

EVANS BANCORP INC  
Form 10-Q  
August 04, 2006

**Table of Contents**

**United States  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

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

For quarterly period ended June 30, 2006

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-18539  
**EVANS BANCORP, INC.**

(Exact name of registrant as specified in its charter)

New York

16-1332767

(State of other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

14 -16 North Main Street, Angola, New York

14006

(Address of principal executive offices)

(Zip Code)

(716) 926-2000

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act: (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.)

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Common Stock, \$.50 par value 2,725,601 shares as of August 2, 2006



INDEX  
EVANS BANCORP, INC. AND SUBSIDIARIES

	PAGE
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
<u>Unaudited Consolidated Balance Sheets June 30, 2006 and December 31, 2005</u>	1
<u>Unaudited Consolidated Statements of Income-Three months ended June 30, 2006 and 2005</u>	2
<u>Unaudited Consolidated Statements of Income-Six months Ended June 30, 2006 and 2005</u>	3
<u>Unaudited Consolidated Statements of Stockholders' Equity-Six months ended June 30, 2006 and 2005</u>	4
<u>Unaudited Consolidated Statements of Cash Flows Six months ended June 30, 2006 and 2005</u>	5
<u>Notes to Unaudited Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	14
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	21
<u>Item 4. Controls and Procedures</u>	22
<u>PART II. OTHER INFORMATION</u>	
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	23
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	23
<u>Item 6. Exhibits</u>	24
<u>SIGNATURES</u>	25
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	
<u>Exhibit 32.1</u>	
<u>Exhibit 32.2</u>	

---

**Table of Contents**

1

PART I FINANCIAL INFORMATION  
 ITEM I FINANCIAL STATEMENTS  
 EVANS BANCORP, INC. AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED BALANCE SHEETS  
 JUNE 30, 2006 AND DECEMBER 31, 2005  
 (in thousands, except share and per share amounts)

	June 30, 2006	December 31, 2005
<b>ASSETS</b>		
Cash and cash equivalents:		
Cash and due from banks	\$ 13,110	\$ 15,635
Securities:		
Available for sale, at fair value	143,627	155,610
Held to maturity, at amortized cost	4,429	4,342
Loans and leases, net of allowance for loan and lease losses of \$3,604 in 2006 and \$3,211 in 2005	269,383	256,810
Properties and equipment, net	8,161	8,151
Goodwill	9,639	9,639
Intangible assets	2,704	2,728
Bank-owned life insurance	9,819	9,586
Other assets	7,193	6,045
<b>TOTAL ASSETS</b>	<b>\$ 468,065</b>	<b>\$ 468,546</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>LIABILITIES</b>		
Deposits:		
Demand	\$ 68,178	\$ 71,183
NOW	11,636	12,401
Regular savings	89,748	86,558
Muni-vest	34,676	27,521
Time	138,770	139,145
Total deposits	343,008	336,808
Federal funds purchased and agreements to repurchase securities	5,934	8,985
Other short-term borrowings	32,178	34,585
Other liabilities	7,512	6,629
Junior subordinated debentures	11,330	11,330
Long-term borrowings	30,874	33,333
Total liabilities	430,836	431,670
<b>CONTINGENT LIABILITIES AND COMMITMENTS</b>		
<b>STOCKHOLDERS EQUITY:</b>		

Edgar Filing: EVANS BANCORP INC - Form 10-Q

Common stock, \$.50 par value; 10,000,000 shares authorized; 2,745,338 and 2,745,338 shares issued, respectively, and 2,727,101 and 2,729,779 shares outstanding, respectively	1,373	1,373
Capital surplus	26,153	26,155
Retained earnings	12,636	11,087
Accumulated other comprehensive loss, net of tax	(2,543)	(1,387)
Less: Treasury stock, at cost (18,237 and 15,559 shares, respectively)	(390)	(352)
Total stockholders' equity	37,229	36,876
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 468,065</b>	<b>\$ 468,546</b>

*See Notes to Unaudited Consolidated Financial Statements*

---

**Table of Contents**

2

## PART I FINANCIAL INFORMATION

## ITEM I FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED STATEMENTS OF INCOME  
 THREE MONTHS ENDED JUNE 30, 2006 AND 2005  
 (in thousands, except share and per share amounts)

