIC is authorized to establish separate annual deposit insurance assessment rates for members of the BIF and the SAIF, and to increase assessment rates if it determines such increases are appropriate to maintain the reserves of either insurance fund. In addition, the FDIC is authorized to levy emergency special assessments on BIF and SAIF members. The FDIC has set the deposit insurance assessment rates for BIF-member institutions for the first six months of 2001 at 0% to .027% of insured deposits on an annualized basis, with the assessment rate for most institutions set at 0%.

In addition, all insured institutions of the FDIC are required to pay assessments at an annual rate of approximately .0212% of insured deposits to fund interest payments on bonds issued by the Financing Corporation, an agency of the Federal government established to recapitalize the predecessor to the SAIF. These assessments will continue until the Financing Corporation bonds mature in 2017.

**Regulatory Capital Requirements.** The FDIC has promulgated capital adequacy requirements for state-chartered banks that, like the Bank, are not members of the Federal Reserve System. At December 31, 2001, the Bank exceeded all regulatory capital requirements and was classified as "well capitalized."

The FDIC's capital regulations establish a minimum 3% Tier I leverage capital requirement for the most highly-rated state-chartered, non-member banks, with an additional cushion of at least 100 to 200 basis points for all other state-chartered, non-member banks, which effectively increases the minimum Tier I leverage ratio for such other banks to 4% to 5%. Under the FDIC's regulation, the highest-rated banks are those that the FDIC determines are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, which are considered a strong banking organization, rated composite 1 under the Uniform Financial Institutions Rating System. Tier I or core capital is defined as the sum of common stockholders' equity (including retained earnings), noncumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain purchased mortgage servicing rights and purchased credit and relationships.

The FDIC's regulations also require that state-chartered, non-member banks meet a risk-based capital standard. The risk-based capital standard requires the maintenance of total capital (which is defined as Tier I capital and supplementary (Tier 2) capital) to risk weighted assets of 8%. In determining the amount of risk-weighted assets, all assets, plus certain off balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on

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the risks the FDIC believes are inherent in the type of asset or item. The components of Tier I capital for the risk-based standards are the same as those for the leverage capital requirement. The components of supplementary (Tier 2) capital include cumulative perpetual preferred stock, mandatory subordinated debt, perpetual subordinated debt, intermediate-term preferred stock, up to 45% of unrealized gains on equity securities and a bank's allowance for loan and lease losses. Allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of supplementary capital that may be included in total capital is limited to 100% of Tier I capital.

A bank that has less than the minimum leverage capital requirement is subject to various capital plan and activities restriction requirements. The FDIC's regulations also provide that any insured depository institution with a ratio of Tier I capital to total assets that is less than 2.0% is deemed to be operating in an unsafe or unsound condition pursuant to Section 8(a) of the FDIA and could be subject to potential termination of deposit insurance.

The Bank is also subject to minimum capital requirements imposed by the Department on Pennsylvania-chartered depository institutions. Under the Department's capital regulations, a Pennsylvania bank or savings bank must maintain a minimum leverage ratio of Tier 1 capital (as defined under the FDIC's capital regulations) to total assets of 4%. In addition, the Department has the supervisory discretion to require a higher leverage ratio for any institutions based on the institution's substandard performance in any of a number of areas. The Bank was in compliance in both the FDIC and Pennsylvania capital requirements as of December 31, 2001.

**Affiliate Transaction Restrictions.** Federal laws strictly limit the ability of banks to engage in transactions with their affiliates, including their bank holding companies. Such transactions between a subsidiary bank and its parent company or the nonbank subsidiaries of the bank holding company are limited to 10% of a bank subsidiary's capital and surplus and, with respect to such parent company and all such nonbank subsidiaries, to an aggregate of 20% of the bank subsidiary's capital and surplus. Further, loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also requires that all transactions between a bank and its affiliates be on terms as favorable to the bank as transactions with non-affiliates.

**Federal Home Loan Bank System.** The Bank is a member of the FHLB of Pittsburgh, which is one of 12 regional FHLBs. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by member institutions and proceeds from the sale of consolidated obligations of the FHLB System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the Board of Trustees of the FHLB.

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As a member, the Bank is required to purchase and maintain stock in the FHLB of Pittsburgh in an amount equal to the greater of 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year or 5% of the Bank's outstanding advances from the FHLB. At December 31, 2001, the Bank was in compliance with this requirement.

**Federal Reserve System.** The Federal Reserve requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts (primarily checking and NOW accounts) and non-personal time deposits. The balances maintained to meet the reserve

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requirements imposed by the Federal Reserve may be used to satisfy the liquidity requirements that are imposed by the Department. At December 31, 2000, the Bank met its reserve requirements.

Restrictions on Dividends. The Pennsylvania Banking Code states, in part, that dividends may be declared and paid only out of accumulated net earnings and may not be declared or paid unless surplus (retained earnings) is at least equal to contributed capital. The Bank has not declared or paid any dividends which cause the Bank's retained earnings to be reduced below the amount required. Finally, dividends may not be declared or paid if the Bank is in default in payment of any assessment due the FDIC.

The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve's view that a bank holding company should pay cash dividends only to the extent that the holding company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company's capital needs, asset quality and overall financial condition. The Federal Reserve also indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Furthermore, under the federal prompt corrective action regulations, the Federal Reserve may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as "undercapitalized."

### Item 2. Description of Properties

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The Bank operates from its main office located at 717 Main Street, Honesdale, Pennsylvania and nine additional branch offices. The Bank's total investment in office property and equipment is \$ 11.1 million with a net book value of \$6.0 million at December 31, 2001. The Bank currently operates automated teller machines at all ten of its facilities and one automated teller machine only location. The Bank leases three of its locations with minimum lease commitments of \$384,000 through 2006. The three locations have various renewal options.

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### Item 3. Legal Proceedings

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Neither the Company nor its subsidiaries are involved in any pending legal proceedings, other than routine legal matters occurring in the ordinary course of business, which in the aggregate involve amounts which are believed by management to be immaterial to the consolidated financial condition or results of operations of the Company.

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

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None.

## PART II

### Item 5. Market for Common Equity and Related Stockholder Matters

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Information relating to the market for Registrant's common equity and

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related stockholder matters appears under "Market and Dividend Information" in the Registrant's Annual Report to Stockholders for the fiscal year ended December 31, 2001("Annual Report") and is incorporated herein by reference.

Item 6. Selected Financial Data  
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The above-captioned information appears under "Selected Financial and Other Data" in the Annual Report, and is incorporated herein by reference.

Item 7. Management's Discussion and Analysis of Financial Conditions and Results  
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of Operations  
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The above-captioned information appears under Management's Discussion and Analysis of Financial Condition and Results of Operations in the Annual Report and is incorporated herein by reference.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk  
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The above-captioned information appears under Management's Discussion and Analysis of Financial Condition and Results of Operations in the Annual Report and is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data  
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The Company's consolidated financial statements listed in Item 14 are incorporated herein by reference.

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Item 9. Changes In and Disagreements with Accountants on Accounting and  
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Financial Disclosure  
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None

PART III

Item 10. Directors and Executive Officers of the Registrant  
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The information contained under the sections captioned "Section 16(a) Beneficial Ownership Reporting Compliance" and "Proposal I-- Election of Directors" in the 2002 Proxy Statement are incorporated herein by reference.

Item 11. Executive Compensation  
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The information contained under the section captioned "Director and Executive Compensation" in the Proxy Statement is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management  
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(a) Security Ownership of Certain Beneficial Owners

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Information required by this item is incorporated herein by reference to the Section captioned "Voting Securities and Principal Holders Thereof-- Security Ownership of Certain Beneficial Owners" of the Proxy Statement.

(b) Security Ownership of Management

Information required by this item is incorporated herein by reference to the sections captioned "Voting Securities and Principal Holders Thereof -- Security Ownership of Certain Beneficial Owners" and "Proposal I -- Election of Directors" of the Proxy Statement.

(c) Management of the Company knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the registrant.

Item 13. Certain Relationships and Related Transactions  
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The information required by this item is incorporated herein by reference to the section in the Proxy Statement captioned "Certain Relationships and Related Transactions".

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Part IV

Item 14. Exhibits, Financial Statements, and Reports on Form 8-K  
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(a) Listed below are all financial statements and exhibits filed as part of this report, and are incorporated by reference.

1. The consolidated balance sheets of Norwood Financial Corp. and subsidiary as of December 31, 2001 and 2000, and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the three year period ended December 31, 2001, together with the related notes and the independent auditors' report of Beard Miller Company LLP. independent accountants.

2. Schedules omitted as they are not applicable.

3. Exhibits

- 3(i) Articles of Incorporation of Norwood Financial Corp.\*
- 3(ii) Bylaws of Norwood Financial Corp.\*
- 4.0 Specimen Stock Certificate of Norwood Financial Corp.\*
- 10.1 Amended Employment Agreement with William W.Davis, Jr.\*\*\*
- 10.2 Amended Employment Agreement with Lewis J. Critelli\*\*\*
- 10.3 Form of Change-in-Control Severance Agreement with nine key employees
- 10.4 Consulting Agreement with Russell L. Ridd\*\*
- 10.5 Wayne Bank Stock Opton Plan\*
- 10.6 Salary Continuation Agreement between the Bank and William W. Davis, Jr.\*\*\*

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- 10.7 Salary Continuation Agreement between the Bank and Lewis J. Critelli\*\*\*
- 10.8 Salary Continuation Agreement between the Bank and Edward C. Kasper\*\*\*
- 10.9 1999 Directors Stock Compensation Plan\*\*\*
- 13 Portions of the Annual Report to Stockholders
- 21 Subsidiaries of Norwood Financial Corp.  
(see Item 1. Business General and Subsidiary Activity)
- 23 Consent of Independent Accountants.

(b) Reports on Form 8K - None

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\* Incorporated herein by reference into this document from the Exhibits to Form 10, Registration Statement initially filed with the Commission on April 29, 1996, Registration No.6-28366.

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\*\* Incorporated herein by reference into this document from the Exhibits to the Registrant's Form 10-K filed with the Commission on March 31, 1997, File No. 0-28366.

\*\*\* Incorporated herein by reference into this document from the Exhibits to the Registrant's Form 10-K filed with the Commission on March 23, 2001, File No. 0-28366.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

NORWOOD FINANCIAL CORP.

Dated: March 22, 2002

By: /s/William W. Davis, Jr.

-----  
William W. Davis, Jr.  
President, Chief Executive  
Officer and Director  
(Duly Authorized Representative)

Pursuant to the requirement of the Securities Exchange Act of 1934, this Report has been signed below on March 22, 2002 by the following persons on behalf of the Registrant and in the capacities indicated.

By: /s/William W. Davis, Jr.

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William W. Davis, Jr.