	Three Months Ended June 30,	
	2006	2005
INTEREST INCOME		
Loans	\$ 4,892	\$ 3,886
Federal funds sold/Interest bearing deposits at other banks	19	63
Securities:		
Taxable	1,075	1,257
Non-taxable	483	488
Total interest income	6,469	5,694
INTEREST EXPENSE		
Deposits	2,126	1,599
Other borrowings	557	342
Junior subordinated debentures	206	158
Total interest expense	2,889	2,099
NET INTEREST INCOME	3,580	3,595
PROVISION FOR LOAN AND LEASE LOSSES	228	188
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	3,352	3,407
NON-INTEREST INCOME:		
Bank charges	477	500
Insurance service and fees	1,510	1,549
Net gain on sales of securities		12
Premium on loans sold	1	3
Bank-owned life insurance	128	103
Life insurance proceeds		80
Other	423	260
Total non-interest income	2,539	2,507
NON-INTEREST EXPENSE:		
Salaries and employee benefits	2,440	2,280
Occupancy	501	480
Supplies	83	92
Repairs and maintenance	134	146
Advertising and public relations	190	112
Professional services	251	259

Edgar Filing: EVANS BANCORP INC - Form 10-Q

Amortization of intangibles	135	127
Other Insurance	90	102
Other	660	704
Total non-interest expense	4,484	4,302
INCOME BEFORE INCOME TAXES	1,407	1,612
INCOME TAXES	336	437
NET INCOME	\$ 1,071	\$ 1,175
Net income per common share-basic	\$ 0.39	\$ 0.44
Net income per common share-diluted	\$ 0.39	\$ 0.44
Cash dividends per common share	\$ 0.00	\$ 0.00
Weighted average number of common shares	2,724,710	2,723,641
Weighted average number of diluted shares	2,727,803	2,726,588

*See Notes to Unaudited Consolidated Financial Statements*

---



**Table of Contents**

3

## PART I FINANCIAL INFORMATION

## ITEM I FINANCIAL STATEMENTS

EVANS BANCORP, INC. AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED STATEMENTS OF INCOME  
 SIX MONTHS ENDED JUNE 30, 2006 AND 2005  
 (in thousands, except share and per share amounts)

	Six Months Ended June 30,	
	2006	2005
<b>INTEREST INCOME</b>		
Loans	\$ 9,507	\$ 7,414
Federal funds sold/Interest bearing deposits at other banks	30	99
Securities:		
Taxable	2,179	2,402
Non-taxable	957	978
<b>Total interest income</b>	<b>12,673</b>	<b>10,893</b>
<b>INTEREST EXPENSE</b>		
Deposits	4,021	2,849
Other borrowings	1,040	786
Junior subordinated debentures	398	301
<b>Total interest expense</b>	<b>5,459</b>	<b>3,936</b>
<b>NET INTEREST INCOME</b>	<b>7,214</b>	<b>6,957</b>
<b>PROVISION FOR LOAN AND LEASE LOSSES</b>	<b>510</b>	<b>339</b>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>6,704</b>	<b>6,618</b>
<b>NON-INTEREST INCOME:</b>		
Bank charges	975	988
Insurance service and fees	3,687	3,576
Net gain on sales of securities		105
Premium on loans sold	4	12
Bank-owned life insurance	233	206
Life insurance proceeds		80
Other	796	568
<b>Total non-interest income</b>	<b>5,695</b>	<b>5,535</b>
<b>NON-INTEREST EXPENSE:</b>		
Salaries and employee benefits	4,941	4,647
Occupancy	1,033	988
Supplies	168	197
Repairs and maintenance	271	294
Advertising and public relations	261	273
Professional services	395	548

Edgar Filing: EVANS BANCORP INC - Form 10-Q

Amortization of intangibles	265	254
Other Insurance	177	196
Other	1,459	1,390
Total non-interest expense	8,970	8,787
INCOME BEFORE INCOME TAXES	3,429	3,366
INCOME TAXES	952	929
NET INCOME	\$ 2,477	\$ 2,437
Net income per common share-basic	\$ 0.91	\$ 0.90
Net income per common share-diluted	\$ 0.91	\$ 0.90
Cash dividends per common share	\$ 0.34	\$ 0.32
Weighted average number of common shares	2,723,835	2,722,118
Weighted average number of diluted shares	2,725,870	2,725,411

*See Notes to Unaudited Consolidated Financial Statements*

---

Table of Contents

4

PART 1 FINANCIAL INFORMATION  
ITEM 1 FINANCIAL STATEMENTSEVANS BANCORP, INC. AND SUBSIDIARIES  
UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY  
SIX MONTHS ENDED JUNE 30, 2006 AND 2005  
(in thousands, except share and per share amounts)

	Common	Capital	Retained	Accumulated Other Comprehensive Income (Loss)	Treasury	Total
	Stock	Surplus	Earnings		Stock	
<b>Balance, January 1, 2005</b>	\$ 1,307	\$ 23,361	\$ 10,808	\$ 563	\$ (565)	\$ 35,474
Comprehensive income:						
Net income			2,437			2,437
Unrealized loss on available-for-sale securities, net of tax effect of \$247 and reclassification adjustment of \$(105)				(387)		(387)
Total comprehensive income						2,050
Cash dividends (\$0.32 per common share)			(857)			(857)
Stock options expense		94				94
Reissued 7,760 shares treasury stock under dividend reinvestment plan			2		176	178
Reissued 5,057 shares treasury stock under employee stock purchase plan			(23)		115	92
Reissued 840 shares treasury stock under director stock option plan			(2)		19	17
Purchased 11,760 shares for treasury					(262)	(262)
<b>Balance, June 30, 2005</b>	\$ 1,307	\$ 23,455	\$ 12,365	\$ 176	\$ (517)	\$ 36,786
<b>Balance, January 1, 2006</b>	\$ 1,373	\$ 26,155	\$ 11,087	\$ (1,387)	\$ (352)	\$ 36,876

Comprehensive income:						
Net Income			2,477			2,477
Unrealized loss on available-for-sale securities, net of tax effect of \$737				(1,156)		(1,156)
Total comprehensive income						1,321
Cash dividends (\$0.34 per common share)			(928)			(928)
Stock options expense	60					60
Reissued 9,642 shares treasury stock under dividend reinvestment plan	(33)			219		186
Reissued 5,773 shares treasury stock under employee stock purchase plan	(29)			129		100
Purchased 18,050 shares for treasury				(386)		(386)
<b>Balance, June 30, 2006</b>	\$ 1,373	\$ 26,153	\$ 12,636	\$ (2,543)	\$ (390)	\$ 37,229

*See Notes to Unaudited Consolidated Financial Statements*

---

**Table of Contents**

5

PART I-FINANCIAL INFORMATION  
ITEM I-FINANCIAL STATEMENTSEVANS BANCORP, INC. AND SUBSIDIARIES  
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS  
SIX MONTHS ENDED JUNE 30, 2006 AND 2005  
(in thousands)

	Six Months Ended June 30,	
	2006	2005
<b>OPERATING ACTIVITIES:</b>		
Interest received	\$ 13,025	\$ 11,080
Fees received	5,413	5,145
Interest paid	(5,523)	(3,717)
Cash paid to employees and suppliers	(7,806)	(7,499)
Income taxes paid	(897)	(702)
Proceeds from sale of loans held for resale	684	1,808
Originations of loans held for resale	(887)	(1,433)
Net cash provided by operating activities	4,009	4,682
<b>INVESTING ACTIVITIES:</b>		
Available for sales securities:		
Purchases	(333)	(23,085)
Proceeds from sales		7,062
Proceeds from maturities	10,328	13,871
Held to maturity securities:		
Purchases	(2,052)	(1,799)
Proceeds from maturities	1,861	344
Additions to properties and equipment	(409)	(969)
Increase in loans, net of repayments	(12,943)	(23,582)
Acquisitions	(184)	
Cash paid on earn-out agreements	(57)	(313)
Net cash used in investing activities	(3,789)	(28,471)
<b>FINANCING ACTIVITIES:</b>		
Repayments of short-term borrowings	(5,458)	(26,766)
Repayments of long-term borrowings	(2,459)	(2,543)
Increase in deposits	6,200	60,117
Dividends paid	(928)	(857)
Purchase of treasury stock	(386)	(262)
Re-issuance of treasury stock	286	287
Net cash (used in) provided by financing activities	(2,745)	29,976

Edgar Filing: EVANS BANCORP INC - Form 10-Q

Net (decrease) increase in cash and equivalents	(2,525)	6,187
<b>CASH AND CASH EQUIVALENTS:</b>		
Beginning of period	15,635	8,124
End of period	\$ 13,110	\$ 14,311

---

**Table of Contents**

6

PART I-FINANCIAL INFORMATION  
 ITEM I-FINANCIAL STATEMENTS  
 EVANS BANCORP, INC. AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 SIX MONTHS ENDED JUNE 30, 2006 AND 2005  
 (in thousands)

	Six Months Ended June 30,	
	2006	2005
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net income	\$ 2,477	\$ 2,437
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	861	978
Deferred tax benefit	(303)	(74)
Provision for loan and lease losses	510	339
Net gain on sales of securities		(105)
Premiums on loans sold	(4)	(12)
Stock options expense	60	94
Changes in assets and liabilities affecting cash flow:		
Other assets	(325)	(316)
Other liabilities	733	1,341
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>\$ 4,009</b>	<b>\$ 4,682</b>