By: /s/Lewis J. Critelli

-----  
Lewis J. Critelli

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President, Chief Executive Officer  
and Director  
(Principal Executive Officer)

Executive Vice President  
(Principal Financial and Accounting  
Officer)

By: /s/Charles E. Case  
-----  
Charles E. Case  
Director

By: /s/John E. Marshall  
-----  
John E. Marshall  
Director

By: /s/Daniel J. O'Neill  
-----  
Daniel J. O'Neill  
Director

By: /s/Dr. Kenneth A. Phillips  
-----  
Dr. Kenneth A. Phillips  
Director

By: /s/Gary P. Rickard  
-----  
Gary P. Rickard  
Director

By: /s/Russell L. Ridd  
-----  
Russell L. Ridd  
Director

By: /s/Harold A. Shook  
-----  
Harold A. Shook  
Director

By: /s/Richard L. Snyder  
-----  
Richard L. Snyder  
Director

ns contemplated by this Agreement. (d) No Law Prohibiting or Restricting Such Sale. There shall not be in effect any law, rule or regulation prohibiting or restricting such sale or requiring any consent or approval of any person which shall not have been obtained to issue the Shares (except as otherwise provided in this Agreement). (e) Opinion of Counsel. Counsel to the Company shall have delivered an opinion of counsel in form reasonably satisfactory to the Purchaser, in the form normally delivered by such counsel in connection with similar transactions. Section 6. Conditions to Obligations of Company 6.1 Conditions to Obligations of Company. The Company's obligation to sell and issue the Shares at the Closing is, at the option of the Company, which may waive any such 10 conditions to the extent permitted by law, subject to the fulfillment on or prior to the Closing Date of the following conditions: (a) Representations and Warranties Correct. The representations and warranties made by the Purchaser in Section 4 hereof shall be true and correct when made, and shall be true and correct on the Closing Date with the same force and effect as if they had been made on and as of said date. (b) Covenants. All covenants, agreements and conditions contained in this Agreement to be performed by the Purchaser on or prior to the Closing Date shall have been performed or complied with in all material respects. (c) No Order Pending. There shall not then be in effect any order enjoining or restraining the transactions contemplated by this Agreement. (d) No Law Prohibiting or Restricting Such Sale. There shall not be in effect any law, rule or regulation prohibiting or restricting such sale or requiring any consent or approval of any person which shall not have been obtained to issue the Shares (except as otherwise provided in this Agreement). Section 7. Covenants of the Company Until the termination of this Agreement in accordance with Section 11.1 hereof or of the particular covenant, as the case may be: 7.1 No Objection. Provided the Purchaser is in compliance with and has performed all covenants, agreements and conditions contained in this Agreement to be performed by the Purchaser, the Company shall not interpose any objection or take any legal action as a plaintiff in connection with the acquisition by the Purchaser of such number of shares of Common Stock as is permitted to be owned by the Purchaser pursuant to this Agreement and the Company hereby approves any such acquisition in accordance with the applicable provisions of the North Carolina Business Corporation Act. 7.2 Sale of Shares. The Company shall take such action as is reasonably necessary, subject to compliance with applicable law, to issue and sell the Shares to the Purchaser. 7.3 Board of Directors. (a) Board Representation. The Company shall be obligated to include in the slate of nominees recommended by the Company's Board of Directors or management to shareholders, for election as directors at the Company's next meeting of shareholders, one person designated by the Purchaser and reasonably acceptable to Company (any such person, a "Purchaser Nominee") In addition, if at any time the number of members constituting the entire Board of Directors shall equal or exceed nine, including the Purchaser Nominee appointed pursuant to the previous sentence, the Purchaser shall be entitled to designate and the Board shall appoint to the Board, an additional Purchaser Nominee in accordance with the provisions 11 of this Section. In the event of a vacancy caused by the disqualification, removal, resignation or other cessation of service of any Purchaser Nominee from the Board, the Board shall elect as a Director (to serve until the Company's immediately succeeding annual meeting of shareholders) a new Purchaser Nominee who has been designated by the Purchaser. The Purchaser shall nominate each Purchaser Nominee in advance of each meeting of shareholders at which such Purchaser Nominee is to be elected. Under no circumstances shall any holder of the Company's capital stock (other than an individual) that Beneficially Owns fewer shares of the Voting Securities than the Purchaser be entitled to nominate, nor shall the Company nominate, more representatives of such holder to the Board of Directors than the Purchaser is entitled to nominate. (b) Nominees. Any proposed Purchaser Nominee shall be a person acceptable to the Board in its reasonable discretion prior to the initial appointment, or election, as the case may be, of each Purchaser Nominee to the Board; provided, that at any time the President or Chief Financial Officer of the Purchaser's Diagnostics Division or the Senior Vice President or the Vice President - Marketing of the Near Patient Testing Segment of the Purchaser's Diagnostics Division, each shall be conclusively deemed to be acceptable to the Board for purposes of this Section; and provided, further, that once a Purchaser Nominee is accepted by, or deemed acceptable to, the Board, such person shall thereafter be conclusively deemed to be acceptable pursuant to this Agreement (together with such persons specified in the foregoing clauses (i) and (ii), the "Pre-Approved Persons"). Any objection by the Company to a proposed Purchaser Nominee must be made no later than five business days after the Purchaser delivers written notice of its proposed Purchaser Nominee; provided, however, that the Company shall in all cases notify the Purchaser of any such objection sufficiently in advance of the date on which proxy materials are mailed by the Company in connection with such election of directors to enable the Purchaser to propose an alternate Purchaser Nominee pursuant to and in accordance with the terms of this Agreement. (c) Election of Directors. The Company agrees, subject to

Section 7.3(b) above, to include such Purchaser Nominee to be added to or retained on the Board pursuant to this Agreement in the slate of nominees recommended by the Board to the Company's shareholders for election as directors and shall use its reasonable efforts to cause the election or reelection of each such Purchaser Nominee to the Board at each meeting of shareholders at which such Purchaser Nominee is up for election, including soliciting proxies in favor of the election of such person(s), it being understood that efforts consistent with those used for other members of the slate recommended by the Board shall be deemed reasonable. (d) Committees. The Board will not establish an executive committee authorized to exercise the power of the Board generally unless the 11 Purchaser is granted representation on such committee proportional to its representation on the Board, nor will the Board establish or employ committees (unless the Purchaser is granted proportional representation thereon) as a means designed to circumvent or having the effect of circumventing the rights of the Purchaser under this Agreement to representation on the Board. (e) Termination. The provisions of this Section 7.3 shall terminate as at any time the Purchaser Beneficially Owns less than 5% of the Voting Securities. 7.4 Change in Control. In the event of a Change in Control as defined in subsections (b), (d) and (e) of the definition thereof, if the price per share to be paid to shareholders of the Company in connection with the Change in Control (the "Change in Control Price Per Share") is less than the Purchase Price Per Share as to the Shares or \$10.00 per share as to the Original Shares and the Purchaser is not in default under that certain Distribution Agreement dated as of April 23, 2001 between the Company and the Purchaser (the "Distribution Agreement") through the date of the Change in Control, then the Company shall be obligated to pay the Purchaser, (a) for each of the Shares the Purchaser then holds, an amount equal to the Purchase Price Per Share minus the Change in Control Price Per Share, and (b) for each of the Original Shares the Purchaser then holds, an amount equal to \$10.00 per Original Share minus the Change in Control Price Per Share, such amounts to be paid to the Purchaser in addition to the Change in Control Price Per Share to be received in connection with the Change in Control; provided that this covenant shall terminate as to any Proposal for a Change in Control Transaction initiated after December 31, 2002, except with respect to closing of a Proposal or Change in Control Transaction initiated prior to December 31, 2002. 7.5 Change in Control Transactions. In the event that the Company receives, commences negotiations with respect to, or otherwise obtains knowledge of, a Proposal, it will promptly notify Purchaser and will provide Purchaser with an opportunity to propose a Change in Control Transaction in which the Purchaser or an Affiliate thereof would be the acquiring company and, in connection therewith will provide Purchaser with all information and equivalent access to the management and Board of Directors (including any committee of the Board of Directors which may be formed to consider such a transaction) as is made available to any other Person making a Proposal. Notwithstanding anything to the contrary contained in this Section 7.5, the Company shall have no obligations under this Section 7.5 to the extent that the Board of Directors determines that complying with the obligations set forth in this Section 7.5 would constitute a breach of duty to the Company or the shareholders of the Company. 7.6 Registration Rights. (a) Demand Registration. (i) At any time on or after the date hereof, the Purchaser, provided the registration rights hereunder have not lapsed as set forth in Section 7.6(i) hereof, may demand in writing that the Company effect a registration under the Securities Act of all or any portion (but not less than 13 than Shares with an aggregate fair market value of \$1,000,000); provided, however, that the Purchaser may request registration of any amount of Registrable Securities where the request relates to all remaining Registrable Securities for the purpose of sale in the manner specified in such demand. Such demand shall also specify the number of Registrable Securities that the Purchaser wishes to have so registered. The Company shall, within 10 days of receipt of such demand, give written notice of such demand to all other holders of the Company's securities with contractual rights on a pari passu basis to have such securities registered under the Securities Act. Any such holder may, within 30 days of its receipt of such notice from the Company, give a written notice (the "Inclusion Notice") to the Company specifying the number of the Company's securities which such holder wishes to include in such registration. The Company shall prepare and file a registration statement on any available form of registration statement, for the public sale of the Registrable Securities as soon as practicable; provided, however, that if the Company shall furnish to the holders of Registrable Securities (including the Purchaser, the "Participating Holders") a certificate signed by the Chairman or President of the Company stating that in the good faith judgment of the Board of Directors of the Company, that such Demand Registration would materially interfere with, or require premature disclosure of, any material financing, acquisition, reorganization or other material transaction involving the Company or any of its Subsidiaries, then the Company's obligation to file a registration statement shall be deferred for a reasonable period not to exceed 180 days from the date of such request, but in no event more than 180 days during any 24 month period. Upon written notice from the Company to the Participating