*See Notes to Unaudited Consolidated Financial Statements*

---

**Table of Contents**

7

**PART 1 FINANCIAL INFORMATION****ITEM 1 FINANCIAL STATEMENTS****EVANS BANCORP, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****SIX MONTHS ENDED JUNE 30, 2006 AND 2005****1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting and reporting policies followed by Evans Bancorp, Inc. (the Company), a financial holding company, and its two direct, wholly-owned subsidiaries: (i) Evans National Bank (the Bank), and its subsidiaries, Evans National Leasing, Inc. (ENL) and Evans National Holding Corp. (ENHC); and (ii) Evans National Financial Services, Inc. (ENFS), and its subsidiary ENB Insurance Agency, Inc. (ENBI) and its subsidiaries, Frontier Claims Services, Inc. (FCS) and ENB Associates Inc. (ENB), in the preparation of the accompanying interim unaudited consolidated financial statements conform with accounting principles generally accepted in the United States of America and with general practice within the banking industry. Except as the context otherwise requires, the Company and its direct and indirect subsidiaries are collectively referred to in this report as the Company.

The accompanying consolidated financial statements are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of the Company's financial position and results of operations for the interim periods have been made. Such adjustments are of a normal recurring nature.

The results of operations for the three and six month period ended June 30, 2006 are not necessarily indicative of the results to be expected for the full year. The accompanying unaudited consolidated financial statements should be read in conjunction with the Audited Consolidated Financial Statements and the Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005.

**2. SECURITIES**

Securities which the Company has the positive ability and intent to hold to maturity are stated at amortized cost. Securities which the Company has identified as available-for-sale are stated at fair value with unrealized gains and losses excluded from earnings and reported net of deferred income taxes, in accumulated other comprehensive income (loss), a component of stockholders equity. Available-for-sale securities are net of unrealized losses of \$4.0 million, \$3.3 million and \$2.1 million as of June 30, 2006, March 31, 2006, and December 31, 2005, respectively. As of June 30, 2006, March 31, 2006, and December 31, 2005, the securities portfolio did not contain any other than temporary declines in fair value.

**3. ALLOWANCE FOR LOAN AND LEASE LOSSES**

The allowance for loan and lease losses represents the amount charged against the Bank's earnings to establish an allowance for probable loan and lease losses based on the Bank's management's evaluation of the loan and lease portfolio. Factors considered by the Bank's management in establishing the allowance include: the collectibility of individual loans and leases, current loan and lease concentrations, charge-off history, delinquent loan and lease percentages, input from regulatory agencies and general economic conditions.

On a quarterly basis, management of the Bank meets to review and determine the adequacy of the allowance for loan and lease losses. In making this determination, the Bank's management analyzes the ultimate collectibility of the loans and leases in its portfolio by incorporating feedback provided by the Bank's internal loan staff, an independent internal loan review function and information provided by examinations performed by regulatory agencies.

The analysis of the allowance for loan and lease losses is composed of three components: specific credit allocation, general portfolio allocation and subjectively by determined allocation. The specific credit allocation includes a detailed review of the credit in accordance with the Statement of Financial Accounting Standards (SFAS) No. 114, Accounting by Creditors for Impairment of a Loan and No. 118, Accounting by Creditors for Impairment of a Loan Income Recognition and Disclosures, and allocation is made based on this analysis. The general portfolio allocation consists of an assigned reserve percentage based on the actual credit rating of the loan or lease.



**Table of Contents**

The subjective portion of the allowance reflects management's evaluation of various conditions, and involves a higher degree of uncertainty because this component of the allowance is not identified with specific problem credits of portfolio segments. The conditions evaluated in connection with this component include the following: industry and regional conditions; seasoning of the loan and lease portfolio and changes in the composition of and growth in the loan and lease portfolio; the strength and duration of the business cycle; existing general economic and business conditions in the lending areas; credit quality trends in nonaccruing loans and leases; historical loan and lease charge-off experience; and the results of bank regulatory examinations.

The following table sets forth information regarding the allowance for loan and lease losses for the six month periods ended June 30, 2006 and 2005.