Holders delivered within 30 days of a demand to register Registrable Securities under this Section 7.6(a), the Purchaser's right to demand registration pursuant to this Section 7.6(a) shall be suspended during the period commencing 90 days before the date estimated in writing by the Company to be the date of filing of a registration statement, and ending six months following the effective date (or withdrawal date) of a registration statement, for an underwritten public offering of the Common Stock. (ii) All Participating Holders (including the Purchaser) proposing to distribute securities through such registration shall enter into an underwriting agreement with the managing or lead managing underwriter in the 14 form customarily used by such underwriter with such changes thereto as the parties thereto shall agree. If any Participating Holder disapproves of the terms of any such underwriting, it may elect to withdraw therefrom by written notice to the Company and the managing or lead managing underwriter. Any Registrable Securities so withdrawn from such underwriting shall be withdrawn from such registration. (iii) Whenever a registration is demanded pursuant to this Section 7.6(a), unless a managing or lead managing underwriter objects thereto, the Company may include in such registration securities for offering by the Company and any other holder of securities, it being understood, however, that the Company's and such other holder right of inclusion in such registration shall be subordinate to, and not pari passu with, the rights of the Participating Holders. (iv) If the managing underwriter thereof determines that the total number of shares of Registrable Securities to be sold in such offering shall be limited due to market conditions or otherwise, the reduction in the total number of shares offered shall be made by first excluding any shares of selling stockholders who are not holders of contractual rights to have such shares registered under the Securities Act and shares of selling stockholders who are holders of contractual rights to have such shares registered under the Securities Act that are subordinate to those of the Participating Holders and shares of selling stockholders who are holders of contractual rights to have such shares registered under the Securities Act that are subordinate to those of the Purchaser, then, if necessary, by reducing the total number of shares to be sold by the Company, and then, if necessary, by excluding pro rata (based on the number of Registrable Securities held) the Registrable Securities to be sold by the Participating Holders. (v) The Participating Holders shall have the right to select the underwriter or underwriters and manager or managers to administer such offering; provided, however, that each Person so selected shall be acceptable to the Company in its reasonable judgment. (vi) The Company shall be obligated to effect not more than two Demand Registrations. For purposes of the preceding sentence, a Demand Registration shall not be deemed to have been effected (i) unless a Demand Registration Statement with respect thereto has become effective, (ii) if after such Demand Registration Statement has become effective, such Demand Registration Statement or the related offer, sale or distribution of Registrable Securities thereunder is interfered with by any stop order, injunction or other order or requirement of the SEC or other governmental agency or court for any reason not attributable to the Participating Holders and such interference is not thereafter eliminated, (iii) if the conditions to closing specified in the underwriting agreement entered into in connection with 15 such registration are not satisfied or waived, other than by reason of a failure on the part of the Participating Holders or (iv) the number of shares of Registrable Securities to be sold by the Purchaser were reduced pursuant to Subsection (iv) above. If the Company shall have complied with its obligations under this Agreement, a right to demand a registration pursuant hereto shall be deemed to have been satisfied upon the earlier of (x) the date as of which all of the Registrable Securities included therein shall have been distributed pursuant to the Demand Registration Statement, and (y) the date as of which such Demand Registration shall have been Continuously Effective for a 60-day period or other period specified herein following the effectiveness of such Demand Registration Statement, provided no stop order or similar order, or proceedings for such an order, is thereafter entered or initiated. (vii) The Company shall use the Company's commercially reasonable efforts to keep the relevant registration statement Continuously Effective, if a Demand Registration Statement, for up to 60 days or until such earlier date as of which all the Registrable Securities under the Demand Registration Statement shall have been disposed of in the manner described in the Registration Statement, or such longer period (but in no event longer than 120 days) as in the judgment of counsel for the underwriters a prospectus is required by law to be delivered in connection with sales of Registrable Securities by an underwriter or dealer in accordance with plan of distribution included in such Demand Registration Statement. Notwithstanding the foregoing, if for any reason the effectiveness of a Demand Registration Statement pursuant to this Subsection is delayed or suspended or filing of the Demand Registration Statement or seeking effectiveness thereof is postponed as permitted herein, the commencement of the foregoing period shall be extended by the aggregate number of days of such suspension or postponement. (viii) Except for registration statements on Forms S-4, S-8 or any successor thereto, the Company will not file with the SEC any other registration statement with respect to its capital stock, whether for

its own account or that of other stockholders, from the date of receipt of a notice from requesting holders pursuant to this Section 7.6 until the completion of the period of distribution of the registration contemplated thereby. (b) Registration Statement Information Relating to the Purchaser. The Purchaser shall promptly upon receipt of written request provide the Company or any underwriter or counsel participating or otherwise involved in any such registration with any information relating to the Purchaser or the Registrable Securities that is reasonably required to be included in the registration statement or the prospectus, or any amendment thereof, relating to such offering or required to cause the registration to be declared and remain effective. Such information shall be submitted in writing, signed by the Purchaser, or a duly authorized representative or agent thereof, and shall state that the information is submitted specifically for the purpose of inclusion in the registration statement, prospectus, offering circular or other document related to the registration or qualification of the Registrable Securities pursuant hereto. If the Purchaser fails within a reasonable time to provide such information, the Company may exclude from such registration the Registrable Securities requested by the Purchaser to be included therein. (c) Registration Procedures. If and whenever the Company is required to effect the registration of any Registrable Securities of the Purchaser pursuant hereto, the Company will: (i) prepare and file with the SEC a registration statement with respect to such Registrable Securities and use reasonable efforts to cause such registration statement to become and remain effective as provided herein; provided, however, that before filing a Demand Registration Statement or prospectus or any amendments or supplements thereto, including documents incorporated by reference after the initial filing of the Demand Registration Statement and prior to effectiveness thereof, the Company shall furnish to counsel for the Purchaser and underwriters, copies of all such documents in the form substantially as proposed to be filed with the SEC at a reasonable time prior to filing for review and comment by such counsel; (ii) prepare and file with the SEC such amendments and supplements to such Demand Registration Statement and the prospectus used in connection with such Demand Registration Statement as may be necessary to comply with the provisions of the Securities Act and rules thereunder with respect to the distribution of all securities covered by such Demand Registration Statement and as may be reasonably requested by the Purchaser or necessary to keep such Demand Registration Statement effective. If the registration is for an underwritten offering, the Company shall amend the Demand Registration Statement or supplement the prospectus whenever required by the terms of the underwriting agreement. Pending such amendment or supplement the Purchaser and all other members of the Purchaser Group, upon written notice by the Company, shall cease making offers or Transfers of Registrable Securities pursuant to the prior prospectus. In the event that any Registrable Securities included in a Demand Registration Statement subject to, or required by, this Agreement remain unsold at the end of the period during which the Company is obligated to use its commercially reasonable efforts to maintain the effectiveness of such Demand Registration Statement, the Company may file a post-effective amendment to the Demand Registration Statement for the purpose of removing such securities from registered status; (iii) notify the Purchaser and the Underwriters' Representative and (if requested) confirm such advice in writing, as soon as practicable after notice thereof is received by the Company (i) when the Demand Registration Statement or any amendment thereto has been filed or becomes effective, the prospectus or any amendment or supplement to the prospectus included therein has been filed, and, to furnish the Purchaser and the underwriters with copies thereof, (ii) of any request by the SEC for amendments or supplements to the Demand Registration Statement or the prospectus included therein or for additional information, (iii) if at any time the representations and warranties of the Company cease to be true and correct, and (iv) of the receipt by the Company of any notification with respect to the suspension or qualification of the Registrable Securities for offering or sale in any jurisdiction or the initiation or threatening of any proceeding for such purpose; (iv) immediately notify the Purchaser, at any time when a prospectus relating thereto is required to be delivered under the Securities Act, of the happening of any event as a result of which the prospectus included in the registration statement, as then in effect, includes an untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading in the light of the circumstances then existing, and if it is necessary, in the opinion of counsel to the Company, to prepare and file with the SEC such amendments and supplements to such registration statement and the prospectus used in connection therewith as may be necessary to keep such registration statement effective and current and to comply with the provisions of the Securities Act with respect to the sale or other disposition of all shares covered by such registration statement, including such amendments and supplements as may be necessary to reflect the intended method of disposition from time to time of the Purchaser if the registration is effected in connection with an offering which is not underwritten; (v) cooperate with the Purchaser and the Underwriters' Representatives to facilitate the timely

preparation and delivery of certificates representing Registrable Securities to be sold and not bearing any restrictive legends; and enable such Registrable Securities to be in such denomination and registered in such names as the 18 Underwriters' Representative may request at least two business days prior to the sale of Registrable Securities to the underwriters; (vi) cooperate with the Purchaser in connection with any filings required to be made with the NASD, and otherwise use its best efforts to comply with the rules, by-laws and regulations of the NASD as they apply to the registration; (vii) furnish to the Purchaser such number of copies of a prospectus, including a preliminary prospectus and any amendments and any supplements thereto, in conformity with the requirements of the Securities Act, as the Purchaser may reasonably request in order to facilitate the public sale or other disposition of the Registrable Securities owned by the Purchaser; (viii) use reasonable efforts to register or qualify the Registrable Securities covered by such registration statement under such other securities or blue sky or other applicable laws of such jurisdictions within the United States as the Purchaser shall reasonably request to enable the Purchaser to consummate the public sale or other disposition of the Registrable Securities owned by the Purchaser, and to obtain the withdrawal of any order suspending the effectiveness of a Demand Registration Statement, or the lifting of any suspension of the qualification (or exemption from qualification) of the offer and Transfer of any of the Registrable Securities in any jurisdiction, at the earliest possible moment; except that the Company shall not for any such purpose be required (i) to qualify generally to do business as a foreign corporation in any jurisdiction in which it would not be required to so qualify but for such registration or qualification, (ii) to subject itself to taxation in any such jurisdiction, or (iii) to consent to general service of process in any such jurisdiction; (ix) use its best efforts to furnish to the Purchaser who has included Registrable Securities in the registration statement a signed counterpart, addressed to the Purchaser, of (A) an opinion of counsel for the Company, dated the date of the closing under the underwriting agreement, and (B) a "cold comfort" letter signed by the independent public accountants who have issued a report on the Company's financial statements included in such registration statement dated the date of effectiveness of the registration statement and the date of the closing under the underwriting agreement, covering substantially the same matters with respect to such registration statement (and the prospectus included therein) and, in the case of such accountants' letters, with respect to events subsequent to the date of such financial statements, as are customarily covered in 19 opinions of issuer's counsel and in accountants' letters delivered to underwriters in underwritten public offerings of securities and, in the case of the accountants' letters, such other financial matters as the Purchaser may reasonably request; (x) otherwise use its best efforts to comply with all applicable rules and regulations of the SEC, and make available to its security holders, as soon as reasonably practicable, an earnings statement covering the period of at least 12 months, beginning with the first month of the first fiscal quarter after the effective date of such registration statement, which earnings statement shall satisfy the provisions of Section 11(a) of the Securities Act; (xi) use its best efforts to list such Registrable Securities on each securities exchange or over-the-counter market on which shares of Common Stock are then listed, if such Registrable Securities are not already so listed and if such listing is then permitted under the rules of such exchange and, if shares of Common Stock are not then listed on a securities exchange or over-the-counter market, to use its best efforts to cause such Registrable Securities to be listed on such securities exchange or over-the-counter market as the managing or lead managing underwriter shall reasonably request; (xii) use its best efforts to provide a transfer agent and registrar for such Registrable Securities not later than the effective date of such registration statement; (xiii) if requested by the managing or lead managing underwriter for any underwritten offering that includes any Registrable Securities, enter into an underwriting agreement with the underwriters of such offering, such agreement to contain such representations and warranties by the Company and such other terms and conditions as are contained in underwriting agreements customarily used by such managing or lead managing underwriter with such changes as the parties thereto shall agree, including, without limitation, provisions relating to indemnification and contribution in lieu thereof; (xiv) cooperate with the Purchaser, and the Underwriters' Representative for such offering in the marketing, and customary selling efforts relating to the Registrable Securities, including participating for a period not in excess of five (5) business days per Demand Registration in customary "road show" presentations as may be reasonably requested by the Underwriters' Representative; (xv) promptly notify the Purchaser of any stop order issued or threatened to be issued by the SEC in connection therewith and take all reasonable actions required to prevent the entry of such stop order or to remove it if entered; and (xvi) make available for inspection by the Purchaser, any underwriter participating in such offering and the representatives of the Purchaser and such underwriter all financial and other information as shall be reasonably requested by them, and provide the Purchaser, any underwriter participating in such offering and the representatives of the Purchaser and such underwriter the reasonable