**Allowance for loan losses**

	Six months ended June 30,	
	2006	2005
	(in thousands)	
Beginning balance, January 1	\$ 3,211	\$ 2,999
Charge-offs:		
Commercial	(105)	(175)
Real estate mortgages		(1)
Installment loans	(28)	(42)
Overdrafts	(14)	
Direct financing leases	(105)	
Total charge-offs	(252)	(218)
Recoveries:		
Commercial	41	
Real estate mortgages		
Installment loans	56	
Overdrafts	9	
Direct financing leases	29	45
Total recoveries	135	45
Net charge-offs	(117)	(173)
Provision for loan and lease losses	510	339
Ending balance, June 30	\$ 3,604	\$ 3,165
Ratio of net charge-offs to average net loans and leases outstanding (annualized)	0.09%	0.30%

**4. PER SHARE DATA**

The common stock per share information is based upon the weighted average number of shares outstanding during each period, retroactively adjusted for stock dividends and stock splits. The Company's potential dilutive securities included 3,093 and 2,035 dilutive shares for the three and six month periods ended June 30, 2006. There were 2,947 and 3,293 dilutive shares for the three and six month periods ended June 30, 2005. On February 21, 2006, the Company declared a cash dividend of \$0.34 per share payable on April 3, 2006 to shareholders of record as of

March 13, 2006. All June 30, 2005 share and per share amounts have been adjusted to reflect a 5% stock dividend paid in December 2005.

Potential common shares that would have the effect of increasing diluted earnings per share are considered to be anti-dilutive. In accordance with SFAS No. 128, Earnings Per Share, these shares were not included in calculating diluted earnings per share. As of the three and six month periods ended June 30, 2006, there were approximately 46 thousand and 59 thousand shares, respectively, that are not included in calculating diluted earnings per share because their effect was anti-dilutive. As of the three and six month periods ended June

---

**Table of Contents**

9

30, 2005, there were approximately 12 thousand shares that are not included in calculating diluted earnings per share because their effect was anti-dilutive.

5. **TREASURY STOCK**

During the quarter ended June 30, 2006 the Company repurchased 7,950 shares of common stock at an average cost of \$22.01 per share, pursuant to the Company's publicly announced common stock repurchase program.

6. **SEGMENT INFORMATION**

The Company is comprised of two primary business segments, banking and insurance agency activities. The following tables set forth information regarding these segments for the three and six month periods ended June 30, 2006 and 2005.

Three Months Ended  
June 30, 2006  
(in thousands)

	<b>Banking Activities</b>	<b>Insurance Agency Activities</b>	<b>Total</b>
Net interest income (expense)	\$ 3,694	\$ (114)	\$ 3,580
Provision for loan and lease losses	228		228
Net interest income (expense) after provision for loan and lease losses	3,466	(114)	3,352
Non-interest income	1,029		1,029
Insurance service and fees		1,510	1,510
Non-interest expense	3,369	1,115	4,484
Income before income taxes	1,126	281	1,407
Income taxes	224	112	336
Net income	\$ 902	\$ 169	\$ 1,071

Six Months Ended  
June 30, 2006  
(in thousands)

	<b>Banking Activities</b>	<b>Insurance Agency Activities</b>	<b>Total</b>
Net interest income (expense)	\$ 7,446	\$ (232)	\$ 7,214
Provision for loan and lease losses	510		510
Net interest income (expense) after provision for loan and lease losses	6,936	(232)	6,704
Non-interest income	2,008		2,008
Insurance service and fees		3,687	3,687
Non-interest expense	6,651	2,319	8,970

Edgar Filing: EVANS BANCORP INC - Form 10-Q

Income before income taxes	2,293	1,136	3,429
Income taxes	498	454	952
Net income	\$ 1,795	\$ 682	\$ 2,477

---

**Table of Contents**

10

Three Months Ended  
June 30, 2005  
(in thousands)

	<b>Banking Activities</b>	<b>Insurance Agency Activities</b>	<b>Total</b>
Net interest income (expense)	\$ 3,691	\$ (96)	\$ 3,595
Provision for loan and lease losses	188		188
Net interest income (expense) after provision for loan and lease losses	3,503	(96)	3,407
Non-interest income	958		958
Insurance service and fees		1,549	1,549
Non-interest expense	3,203	1,099	4,302
Income before income taxes	1,258	354	1,612
Income taxes	296	141	437
Net income	\$ 962	\$ 213	\$ 1,175

Six Months Ended  
June 30, 2005  
(in thousands)

	<b>Banking Activities</b>	<b>Insurance Agency Activities</b>	<b>Total</b>
Net interest income (expense)	\$ 7,140	\$ (183)	\$ 6,957
Provision for loan and lease losses	339		339
Net interest income (expense) after provision for loan and lease losses	6,801	(183)	6,618
Non-interest income	1,959		1,959
Insurance service and fees		3,576	3,576
Non-interest expense	6,443	2,344	8,787
Income before income taxes	2,317	1,049	3,366
Income taxes	510	419	929
Net income	\$ 1,807	\$ 630	\$ 2,437

**Table of Contents**

11

**7. CONTINGENT LIABILITIES AND COMMITMENTS**

The unaudited consolidated financial statements do not reflect various commitments and contingent liabilities, which arise in the normal course of business, and which involve elements of credit risk, interest rate risk and liquidity risk. These commitments and contingent liabilities consist of commitments to extend credit and standby letters of credit. A summary of the Bank's commitments and contingent liabilities at June 30, 2006 and 2005 is as follows:

	<b>2006</b>	<b>2005</b>
	(in thousands)	
Commitments to extend credit	\$ 54,966	\$ 65,716
Standby letters of credit	2,080	2,244
Total	\$ 57,046	\$ 67,960

Commitments to extend credit and standby letters of credit include some exposure to credit loss in the event of nonperformance of the customer. The Bank's credit policies and procedures for credit commitments and financial guarantees are the same as those for extensions of credit that are recorded on the Company's unaudited consolidated balance sheets. Because these instruments have fixed maturity dates, and because they may expire without being drawn upon, they do not necessarily represent cash requirements of the Bank. The Bank has not incurred any losses on its commitments during the past two years.

Certain lending commitments for construction residential mortgage loans are considered derivative instruments under the guidelines of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. The changes in the fair value of these commitments due to interest rate risk are not recorded on the consolidated balance sheets as these derivatives are not considered material.

The Company is subject to possible litigation proceedings in the normal course of business. As of June 30, 2006, there were no claims pending against the Company that management considered to be material.

**8. RECLASSIFICATIONS**

Certain reclassifications have been made to the 2005 unaudited consolidated financial statements to conform with the presentation used in 2006.

**9. NET PERIODIC BENEFIT COSTS**

The Bank has a defined benefit pension plan covering substantially all Company employees. The plan provides benefits that are based on the employees' compensation and years of service. The Bank uses an actuarial method of amortizing prior service cost and unrecognized net gains or losses which result from actual experience and assumptions being different than those that are projected. The amortized method the Bank is using recognizes the prior service cost and net gains or losses over the average remaining service period of active employees.

The Bank also maintains a nonqualified supplemental executive retirement plan covering certain members of the Company's senior management. The Bank uses an actuarial method of amortizing unrecognized net gains or losses which result from actual expense and assumptions being different than those that are projected. The amortization method the Bank uses recognizes the net gains or losses over the average remaining service period of active employees.

---

**Table of Contents**

12

The following table represents net periodic benefit costs recognized:

Three months ended June 30,  
(in thousands)

	<b>Pension Benefits</b>		<b>Supplemental Executive Retirement Plan</b>	
	2006	2005	2006	2005
	Service cost	\$ 79	\$ 72	\$ 29
Interest cost	49	44	38	37
Expected return on plan assets	(58)	(48)		
Amortization of prior service cost	(4)	(4)	14	15
Amortization of the net loss	6	1	4	4
<b>Net periodic benefit cost</b>	<b>\$ 72</b>	<b>\$ 65</b>	<b>\$ 85</b>	<b>\$ 82</b>

Six months ended June 30,  
(in thousands)

	<b>Pension Benefits</b>		<b>Supplemental Executive Retirement Plan</b>	
	2006	2005	2006	2005
	Service cost	\$ 158	\$ 144	\$ 58
Interest cost	98	88	76	74
Expected return on plan assets	(116)	(96)		
Amortization of prior service cost	(8)	(8)	28	30
Amortization of the net loss	12	2	8	8
<b>Net periodic benefit cost</b>	<b>\$ 144</b>	<b>\$ 130</b>	<b>\$ 170</b>	<b>\$ 164</b>

**10. STOCK-BASED COMPENSATION**

In December 2004, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 123 (revised 2004), Share Based Payment ( SFAS No. 123(R) ). SFAS No. 123(R) supersedes Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees, and amends SFAS No. 95, Statement of Cash Flows. Generally, the fair value approach in SFAS No. 123(R) is similar to the fair value approach described in SFAS No. 123. In 2005, the Company used the Black-Scholes-Merton formula to estimate the fair value of stock options granted to employees. The Company adopted SFAS No. 123(R), using the modified-prospective method, beginning January 1, 2006. Based on the terms of its equity compensation plans, the adoption of SFAS No. 123(R) did not require the Company to record a cumulative effect of adjustment. The Company also elected to continue to estimate the fair value of stock options using the Black-Scholes-Merton formula.