opportunity to discuss the business affairs of the Company with its principal executives and independent public accountants who have certified the audited financial statements included in such registration statement, in each case all as necessary to enable them to exercise their due diligence responsibilities under the Securities Act; provided, however, that information that the Company determines, in its reasonable and good faith judgment, to be confidential and which the Company advises such Person in writing, is confidential shall not be disclosed unless such Person signs a confidentiality agreement reasonably satisfactory to the Company. (d) Termination of Sales. During the effective period of any registration statement covering Registrable Securities, the Purchaser will not effect sales thereof after receipt of telegraphic or written notice from the Company to suspend sales to permit the Company to correct or update a registration statement or prospectus until the Purchaser receives written notice from the Company that the registration statement or prospectus has been corrected or updated. At the end of the effective period of any registration statement covering any Registrable Securities, the Purchaser shall discontinue sales of shares pursuant to such registration statement upon receipt of notice from the Company of its intention to remove from registration the shares covered by such registration statement which remain unsold, and the Purchaser shall notify the Company of the number of shares registered which remain unsold immediately upon receipt of such notice from the Company. (e) Expenses of Registration. With respect to the Demand Registrations effected pursuant to Subsection (a) hereof, the Company shall bear and pay all expenses incurred in connection with any registration, filing, or qualification of Registrable Securities with respect to such Demand Registration, including all registration, filing and NASD fees, all fees and expenses of complying with securities or blue sky laws, all word processing, duplicating and printing expenses, messenger and delivery expenses, and the reasonable fees and disbursements of counsel for the Company, and of the Company's independent public accountants, including the expenses of "cold comfort" letters required by or incident to such performance and compliance (the "Registration Expenses"), but in no event shall the Company bear underwriting 21 discounts and commissions relating to Registrable Securities or fees and expenses of the Purchaser's counsel (which shall be paid by the Purchaser) and provided that the Company shall not be required to pay for any expenses of any registration begun pursuant to Subsection (a) if the registration is subsequently withdrawn at the request of the Purchaser (in which case the Purchaser shall bear such expense), other than by reason of failure of the Company to comply with its covenants contained herein unless the Purchaser agrees that such withdrawn registration shall constitute one of the Demand Registrations under Subsection (a) hereof. (f) Indemnification. (i) In any registration in which the Purchaser participates, the Company will indemnify the Purchaser and each underwriter and selling broker for the Purchaser and each officer and director of the Purchaser and each person, if any, who controls the Purchaser or any such underwriter or broker within the meaning of Section 15 of the Securities Act, against all claims, losses, damages, expenses and liabilities (or actions in respect thereof), including any of the foregoing incurred in settlement of any litigation, commenced or threatened, arising out of or based on any untrue statement (or alleged untrue statement) of a material fact contained in any preliminary prospectus or amended preliminary prospectus or in the prospectus, offering circular or other document incident to any registration, qualification or compliance (or in any related registration statement, notification or the like) as such may be amended or supplemented from time to time or any omission (or alleged omission) to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, or any violation by the Company of the Securities Act or any rule or regulation promulgated thereunder or any state securities laws or regulations applicable to the Company in connection with any such registration, qualification or compliance, and will reimburse the Purchaser and each such underwriter, broker and controlling person for any legal and any other expenses reasonably incurred, as such expenses are incurred, in connection with investigating or defending any such claim, loss, damage, liability or action; provided, however, that the Company will not be liable in any such case to the extent that any such claim, loss, damage or liability arises out of or is based on any untrue statement or omission made in reliance upon and in conformity with written information furnished to the Company in an instrument executed by the Purchaser or the underwriter for the Purchaser or any representative of the Purchaser or the underwriter for the Purchaser and stated to be specifically for use therein. 22 (ii) In any registration in which the Purchaser participates, the Purchaser will indemnify the Company and its officers and directors, each person, if any, who controls any thereof within the meaning of Section 15 of the Securities Act and their respective successors and any underwriter for the Company for such registration and each other security holder participating in the registration against all claims, losses, damages, expenses and liabilities (or actions in respect thereof) arising out of or based on any untrue statement (or alleged untrue statement) of a material fact contained in any preliminary prospectus or

amended prospectus or in the prospectus, offering circular or other document incident to any registration statement, qualification or compliance (or in any related registration statement, notification or the like) as such may be amended or supplemented from time to time or any omission (or alleged omission) to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, and will reimburse the Company and each other person indemnified pursuant to this paragraph (ii) for any legal and any other expenses reasonably incurred, as such expenses are incurred, in connection with investigating or defending any such claim, loss, damage, liability or action; provided, however, that this paragraph (ii) shall apply only if (and only to the extent that) such statement or omission was made in reliance upon and in conformity with written information (including, without limitation, written negative responses to inquiries) furnished to the Company specifically for inclusion in the prospectus, offering circular, or other document incident to the registration statement by an instrument duly executed by the Purchaser or its representatives, and as to which the Company had no actual knowledge. Notwithstanding the foregoing, the liability of the Purchaser under this paragraph (ii) shall be limited to an amount equal to the aggregate proceeds received by the Purchaser from the sale of its shares in such registration, unless such liability arises out of or is based on willful misconduct by the Purchaser. (iii) Each party entitled to indemnification hereunder (the "Indemnified Party") shall give notice to the party required to provide indemnification (the "Indemnifying Party") promptly after such Indemnified Party has actual knowledge of any claim as to which indemnity may be sought, and shall permit the Indemnifying Party (at its expense) to assume the defense of any claim or any litigation resulting therefrom, provided that counsel for the Indemnifying Party, who shall conduct the defense of such claim or litigation, shall be satisfactory to the Indemnified Party, and the Indemnified Party may participate in such defense at such party's expense, and provided, further, that the omission by any Indemnified Party to give notice as provided herein shall not relieve the Indemnifying Party of its obligations under this Section 7.6(f) except to the extent that the omission results from a failure of actual notice to the Indemnifying Party by the Indemnified Party and such Indemnifying Party is damaged solely as a result of the failure to give notice; and provided further, however, that the Indemnifying Party shall not be entitled to assume the defense for matters as to which there is, in the opinion of counsel to the Indemnified Party, a conflict of interest or separate and different defenses. No Indemnifying Party, in the defense of any such claim or litigation, shall, except with the consent of each Indemnified Party, consent to entry of any judgment or enter into any settlement which does not include as an unconditional term thereof the giving by the claimant or plaintiff to such Indemnified Party of a release from all liability in respect of such claim or litigation. (iv) The payments with respect to any indemnity required by this Section 7.6(f) shall be made by periodic payments during the course of the investigation or defense, as and when bills are received or expenses incurred, upon submission of supporting invoices or other claims for payment, including any calculations necessary to pro-rate any amounts payable pursuant to the indemnity. (g) Contribution. (i) If the indemnification provided for in Section 7.6(f) hereof is unavailable to the Indemnified Parties in respect of any losses, claims, damages, liabilities or expenses (or actions in respect thereof) referred to therein, then each such Indemnifying Party, in lieu of indemnifying such Indemnified Party, shall contribute to the amount paid or payable by such Indemnified Party as a result of such losses, claims, damages, liabilities or expenses (or actions in respect thereof) in such proportion as is appropriate to reflect the relative fault of the Indemnifying Party on the one hand and the Indemnified Party on the other in connection with the statement or omission which resulted in such losses, claims, damages, liabilities or expenses (or actions in respect thereof), as well as any other relevant equitable considerations. The relative fault shall be determined by reference to, among other things, whether the untrue statement (or alleged untrue statement) of a material fact or the omission (or alleged omission) to state a material fact relates to information supplied by the Indemnifying Party or the Indemnified Party and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission. The Company and each Purchaser agree that it would not be just and equitable if contribution pursuant to this Section 7.6(g) were determined by pro rata allocation or by any other method of allocation which does not take account of the equitable considerations referred to above. The amount paid or payable by an Indemnified Party as a result of the losses, claims, damages, liabilities or expenses (or actions in respect thereof) referred to above in this Section 7.6(g) or in Section 7.6(f) shall be deemed to include any legal or other expenses reasonably incurred by such Indemnified Party in connection with investigating or defending any such action or claim. (ii) Notwithstanding anything to the contrary contained herein, the obligation of the Purchaser to contribute pursuant to this Section 7.6(g) is several and not joint and the Purchaser shall not be required to contribute any amount in excess of the amount by which the total price at which the shares of the Purchaser were offered to the public exceeds the

amount of any damages which the Purchaser has otherwise been required to pay by reason of such untrue statement (or alleged untrue statement) or omission (or alleged omission). (iii) No person guilty of fraudulent misrepresentation (within the meaning of Section 11 (f) of the Securities Act) shall be entitled to contribution from any person who was not guilty of such fraudulent misrepresentation. (h) Rule 144 Requirements. The Company shall make whatever filings with the SEC or otherwise and undertake to make publicly available and available to the Purchaser, pursuant to Rule 144 of the SEC under the Securities Act (or any successor rule or regulation), such information as is necessary to enable the Purchaser to make sales of Registrable Securities pursuant to that Rule. The Company shall furnish to the Purchaser, upon request, a written statement executed by the Company as to the steps it has taken to comply with the current public information requirements of Rule 144. (i) Survival and Termination of Rights. The agreements and covenants contained in this Section 7.6 shall be continuing and shall survive any Transfer of the Shares to any member of the Purchaser Group. However, the rights of the Purchaser to cause the Company to register its Registrable Securities hereunder shall terminate with respect to such securities and such securities shall no longer be deemed to be Registrable Securities following a bona fide, firmly underwritten public offering of such Registrable Securities under the Securities Act or at such time as the Purchaser is able to dispose of all of its Registrable Securities in one three-month period pursuant to the provisions of Rule 144. 25 (j) Sales During Registration. If so requested by the Underwriters' Representative in connection with an offering of any Registrable Securities, the Company shall agree not to effect any sale or distribution of shares of Common Stock during the 7-day period prior to, and during the 90-day period beginning on, the date such Demand Registration Statement is declared effective under the Securities Act by the SEC. The Company agrees to use its commercially reasonable efforts to obtain from each holder of restricted securities of the Company the same as or similar to those being registered by the Company on behalf of the Purchaser, or any restricted securities convertible into or exchangeable or exercisable for any of its securities, an agreement not to effect any sale or distribution of such securities (other than securities purchased in a public offering) during any period referred to in this paragraph, except as part of any such Demand Registration Statement if permitted. Without limiting the foregoing, if the Company grants any Person (other than a holder of Registrable Securities) any rights to demand or participate in a Registration, the Company agrees that the agreement with respect thereto shall include such Person's agreement as contemplated by the previous sentence. (k) Granting of Registration Rights. Notwithstanding anything to the contrary contained herein, the Company shall not, without the prior written consent of the Purchaser Group, grant any rights to any Persons to register any shares of capital stock or other securities of the Company if such rights could reasonably be expected to be superior to or be on parity with, the rights of the holders of Registrable Securities granted pursuant to this Agreement upon the exercise of Demand Registration rights contained herein. 7.7 No Restrictions. The Company will not, prior to January 1, 2003, make or recommend to its shareholders any amendment to the Company's Articles of Incorporation or Bylaws which would impose limitations on the legal rights of the Purchaser Group as Company shareholders (other than those imposed pursuant to this Agreement) based upon the size of security holding permitted under this Agreement, the business in which a security holder is engaged or other considerations applicable to the Purchaser Group and not to security holders generally. 7.8 Share Listing. As soon as practicable, the Company shall take reasonable action as is required to cause the Shares to be listed for trading on The NASDAQ Stock Market ("NASDAQ"). 7.9 Preemptive Rights. The Company shall, prior to any issuance by the Company of any of its securities (other than debt securities with no equity feature), offer to the Purchaser by written notice the right, for a period of thirty (30) days, to purchase the Purchaser's Pro Rata Share (as such term is defined below) of such securities for cash at a price equal to the price or other consideration for which such securities are to be issued; provided, however, that the preemptive rights of the Purchaser pursuant to this Section 7.9 shall not apply to securities issued (A) upon conversion of any shares of 26 the Preferred Stock outstanding on the Closing Date (B) as a stock dividend or upon any subdivision of shares of Common Stock, provided that the securities issued pursuant to such stock dividend or subdivision are limited to additional shares of Common Stock, (C) pursuant to options or other rights which are issued pursuant to the 1994 or 1995 Stock Option Plans or any similar plan approved by the Board of Directors of the Company and the holders of Voting Securities within one year of such Board approval or (D) in payment of dividend obligations on the Preferred Stock. The Company's written notice to the Purchaser shall describe the securities proposed to be issued by the Company and specify the number, price and payment terms. The Purchaser may accept the Company's offer as to the full number of securities offered to it or any lesser number by written notice thereof given by it to the Company prior to the expiration of the aforesaid thirty (30) day period, in which event the Company shall promptly sell and the