In the first six months of 2006, because the fair value recognition provisions of SFAS No. 123, *Stock-Based Compensation*, and SFAS No. 123(R) were materially consistent under the Company's valuation of its equity plans, the adoption of SFAS No. 123(R) did not have a significant impact on the Company's financial position or the Company's results of operations. Further, the Company believes the adoption of SFAS No. 123(R) will not have a material impact on the Company's future stock-based compensation expense.

Under the Company's 1999 Employee Stock Option and Long-Term Incentive Plan, as amended (the "Option Plan"), the Company may grant options to its officers, directors and key employees for up to 289,406 shares of common stock (as adjusted for stock dividends). Under the Option Plan, the exercise price of each option is not to be less than 100% of the market price of the Company's stock on the date of

---



**Table of Contents**

13

grant and an option's maximum term is ten years. The Company normally issues shares out of its treasury for any options exercised. The options have vesting schedules from 1 1/2 years through 9 years. At June 30, 2006, there were a total of 196,970 shares available for grant under the Option Plan.

As of December 31, 2005 there were 88,577 stock options outstanding under the Option Plan with a weighted-average exercise price of \$21.32. During the three and six month period ended June 30, 2006 there were no options granted, exercised, forfeited, or expired. At June 30, 2006 there were 88,577 stock options outstanding under the Option Plan with a weighted-average exercise price of \$21.32, an intrinsic value of \$93 thousand, and a weighted-average remaining contractual term of 8.06 years. At June 30, 2006 there were 38,502 options exercisable at a weighted average exercise price of \$21.77, an intrinsic value of \$23 thousand, and a weighted-average remaining contractual term of 7.85 years.

On February 18, 2003, the Board of Directors of the Company adopted the Evans Bancorp, Inc. Employee Stock Purchase Plan (the Purchase Plan). As of June 30, 2006, there were 84,090 shares of common stock available to issue to its full-time employees, nearly all of whom are eligible to participate. Under the terms of the Purchase Plan, employees can choose each year to have up to 15% of their annual base earnings withheld to purchase the Company's common stock. The Company grants options on January 1 and July 1 of each year during the term of the Purchase Plan. The purchase price of the stock is 85% of the lower of its price on the grant date or the exercise date. Compensation cost is recognized for the fair value of the employees' purchase rights, which was estimated using the Black-Scholes-Merton model.

As of June 30, 2006, there was approximately \$151 thousand of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Company's equity plans. That cost is expected to be recognized over a weighted-average period of 2.2 years. This expected cost does not include the impact of any future stock-based compensation awards. The compensation cost charged against income for those plans was \$30 thousand and \$60 thousand for the three and six month periods ended June 30, 2006, respectively, and \$49 thousand and \$96 thousand for the same periods of 2005.

#### 11. RECENT ACCOUNTING PRONOUNCEMENTS

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140 (SFAS 156). This Statement amends SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities. This Statement requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. It permits an entity to choose either the amortization method or the fair value measurement method for subsequent measurement for each class of separately recognized servicing assets and servicing liabilities. This Statement will be effective for fiscal years beginning after September 15, 2006. The adoption of this Statement is not expected to have a material impact on the Company's financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). The interpretation clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. Specifically, the pronouncement prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on the related derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition of uncertain tax positions. This interpretation will be effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 is not expected to have a material impact on the Company's financial statements.

---

**Table of Contents**

14

**ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This Quarterly Report on Form 10-Q may contain certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), that involve substantial risks and uncertainties. When used in this report, or in the documents incorporated by reference herein, the words anticipate, believe, estimate, expect, intend, may, plan, seek, and similar expressions identify such forward-looking statements. These forward-looking statements include statements regarding the Company's business plans, prospects, growth and operating strategies, statements regarding the asset quality of the Company's loan and investment portfolios, and estimates of the Company's risks and future costs and benefits.

These forward-looking statements are based largely on the expectations of the Company's management and are subject to a number of risks and uncertainties, including but not limited to general economic conditions, either nationally or in the Company's market areas, that are worse than expected; increased competition among depository or other financial institutions; inflation and changes in the interest rate environment that reduce the Company's margins or reduce the fair value of financial instruments; changes in laws or government regulations affecting financial institutions, including changes in regulatory fees and capital requirements; the Company's ability to enter new markets successfully and capitalize on growth opportunities; the Company's ability to successfully integrate acquired entities; changes in accounting pronouncements and practices, as adopted by financial institution regulatory agencies, the Financial Accounting Standards Board and the Public Company Accounting Oversight Board; changes in consumer spending, borrowing and saving habits; changes in the Company's organization, compensation and benefit plans; and other factors discussed elsewhere in this Report on Form 10-Q, as well as in the Company's periodic reports filed with the Securities and Exchange Commission (the SEC). Many of these factors are beyond the Company's control and are difficult to predict.