Purchaser shall buy, upon the terms specified, the number of securities agreed to be purchased by the Purchaser. For purposes of this Section 7.9, the Purchaser's "Pro Rata Share" of offered securities shall be determined by multiplying the full number of securities offered by the Company by a fraction, the numerator of which shall be the number of shares of Common Stock held by the Purchaser as of the date of the Company's notice of offer and the denominator of which shall be the aggregate number of shares of Common Stock (calculated as aforesaid) held on such date by all holders of capital stock of the Company. The Company shall be free at any time following expiration of the thirty-day offer period and prior to ninety (90) days after the expiration of the thirty day offer period, to offer and sell to any third party or parties the number of the securities not agreed by the Purchaser to be purchased by it, all at a price and on payment terms no less favorable to the Company than those specified in such notice of offer to the Purchaser. However, if such third party sale or sales are not consummated within such ninety (90) day period, the Company shall not sell such securities as shall not have been purchased within such period without again complying with this Section 7.9.

**7.10 Share Buyback.** In the event the Company or any of its Affiliates shall repurchase shares of Voting Securities, including any redemption of the Preferred Stock, the Company shall offer to purchase such number of shares of Voting Securities as would be necessary on a pro rata basis to ensure that Purchaser as an "other entity" does not exceed 20% Beneficial Ownership of the Company's "Voting Shares" within the meaning of the North Carolina Shareholder Protection Act. The purchase price per share of such Voting Securities shall be the Average Market Price as of the date of the Purchaser's acceptance of the offer to purchase.

**Section 8. Covenants of the Purchaser Until the termination of this Agreement in accordance with Section 11.1 hereof or of the particular covenant, as the case may be:**

**8.1 Limitation on Ownership of Voting Securities.** (a) The Purchaser shall not (and shall not permit any Subsidiary to directly or indirectly) acquire Beneficial Ownership of any Voting Securities, or any other rights to acquire Voting Securities (except, in any case, by way of stock dividends or other distributions or offerings made available to holders of any Voting Securities generally) or authorize or make a tender, exchange or other offer, without the written consent of the Company, if the effect of such acquisition would be to increase the Voting Power of all Voting Securities then owned by the Purchaser or which it has a right to acquire to more than 20 % of the Total Voting Power of the Company. (b) Nothing in Section 8.1 (a) above shall prevent the Purchaser from acquiring Voting Securities without regard to the limitation set forth therein (i) if an offer is made (as evidenced by the filing with the SEC of a Schedule 14D-1) by another person or group (which is not controlled by or under common control with the Purchaser) to purchase or exchange for cash or other consideration any Voting Securities which, if successful, would result in such Person or group owning or having the right to acquire more than 20 % of the Total Voting Power of the Company then in effect and such offer is not withdrawn, terminated or enjoined prior to the Purchaser acquiring Voting Securities in response thereto, or (ii) if it is publicly disclosed or the Purchaser otherwise learns that another Person or group has acquired any Voting Securities (or rights to acquire Voting Securities) which results in such Person or group owning or having the right to acquire Voting Securities that would result in a Total Ownership Percentage of not less than 20 % or (iii) a Proposal for a Change in Control Transaction is made to the Company other than by the Purchaser.

**8.2 Voting.** The Purchaser shall vote all shares of Voting Securities which it Beneficially Owns, at any shareholder meeting or in connection with any action by written consent at or in which such shares of Voting Securities are entitled to vote, (a) in favor of the slate of nominees (including any Purchaser Nominee to be included in such slate in accordance with Section 7.3) proposed by the Board, provided that the Company has complied with Section 7.3, and (b) on any non-Company sponsored shareholder proposal which is opposed by the Company, in accordance with the direction of the Board as to how such shares of Voting Securities shall be voted. On all other matters the Purchaser shall be entitled to vote the Voting Securities held by it in its discretion. The Purchaser, as the holder of shares of Voting Securities, shall be present, in person or by proxy, at all meetings of shareholders of the Company so that all shares of Voting Securities beneficially owned by the Purchaser may be counted for the purposes of determining the presence of a quorum at such meetings.

**8.3 Voting Trust, etc.** The Purchaser shall not deposit any shares of Voting Securities in a voting trust or, except as otherwise provided herein, subject any Voting Securities to any arrangement or agreement with respect to the voting of such Voting Securities.

**8.4 Solicitation of Proxies.** The Purchaser shall not solicit proxies with respect to any Voting Securities, and shall not become a "participant" in any "election contest" (as such terms are used in Rule 14a-11 of Regulation 14A under the Exchange Act relating to the election of directors of the Company).

**8.5 Acts in Concert with Others.** The Purchaser Group shall not join a partnership, limited partnership, syndicate or other group, or otherwise act in concert with any third person, for the purpose of acquiring, holding, or disposing of Voting Securities.

**8.6 Restrictions on Transfer of Voting**

Securities. (a) The Purchaser shall not, directly or indirectly, sell or Transfer any Voting Securities for a period of one year commencing with the Closing Date. (b) Subject to Section 8.6(a), the Purchaser shall not, directly or indirectly, sell or Transfer any Voting Securities, except (i) to the Company or any person or group approved by the Company; (ii) to an Affiliate of the Purchaser, as long as such Affiliate agrees to hold such Voting Securities subject to all the provisions of this Agreement, including this Section 8.6, and agrees to Transfer such Voting Securities to the Purchaser or another Affiliate of the Purchaser if it ceases to be an Affiliate of the Purchaser; (iii) pursuant to Rule 144 under the Securities Act (but only to the extent the sale or Transfer of Voting Securities at any time is in compliance with the volume limitations of paragraph (e) thereunder); (iv) pursuant to an effective registration statement under the Securities Act; (v) subject to the Company's right of first refusal as set forth in Section 9.1 hereof, in transactions not otherwise described in this Section 9.1(b) as long as such transactions do not, directly or indirectly, individually or in the aggregate, result, to the best knowledge of the Purchaser, after reasonable inquiry, in any single person or group owning or having the right to acquire Voting Securities representing 5% or more of the Total Voting Power of the Company then in effect; (vi) pursuant to a bona fide pledge of such Voting Securities to an institutional lender to secure a loan, guarantee or other financial support, provided that such lender agrees to hold such Voting Securities subject to all provisions of this Agreement and any sale or disposition by such lender of such pledged Voting Securities shall be subject to the limitations of this Section 8.6; or (vii) pursuant to a pro rata dividend to the stockholders of the Purchaser. (c) Notwithstanding Section 8.6(a), Purchaser may, directly or indirectly, sell or Transfer any Voting Securities: (i) in response to (A) an offer to purchase or exchange for cash or other consideration any Voting Securities (I) which is made by or 29 on behalf of the Company, or (II) which is made by another person or group and is either recommended to the shareholders of the Company by the Board of Directors or not opposed by the Board of Directors of the Company within the time such Board is required, pursuant to regulations under the Exchange Act, to advise the Company's shareholders of such Board's position on such offer, or (III) in the case of a merger or other business combination transaction, which has been approved by the shareholders of the Company (including approval without a meeting pursuant to the short-form merger provisions of the North Carolina Business Corporation Act) in a manner so as to be legally binding on all shareholders of the Company and so as to require the disposition by such shareholders of their shares pursuant to such merger or other business combination transaction (without regard to this Agreement) or (B) subject to the Company's rights of first refusal as set forth in Section 9.1, any other offer made by another person or group to purchase or exchange for cash or other consideration any Voting Securities which, if successful, would result in such person or group owning or having the right to acquire Voting Securities representing more than 50 % of the Total Voting Power of the Company then in effect; (ii) in the event of a merger or consolidation in which the holders of Voting Securities of the Company prior to the merger or consolidation cease to hold at least 51% of the voting securities of the surviving entity; or (iii) pursuant to a plan of liquidation of the Company. Any shares permitted to be sold hereunder shall be free and clear of the restrictions contained in this Agreement.

8.7 Non-Disclosure. (a) During the duration of this Agreement and for a period of five (5) years thereafter, neither party shall disclose to third parties, or use for its benefit, in whole or in part, any Proprietary Information received from other party, except to the extent required to comply with the Food, Drug and Cosmetic Act (21 U.S.C. ss.ss. 301 et seq.) and the regulations promulgated thereunder and all foreign equivalents thereof or other laws. Each party shall take all reasonable steps to minimize the risk of disclosure of Proprietary Information, including, without limitation: (i) ensuring that only its employees whose duties require them to possess such information have access thereto; and 30 (ii) exercising at least the same degree of care that it uses for its own Proprietary Information. (b) Duties Upon Termination. Except as otherwise permitted under this Agreement, upon request by the disclosing party after expiration or termination of this Agreement, the other party shall either return all of such disclosing party's Proprietary Information (including data, memoranda, drawings and other writings and tapes and all copies thereof) received or prepared by it or destroy the same, and in any event shall make no further use of such Proprietary Information at any time provided, however, that counsel for the receiving party may keep one copy of the Proprietary Information for purposes of ascertaining the receiving party's obligations pursuant to this Section 8.7. (c) Use of Proprietary Information. During the duration of this Agreement and for a period of five (5) years thereafter, neither party shall use the other party's Proprietary Information for any purposes, except to perform its obligations hereunder. In no event shall the Purchaser use any Proprietary Information for commercial purposes subsequent to the termination of this Agreement. (d) Injunctive Relief. Each party acknowledges that the other party would not have an adequate remedy at law for breach of any of the covenants contained in this Section 8.7 and hereby

consents to the enforcement of same by the other party by means of temporary or permanent injunction issued by any court having jurisdiction thereof and further agrees that the other party shall be entitled to assert any claim it may have for damages resulting from the breach of such covenants in addition to seeking injunctive or other relief. The provisions of this Agreement relating to Proprietary Information shall supercede any prior agreements relating to Proprietary Information between the Purchaser and the Company.

**8.8 Company Right of Repurchase.** If at any time there is a Change in Control of the Purchaser involving another entity having any operations related to rapid coagulation monitoring systems, then the Company shall have the right to purchase all, but not a part of, the Voting Securities then Beneficially Owned by the Purchaser and its Subsidiaries upon or prior to the effective date of the Change in Control of the Purchaser. The purchase price per share of such Voting Securities shall be the Average Market Price as of the date of the Company's exercise of its right to repurchase.

**8.9 Acquisition of Stock.** The Purchaser shall advise management of the Company as to the Purchaser's acquisition of any additional shares of Voting Securities, or rights thereto, in writing within 10 calendar days following any such acquisition. All of the Purchaser's purchases of Voting Securities shall be in compliance with applicable laws and regulations and the provisions of this Agreement.

**31 Section 9. Company Right of First Refusal** Until the termination of this Agreement in accordance with Section 11.1 hereof or of the particular covenant:

**9.1 Right of First Refusal.** Prior to making any sale or Transfer of Voting Securities of the Company pursuant to Section 8.6(a)(v), the Purchaser shall give the Company the opportunity to purchase such Voting Securities in the following manner: (a) The Purchaser shall give notice (the "Transfer Notice") to the Company in writing of such intention specifying the approximate number of the proposed purchasers or transferees, the amount of Voting Securities proposed to be sold or transferred, the proposed price per share therefor (the "Transfer Price") and the other material terms upon which such disposition is proposed to be made. (b) The Company shall have the right, exercisable by written notice given by the Company to the Purchaser within 30 days after receipt of such Transfer Notice, to purchase all but not part of the Voting Securities specified in such Transfer Notice for cash per share equal to the Transfer Price. (c) If the Company exercises its right of first refusal hereunder, the closing of the purchase of the Voting Securities with respect to which such right has been exercised shall take place within 60 calendar days after the Company receives notice, which period of time shall be extended if necessary in order to comply with any applicable laws and regulations. Upon exercise of its right of first refusal, the Company and the Purchaser shall be legally obligated to consummate the purchase contemplated thereby and shall use their best efforts to secure any approvals required in connection therewith. (d) If the Company does not exercise its right of first refusal hereunder within the time specified for such exercise, the Purchaser shall be free, during the period of 90 calendar days following the expiration of such time for exercise, to sell the Voting Securities specified in such Transfer Notice and if no sale occurs within such time period, the Voting Securities shall again be subject to the provisions of this Section 9.1. The Purchaser's transferee shall acquire such Voting Securities free from any of the provisions of this Agreement; however, such Voting Securities shall be subject to any restrictions imposed under applicable securities laws. (e) Notwithstanding anything to the contrary contained in this Section 9.1, if Purchaser intends to sell or Transfer any Voting Securities of the Company pursuant to Section 8.6(a)(v), and such proposed sale or Transfer is to an institutional purchaser approved by the Company at or above the Average Market Price, then the Company must exercise its right of first refusal, if at all, within ten (10) business days of receipt of the Transfer Notice, and if not, the proposed Transfer shall thereafter be subject to the provisions of subparagraph 9.1 (d) above.

**9.2 Tender Offer Sale.** Prior to making any sale or exchange of Voting Securities pursuant to Section 8.6(c)(i)(B) in response to a tender or exchange offer, the Purchaser shall give the Company the opportunity to purchase such Voting Securities in the following manner: (a) The Purchaser shall give notice (the "Tender Notice") to the Company in writing of such intention no later than 10 calendar days prior to the latest time by which Voting Securities must be tendered in order to be accepted pursuant to such offer or to qualify for any proration applicable to such offer (the "Tender Date"), specifying the amount of Voting Securities proposed to be tendered. For purposes hereof, a tender offer to purchase Voting Securities shall be deemed to be an offer at the price specified therein, without regard to any provisions thereof with respect to proration or conditions to the offeror's obligation to purchase (assuming such conditions are not impossible of performance when the offer is made, without giving effect to the Company's right of first refusal). (b) If the Tender Notice is given, the Company shall have the right, exercisable by giving notice to the Purchaser at least two business days prior to the Tender Date, to purchase all but not part of the Voting Securities specified in the Tender Notice for cash. If the Company exercises such right by giving such notice, the closing of the purchase of such Voting Securities shall take place not later than one business day prior to the

Tender Date; provided, however, that if the purchase price specified in the tender offer includes any property other than cash, the value of any property included in the purchase price shall be jointly determined by a nationally recognized investment banking firm selected by each party or, in the event such firms are unable to agree, a third nationally recognized investment banking firm to be selected by such two firms. (c) The parties shall use their best efforts to cause any determination of the value of any securities included in the purchase price to be made within three business days after the date of delivery of the Tender Notice. If the firms selected by the Purchaser and the Company are unable to agree upon the value of any such securities within such three-day period, the firms shall promptly select a third firm whose determination shall be made promptly and shall be conclusive. (d) The parties shall use their best efforts to cause any determination of the value of property other than securities to be made within four business days after the date of delivery of the Tender Notice. If the firms selected by the Purchaser and the Company are unable to agree upon a value within such four-day period, the firms shall promptly select a third firm whose determination shall be made promptly and shall be conclusive. 33 (e) The purchase price to be paid by the Company pursuant to this Section 9.2 shall be (x) if such tender offer is consummated, the purchase price that the Purchaser would have received if it had tendered the Voting Securities purchased by the Company and all such Voting Securities had been purchased in such tender offer, including any increases in the price paid by the tender offeror after exercise by the Company of its right of first refusal hereunder, or (y) if such tender offer is not consummated, the highest bona fide price offered pursuant thereto, in each case with property, if any, to be valued as aforesaid. Each party shall bear the cost of its own investment banking firm and the parties shall share the cost of any third firm selected hereunder. (f) If the Company does not exercise such right by giving such notice or fails to complete the purchase, then the Purchaser shall be free to accept the tender offer with respect to which the Tender Notice was given. (g) If the Company does not purchase the shares, the Company will provide such assurance as the tender offeror shall reasonably request to provide the tender offeror with certificates for the Purchaser's shares without legends referring to this Agreement. 9.3

Assignment of Rights. In the event that the Company elects to exercise a right of first refusal under this Section 9, the Company may specify, prior to closing such purchase and upon not less than three business days prior notice to the Purchaser, another person as its designee to purchase the Voting Securities to which such notice relates. If the Company shall designate another person as the purchaser pursuant to this Section 9, the giving of notice of acceptance of the right of first refusal by the Company shall constitute a legally binding obligation of the Company to complete such purchase if such designee shall fail to do so. Section 10. Definitions "Affiliate" of a Person has the meaning set forth in Rule 12b-2 under the Exchange Act. "Agreement" has the meaning set forth in the recitals hereof. "Average Market Price" of any security at any date shall be the average of the closing prices for a share or other single unit of such security on the 30 consecutive trading days ending on the trading date last preceding the date of determination of such price on the principal national securities exchange on which such security is listed, or, if such security is not listed on any national securities exchange, the average of the closing sales prices for a share of such security on NASDAQ or, if such closing sales prices shall not be reported on NASDAQ, the average of the mean between the closing bid and asked prices of a share of such security in such case as reported by The Wall Street Journal, or, if such prices shall not be so reported, as the same shall be reported by the National Quotation Bureau Incorporated, or, in all other cases, the value as determined by a single nationally recognized investment banking firm jointly selected by the Company and the Purchaser. For this purpose, the parties shall use their best efforts to cause any determination of the value to be made within 10 business days after the date on which the value is to be 34 measured. The determination by the investment banking firm selected in the manner set forth above shall be conclusive. "Beneficially Own" with respect to any securities means having "beneficial ownership" of such securities (as determined pursuant to Rule 13d-3 under the Exchange Act, as in effect on the date hereof, without limitation by the 60-day provision in paragraph (d)(1)(i) thereof). The terms "Beneficial Ownership" and "Beneficial Owner" have correlative meanings. "Change in Control" means the occurrence of any of the following events: (a) the direct or indirect purchase or acquisition by any Person or 13D Group (other than an Excluded Person) of Beneficial Ownership of Voting Securities or Common Securities of the Company if, after giving effect to such acquisition, such Person or 13D Group would Beneficially Own Voting Securities or Common Securities representing an Equity Percentage of 30% or more on a fully diluted basis; (b) the consummation by the Company or any of its Subsidiaries of a merger, consolidation or other business combination with any Person (other than an Excluded Person) that requires the approval of the holders of the Company's capital stock, whether for such transaction or the issuance of securities in such transaction, if immediately after giving effect to such transaction, the Persons who Beneficially Owned Voting Securities or Common Securities

immediately prior to such transaction Beneficially Own in the aggregate Voting Securities or Common Securities (or voting securities or common securities in the case of a surviving entity other than the Company) representing a Voting Ownership Percentage or a Total Ownership Percentage (or voting power or common equity ownership of common securities in the case of a surviving entity other than the Company) on a fully diluted basis of less than 50% immediately after giving effect to such transaction; (c) the consummation by the Company of a plan of complete liquidation or dissolution of the Company; (d) the sale of all or substantially all of the Company's assets to any Person (other than an Excluded Person); or (e) the sale or transfer of all or substantially all of the Company's rights related to the manufacture and sale of products in the Company's Routine Product or Specialty Product division, as such terms are defined in the Distribution Agreement, to any Person (other than an Excluded Person). "Change in Control of the Purchaser" shall mean any of the following: (i) a merger or consolidation to which the Purchaser is a party if the shareholders of the Purchaser immediately prior to the effective date of such merger or consolidation have Beneficial Ownership of voting securities representing less than 50 % of the Total Voting Power of the surviving corporation following such merger or consolidation; (ii) an acquisition by any person, entity or group of 35 direct or indirect Beneficial Ownership of voting securities of the Purchaser representing 40 % or more of the Total Voting Power of the Purchaser then issued and outstanding; (iii) a sale of all or substantially all the assets of Purchaser; (iv) a liquidation of Purchaser; or (v) a change in the composition of the Board of Directors of the Purchaser such that during any consecutive 24-month period, directors who are members of the Board at the beginning of such 24-month period, or their successors who were elected, nominated or recommended by at least a majority of the Board of Directors as constituted at the time of their appointment to the Board, cease to constitute at least a majority of the Board of Directors. "Change in Control Transaction" means a transaction which, if consummated, would result in a Change in Control. "Change in Control Price Per Share" has the meaning set forth in Section 7.4. "Closing" has the meaning set forth in Section 2.1. "Closing Date" has the meaning set forth in Section 2.1. "Common Stock" has the meaning set forth in Section 1.1. "Common Securities" means the Common Stock, the Preferred Stock and any other securities of the Company (excluding non-voting securities (other than capital stock) issued to directors, officers or employees of the Company as compensation) to the extent to which such securities by the terms thereof (i) are not effectively limited in amount as to dividends or amounts payable upon liquidation of the Company or (ii) are otherwise a substantial equivalent of Common Stock as to dividends or upon liquidation of the Company or upon consummation of a merger or other extraordinary transaction in which the outstanding shares of Common Stock participate. "Company" has the meaning set forth in the recitals hereof. "Continuously Effective," with respect to a specified registration statement, shall mean that such registration statement shall not cease to be effective and available for transfers of Registrable Securities thereunder for longer than either (i) any ten (10) consecutive business days, or (ii) an aggregate of fifteen (15) business days during the period specified in the relevant provision of this Agreement. "Current Facility" means the equipment and space used in the operation of the business prior to the effective date hereof, including the approximately 60,000 square feet of building space leased by the Company, and the surrounding property leased, controlled, or used by the Company at 5301 Departure Drive, Raleigh, North Carolina, 27616. "Demand Registration" shall have the meaning set forth in Section 7.6(a). "Distribution Agreement" has the meaning set forth in Section 7.4. "Environment" shall mean soil, surface waters, groundwaters, land, stream sediments, surface or subsurface strata, indoor or outdoor air, and any environmental medium. 36 "Environmental Condition" shall mean any condition with respect to the Environment on or off the Facilities, whether or not yet discovered, which could or does result in any damage, loss, cost, expense, claim, demand, order, or liability to or against the Company or the Purchaser by any third party (including, without limitation, any government authority), including, without limitation, any condition resulting from the operation of the Company's business and/or the operation of the business of any other property owner or operator in the vicinity of the Facilities and/or any activity or operation formerly conducted by any person or entity on or off the Facilities. "Environmental Law" shall mean any statute, rule, regulation, ordinance, decree, or order of any Governmental Entity or court, including common law, relating to (i) the control of any potential pollutant, pathogen, or waste; (ii) protection of the Environment; or (iii) protection of public or occupational health and safety, whether any of the foregoing are enacted or promulgated at the federal, state, or local level, including but not limited to, the terms, conditions, restrictions, and obligations imposed by any Environmental Permit (as defined below). The term "Environmental Law" shall include, but not be limited to, the following statutes and regulations promulgated thereunder: the Clean Air Act, 42 U.S.C. ss. 7401 et seq., the Clean Water Act, 33 U.S.C. ss. 1251 et seq., the Superfund Amendments and Reauthorization Act, 42 U.S.C. ss. 1101 et

seq. ("SARA"), the Toxic Substances Control Act, 15 U.S.C. ss. 2601 et seq., the Safe Drinking Water Act, 42 U.S.C. ss. 300f et seq., the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"), and any state, county, or local statutes, regulations, or ordinances similar thereto. "Environmental Permits" has the meaning set forth in Section 3.9(b). "Equity Percentage" means, with respect to any Common Securities calculated at any particular point in time, the ratio, expressed as a percentage of (a) the total number of shares of Common Stock included in, or issuable upon conversion of (whether or not then convertible), or otherwise constituting the economic equivalent of, such Common Securities over (b) the total number of shares of Common Stock then outstanding and the number of shares of Common Stock issuable upon conversion of (whether or not then convertible), or otherwise constituting the economic equivalent of, all outstanding Common Securities. "Exchange Act" has the meaning set forth in Section 3.5. "Excluded Person" shall mean (i) any member of the Purchaser Group, (ii) any wholly owned Subsidiary of the Company, or (iii) any underwriter temporarily holding Common Securities in connection with a public offering of such securities. "Facilities" means either the Current Facility or the New Facility or both of them. "Governmental Entity" means any government or any agency, bureau, board, commission, court, department, political subdivision, tribunal, or other instrumentality of any government (including any regulatory or administrative agency), whether federal, state or local, domestic or foreign. "Group" shall have the meaning comprehended by Section 13(d)(3) of the Exchange Act and the rules and regulations promulgated thereunder. 37 "Inclusion Notice" has the meaning set forth in Section 7.6(a). "Indemnified Party" has the meaning set forth in Section 7.6(f). "Indemnifying Party" has the meaning set forth in Section 7.6(f). "Intellectual Property" means any and all, whether domestic or foreign, patents, patent applications, patent rights, trade secrets, confidential business information, formulae, processes, copyrights, software methodologies, claims of infringement against third parties, licenses (other than software or similar licenses commercially available), permits, license rights, contract rights with employees, consultants and third parties, joint venture rights or rights under any contract or agreement involving the license or transfer of technology (whether to or from the Company or its Subsidiaries with third parties), rights of priority, goodwill, Trademarks, trademark rights, works of authorships, inventions and discoveries, and other such rights generally classified as intangible, intellectual property assets in accordance with generally accepted accounting principles; provided that when used with respect to the Company or its Subsidiaries, the term refers to Intellectual Property used or held for use in or required for use in connection with the business of the Company or its Subsidiaries as now operated or as proposed to be operated by the Company or its Subsidiaries in the future. "Intellectual Property Agreements" means all agreements, arrangements or understandings (whether written or oral) pursuant to which the Company or any Subsidiary has either purchased, sold, licensed, secured or disposed of rights in Intellectual Property from or to another Person or agreed to do any of the foregoing (other than licenses to commercially available off-the-shelf computer software acquired or entered into by the Company or any Subsidiary in the ordinary course of business). "Material Adverse Effect" means any material adverse effect on the financial condition, business or operations of the Company and its Subsidiaries taken as a whole. "NASD" has the meaning set forth in Section 3.6. "NASDAQ" has the meaning set forth in Section 7.8. "New Facility" means the equipment and space to which the Company has moved the operation of the business, the approximately 60,000 square feet of building space leased by the Company, and the surrounding property leased, controlled or used by the Company at 9401 Globe Center, Morrisville, North Carolina 27560. "Order" means any judgment, decree, order, writ, award, ruling, stipulation, injunction or determination of an arbitrator or court or other Governmental Entity. "Original Shares" means the 600,000 shares of common stock of the Company previously acquired by Chiron Diagnostics Corporation (predecessor to the Company) as a result of the Company's exchange offer in 1998. "Participating Holders" has the meaning set forth in Section 7.6(a). 38 "Permit" shall mean any permit, license, approval, consent, or authorization issued by a federal, state, or local Governmental Entity pursuant to Environmental Law, and any term, condition, restriction, or obligation imposed thereby. "Person" means any individual, corporation, company, association, partnership, joint venture, limited liability company, trust or unincorporated organization, group (within the meaning of Rule 13d-5 under the Exchange Act) or a government or any agency or political subdivision thereof (whether foreign, federal, state, local or otherwise). "Pre-Approved Persons" has the meaning set forth in Section 7.3(b). "Preferred Stock" has the meaning set forth in Section 3.2. "Pro Rata Share" has the meaning set forth in Section 7.9. "Proposal" means any inquiry, indication of interest, proposal or offer made to the Company or publicly disclosed by any Person relating to any Change in Control Transaction. "Proprietary Information" means: all financial information, marketing information, sales information, customer information, raw materials, know-how, drawings, compositions,

manufacturing and other specifications, analytical procedures, flow sheets, reports, market studies, preclinical and clinical test results, FDA and other regulatory submissions, software and other medical, research, technical, and marketing information disclosed, directly or indirectly, by either party or any of its Affiliates to the other party, retroactively to December 17, 1997, in writing, marked "Confidential", "Proprietary" or the like, or, if transmitted orally or by observation of equipment or other material, confirmed by a writing so marked within sixty (60) days of its disclosure, or which by its nature is information normally intended to be held in confidence, unless the same: (a) is or becomes public knowledge through no fault of the receiving party; (b) is legally in the possession of the receiving party prior to receipt from the disclosing party; (c) is subsequently and lawfully received from a third party without its breach of any nondisclosure obligation; (d) is independently developed by employees of the receiving party who have had no access to the Proprietary Information of the disclosing party; or (e) is required to be disclosed by order of a court or administrative agency, provided that in such event the party that is subject to the required disclosure furnish the other party with adequate notice. Notwithstanding the immediately preceding sentence, the Company agrees that all new materials and other information which the Purchaser or its predecessor provided to the Company prior to December 17, 1997, shall be treated as Proprietary Information. "Purchase Price Per Share" has the meaning set forth in Section 1.2. "Purchaser" has the meaning set forth in the recitals hereof. "Purchaser Group" shall mean (a) the Purchaser, (b) any Subsidiary of the Purchaser, (c) any Affiliate of the Purchaser controlled by the Purchaser such that the Purchaser has the legal or contractual power (including, without limitation, through negative control or through the Purchaser's designees or representatives on the board of directors or other governing body of such Affiliate or under the articles of incorporation or other constituent documents of such Affiliate or as a result of the voting rights of any securities or other 39 instruments issued by such Affiliate) to cause such Affiliate to comply with the terms of this Agreement applicable to the Purchaser, and (d) any Person with whom the Purchaser or any Person included in the foregoing clauses (b) or (c) is part of a 13D Group. "Purchaser Nominee" has the meaning set forth in Section 7.3(a). "Register," "registered," and "registration" shall refer to a registration effected by preparing and filing a registration statement or similar document in compliance with the Securities Act, and the declaration or ordering by the SEC of effectiveness of such registration statement or document. "Registrable Securities" shall mean (A) the Shares, (B) the Original Shares and (C) any shares of Common Stock issued as (or issuable upon the conversion of any warrant, right or other security which is issued as) a dividend or other distribution with respect to or in replacement of the Common Stock described in clauses (A), (B) and (C) above. In the event that the Common Stock is converted into any other security pursuant to any merger, consolidation, recapitalization, liquidation or other similar transaction, and if any securities are distributed in respect of any Registrable Securities, then all of such securities shall be considered Registrable Securities for purposes of this Agreement. "Registration Expenses" shall have the meaning set forth in Section 7.6(e). "Regulatory Approvals" means any and all certificates, permits, licenses, franchises, concessions, grants, consents, approvals, orders, registrations, authorizations, waivers, variances or clearance from a Governmental Entity. "Release" shall mean any releasing, spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, disposing, or dumping into the Environment. "Securities Act" has the meaning set forth in Section 2.2. "SEC" has the meaning set forth in Section 3.5. "SEC Reports" means (i) the Company's Annual Report on Form 10-K for the fiscal years ended December, 2000, 1999 and 1998; and (ii) each registration statement, report on Form 8-K and Form 8-A, proxy statement, information statement or other document, report or statement filed by the Company or any of its Subsidiaries with the SEC since January 1, 1998, in each case in the form (including financial statements, schedules, exhibits and any amendments thereto) filed with the SEC. "Shares" has the meaning set forth in Section 1.2. "Subsidiary" means, as to any Person, any other Person more than fifty percent (50%) of the shares of the voting securities or other voting interests of which are owned or controlled, or the ability to select or elect more than fifty percent (50%) of the directors or similar managers is held, directly or indirectly, by such first Person or one or more of its Subsidiaries or by such first Person and one or more of its Subsidiaries. A Subsidiary that is directly 40 or indirectly wholly-owned by another Person except for directors' qualifying shares shall be deemed wholly-owned for purposes of this Agreement. "Substances" means any pollutant, toxic substance, hazardous substance, hazardous material, pathogen, radioactive substance, solid waste, hazardous waste, biological waste, petroleum, or petroleum substance as defined in or regulated pursuant to any Environmental Law enacted on or prior to the date hereof. "13D Group" shall mean any group of Persons who, with respect to those acquiring, holding, voting or disposing of Voting Securities would, assuming ownership of the requisite percentage thereof, be required under Section 13(d) of the Exchange Act and the rules and regulations thereunder to file a statement on Schedule 13D with

the SEC as a "person" within the meaning of Section 13(d)(3) of the Exchange Act, or who would be considered a "person" for purposes of Section 13(g)(3) of the Exchange Act. "13D Group" when used with reference to standards or tests that are based on securities other than Voting Securities shall have the foregoing meaning except that the words "Voting Securities" in the second line of the definition of "13D Group", in the case of standards or tests based on "securities of the Company", shall be replaced with the words "securities of the Company". "Tender Notice" has the meaning set forth in Section 9.2(a). "Tender Date" has the meaning set forth in Section 9.2(a). "Threat of Release" shall mean a substantial likelihood of a Release that requires action to prevent or mitigate damage to the Environment that may result from such Release. "Total Ownership Percentage" means, with respect to any Person calculated at a particular point in time, the ratio, expressed as a percentage, of (a) the total number of shares of Common Stock Beneficially Owned by such Person and issuable upon conversion of (whether or not then convertible), or otherwise constituting the economic equivalent of, all Common Securities Beneficially Owned by such Person, over (b) the total number of shares of Common Stock then outstanding and the number of shares of Common Stock issuable upon conversion (whether or not then convertible) of, or otherwise constituting the economic equivalent of, all outstanding Common Securities. "Total Voting Power" means the total number of votes which may be cast in the election of directors of a Person at any meeting of shareholders of the Person if all securities entitled to vote in the election of directors of the Person were present and voted at such meeting (other than votes that may be cast only upon the happening of a contingency) plus, without duplication of any Votes otherwise taken into account, the number of Votes attributable to any voting securities issued by the Person since the most recent meeting of shareholders of the Person. "Trademark" shall mean any word, name, symbol or device or any combination thereof, whether or not registered, used to identify and distinguish a Person's goods or services, including unique products, from those manufactured or sold by others and to indicate the source of the goods or services, even if that source is unknown. 41 "Transfer" shall mean and include the act of selling, giving, transferring, creating a trust (voting or otherwise), assigning or otherwise disposing of (other than pledging, hypothecating or otherwise transferring as security) (and correlative words shall have correlative meanings); provided, however, that any transfer or other disposition upon foreclosure or other exercise of remedies of a secured creditor after an event of default under or with respect to a pledge, hypothecation or other transfer as security shall constitute a "Transfer." "Transfer Notice" has the meaning set forth in Section 9.1(a). "Transfer Price" has the meaning set forth in Section 9.1(a). "Underwriters' Representative" shall mean the managing underwriter, or, in the case of a co-managed underwriting, the managing underwriter designated as the Underwriters' Representative by the co-managers. "Votes" shall mean, at any time, with respect to any Voting Securities, the total number of votes that would be entitled to be cast by the holders of such Voting Securities generally (by the terms of such Voting Securities, the Articles of Incorporation or any certificate of designations for such Voting Securities) in a meeting for the election of Directors held at such time, including the votes that would be able to be cast by holders of shares of any preferred stock. "Voting Ownership Percentage" shall mean, calculated at a particular point in time, the Voting Power represented by the Voting Securities Beneficially Owned by the Person whose Voting Ownership Percentage is being determined. "Voting Power" shall mean, calculated at a particular point in time, the ratio, expressed as a percentage, of (a) the Votes represented by the Voting Securities with respect to which the Voting Power is being determined to (b) Total Voting Power of the Company. "Voting Securities" means the shares of Common Stock, the Preferred Stock and any other securities of the Company entitled to vote generally for the election of directors, and any securities (other than employee stock options) which are convertible into, or exercisable or exchangeable for, Voting Securities. "Warrants" shall mean those certain warrants to purchase shares of the Common Stock issued pursuant to that certain Preferred Stock and Warrant Purchase Agreement dated as of February 24, 2000.

Section 11. Miscellaneous 11.1 Termination of Agreement. (a) The Company may terminate its obligation to perform or observe any of its covenants and agreements hereunder if the Purchaser violates any of the covenants or agreements of the Purchaser under this Agreement or the Distribution Agreement, and the Purchaser may terminate its obligations to perform or observe any of its covenants and agreements hereunder if the Company violates 42 or fails to perform any of the covenants or agreements of the Company under this Agreement; provided, however, that the Company or the Purchaser, as the case may be, may not terminate any of its obligations under this Agreement pursuant to this sentence unless it shall have delivered written notice of such default to the other party and such default shall not have been cured within 30 calendar days after the delivery of such notice. (b) From and after the termination of this Agreement, the covenants, obligations and agreements of the parties set forth herein shall be of no further force or effect and the parties shall be under no further obligation with respect thereto. (c) Notwithstanding the provisions of

this Section 11.1, the respective obligations of the Company and the Purchaser under Sections 7.6 and 8.7 of this Agreement shall survive any termination of this Agreement. 11.2 Best Efforts. As long as the other party hereto is not in default of any material obligation under this Agreement, each of the Company and the Purchaser shall use its best efforts to take all actions required under any law, rule or regulation adopted subsequent to the date hereto in order that the respective agreements and covenants of the parties hereto may be carried out on a timely basis in the manner contemplated by this Agreement. 11.3 Governing Law. This Agreement shall be governed in all respects by the laws of the State of North Carolina as applied to contracts entered into solely between residents of, and to be performed entirely within, such state. 11.4 Survival. The representations and warranties in Sections 3 and 4 of this Agreement shall survive any investigation made by the Purchaser or the Company and the Closing, and shall expire one year after the Closing; provided that such representations and warranties shall not be construed so as to constitute representations and warranties concerning circumstances existing after the date of this Agreement (except for the representation made in Section 4.1 hereof which shall be deemed to be made by the Purchaser in connection with each purchase of shares purchased from the Company pursuant to this Agreement). 11.5 Successors and Assigns. This Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns. Except as otherwise provided in this Agreement, this Agreement may not be assigned by a party without the prior written consent of the other party except by operation of law and except, in the case of the Purchaser, to an Affiliate of the Purchaser, in which case the assignee shall be subject to all of the provisions of this Agreement. The Purchaser may not assign this Agreement to any pledgee of its shares of Common Stock. 11.6 Entire Agreement; Amendment. This Agreement and the other documents delivered pursuant hereto constitute the full and entire understanding and agreement between the parties with regard to the subject matter hereof and thereof and supersede all prior agreements and understandings among the parties relating to the subject matter hereof. No party shall be liable or bound to any other party in any manner by any warranties, representations or covenants except as specifically set forth herein. Neither this Agreement nor any term hereof may be amended, waived, discharged or terminated other than by a written instrument signed by the party against whom enforcement of any such amendment, waiver, discharge or termination is sought. 11.7 Notices and Dates. Any notice or other communication given under this Agreement shall be sufficient if in writing and delivered by hand, by messenger or by courier, or transmitted by facsimile, to a party at its address set forth below (or at such other address as shall be designated for such purpose by such party in a written notice to the other party hereto): if to the Company, to it at: Pharmanetics, Inc. 9401 Globe Center Drive Suite 140 Morrisville, NC 27560 Attention: President Fax: (919) 954-9932 with a copy to: Larry E. Robbins, Esq. Wyrick Robbins Yates & Ponton, LLP 4101 Lake Boone Trail, Suite 300 Raleigh, North Carolina 27607 Fax: (919) 781-4865 if to Purchaser, to it at: Bayer Corporation 63 North Street Medfield, Massachusetts 02052 Attention: Senior Vice President and General Manager, Near Patient Testing Segment Fax: (508) 359-3115 44 with copies to: Bayer Corporation 63 North Street Medfield, Massachusetts 02052 Attention: NPT Counsel Fax: (508) 359-3885 Marilyn Mooney Fulbright & Jaworski L.L.P. 801 Pennsylvania Avenue, N.W. Washington, D.C. 20004-2615 Fax: (202) 662-4643 Each such notice or other communication shall for all purposes of this Agreement be treated as effective or having been given when delivered if delivered personally, by messenger or by courier, or, if sent by facsimile, upon confirmation of receipt. 11.8 Specific Performance. The parties hereto acknowledge and agree that irreparable damage would occur in the event any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached and that such damage would not be compensable in money damages and that it would be extremely difficult or impracticable to measure the resultant damages. It is accordingly agreed that any party hereto shall be entitled to an injunction or injunctions to prevent breaches of the provisions of the Agreement and to enforce specifically the terms and provisions hereof, in addition to any other remedy to which it may be entitled at law or equity, and such party that is sued for breach of this Agreement expressly waives any defense that a remedy in damages would be adequate and expressly waives any requirement in an action for specific performance for the posting of a bond by the party bringing such action. 11.9 Further Assurances. The parties hereto shall do and perform or cause to be done and performed all such further acts and things and shall execute and deliver all such other agreements, certificates, instruments or documents as any other party may reasonably request from time to time in order to carry out the intent and purposes of this Agreement and the consummation of the transactions contemplated hereby. Neither the Company nor the Purchaser shall voluntarily undertake any course of action inconsistent with satisfaction of the requirements applicable to them set forth in this Agreement and each shall promptly do all such acts and take all such measures as may be appropriate to enable them

to perform as early as practicable the obligations herein required to be performed by them. 11.10Counterparts. This Agreement may be executed in any number of counterparts, each of which may be executed by fewer than all of the parties, each of which shall be enforceable against the parties actually executing such counterparts, and all of which together shall constitute one instrument. 45 11.11Severability. In the event that any provision of this Agreement becomes or is declared by a court of competent jurisdiction to be illegal, unenforceable or void, this Agreement shall continue in full force and effect without said provision; provided, that no such severability shall be effective if it materially changes the economic impact of this Agreement on any party. 11.12Captions. Headings of the various sections of this Agreement have been inserted for convenience of reference only and shall not be relied upon in construing this Agreement. Use of any gender herein to refer to any person shall be deemed to comprehend masculine, feminine and neuter unless the context clearly requires otherwise. 11.13Public Statements. The Company and the Purchaser agree not to issue any public statement with respect to the Purchaser's investment or proposed investment in the Company or the terms of any agreement or covenant among them without the other party's reasonable prior written consent, except such disclosures as may be required under applicable law or under any applicable order, rule or regulation or, in the case of the Company, except as necessary to pursue discussions with other strategic Purchasers. 11.14 Brokers. (a) The Company has not engaged, consented to or authorized any broker, finder or intermediary to act on its behalf, directly or indirectly, as a broker, finder or intermediary in connection with the transactions contemplated by this Agreement. The Company hereby agrees to indemnify and hold harmless the Purchaser from and against all fees, commissions or other payments owing to any such person or firm acting on behalf of the Company hereunder. (b) The Purchaser has not engaged, consented to or authorized any broker, finder or intermediary to act on its behalf, directly or indirectly, as a broker, finder or intermediary in connection with the transactions contemplated by this Agreement. The Purchaser hereby agrees to indemnify and hold harmless the Company from and against all fees, commissions or other payments owing to any such person or firm acting on behalf of the Purchaser hereunder, 11.15Costs and Expenses. Each party hereto shall pay its own costs and expenses incurred in connection herewith, including the fees of its counsel, auditors and other representatives, whether or not the transactions contemplated herein are consummated. 11.16No Third-Party Rights. Nothing in this Agreement shall create or be deemed to create any rights in any person or entity not a party to this Agreement except for such rights as may exist by virtue of any contract or other agreement existing on the date hereof. 11.17Attorneys' Fees, The prevailing party in any litigation between the Purchaser and the Company involving this Agreement shall be entitled to recover from the other party its reasonable attorneys' fees and costs, 46 11.18Amendment. Sections 7, 8, 9, 10 and 11 of that certain Stock Purchase Agreement dated August 28, 1998 between Cardiovascular Diagnostics, Inc. (predecessor to the Company) and Chiron Diagnostics Corporation (predecessor to the Purchaser) is hereby amended and restated in their entirety in Sections 7, 8, 9, 10 and 11, respectively, of this Agreement; provided that Section 8.6(a) shall be deemed satisfied with respect to the Original Shares. [The next page is the signature page.] 47 IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their respective authorized officers as of the date first above written. PHARMANETICS, INC. By: /s/ John Funkhouser John Funkhouser President BAYER CORPORATION By: /s/ Frances L. Tuttle Frances L. Tuttle Senior Vice President - Near Patient Testing 48