Because of these and other uncertainties, the Company's actual results, performance or achievements could differ materially from those contemplated, expressed or implied by the forward-looking statements contained herein. Forward-looking statements speak only as of the date they are made. The Company undertakes no obligation, to publicly update or revise forward-looking information, whether as a result of new, updated information, future events or otherwise.

**APPLICATION OF CRITICAL ACCOUNTING ESTIMATES**

The Company's Unaudited Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the industries in which it operates. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the Company's Unaudited Consolidated Financial Statements and Notes. These estimates, assumptions and judgments are based on information available as of the date of the Unaudited Consolidated Financial Statements. Accordingly, as this information changes, the Unaudited Consolidated Financial Statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments, and as such, have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. When third-party information is not available, valuation adjustments are estimated in good faith by management primarily through the use of internal cash flow modeling techniques.

The most significant accounting policies followed by the Company are presented in Note 1 to the Audited Consolidated Financial Statements included in Item 8 in its Annual Report on Form 10-K. These policies, along with

the disclosures presented in the other Notes to the Company's Audited Consolidated Financial Statements contained in its Annual Report on Form 10-K and in this financial review, provide information on how significant assets and liabilities are valued in the Company's Unaudited Consolidated Financial Statements and how those values are determined.

Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance

---

**Table of Contents**

15

for loan and lease losses and valuation of goodwill to be the accounting areas that require the most subjective or complex judgments, and as such, could be most subject to revision as new information becomes available.

**Allowance for Loan and Lease Losses**

The allowance for loan and lease losses represents management's estimate of probable losses in the Bank's loan and lease portfolio. Determining the amount of the allowance for loan and lease losses is considered a critical accounting estimate because it requires significant judgment on the part of management and the use of estimates related to the amount and timing of expected future cash flows on impaired loans and leases, estimated losses on pools of homogeneous loans and leases based on historical loss experience and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan and lease portfolio also represents the largest asset type on the Unaudited Consolidated Balance Sheets. Note 1 to the Audited Consolidated Financial Statements included in Item 8 in its Annual Report on Form 10-K describes the methodology used to determine the allowance for loan and lease losses.

**Goodwill**

The amount of goodwill reflected in the Company's Unaudited Consolidated Financial Statements is required to be tested by management for impairment on at least an annual basis. The test for impairment of goodwill on the identified reporting unit is considered a critical accounting estimate because it requires judgment on the part of management and the use of estimates related to the growth assumptions and market multiples used in the valuation model.

**ANALYSIS OF FINANCIAL CONDITION****Loan and Lease Activity**

Total gross loans and leases grew to \$273.0 million at June 30, 2006, reflecting an \$11.5 million or 4.4% increase from March 31, 2006 and a \$13.0 million or 5.0% increase from December 31, 2005. Gross loans and leases are net of \$6.3 million, \$4.9 million and \$4.0 million unearned income on direct financing leases as of June 30, 2006, March 31, 2006 and December 31, 2005, respectively. Commercial loans and leases totaled \$190.0 million at June 30, 2006, reflecting an \$8.1 million or 4.4% increase from March 31, 2006 and a \$7.4 million or 4.1% increase from December 31, 2005. Growth in direct financing leases of \$4.8 million or 23.1%, commercial real estate of \$1.2 million or 0.9%, and commercial lines of credit of \$1.3 million or 13.7%, were largely responsible for the increase from March 31, 2006. Growth in direct financing leases of \$8.5 million or 50.2%, offset by decreases in commercial lines of credit of \$1.0 million or 8.2% were largely responsible for the increase from December 31, 2005. Consumer loans totaled \$82.3 million at June 30, 2006, reflecting a \$3.4 million or 4.4% increase from March 31, 2006 and a \$5.6 million or 7.3% increase from December 31, 2005. Consumer real estate loans increased \$3.2 million or 7.5% from March 31, 2006 and \$4.7 million or 11.7% from December 31, 2005. The Bank continues to sell certain fixed rate residential mortgages originated below a designated interest level to the Federal National Mortgage Association (FNMA), while maintaining the servicing rights for those mortgages. During the three month period ended June 30, 2006, the Bank sold mortgages to FNMA totaling \$0.2 million, as compared to \$0.1 million during the three month period ended June 30, 2005. During the six month period ended June 30, 2006, the Bank sold mortgages to FNMA totaling \$0.7 million, as compared to \$1.8 million during the six month period ended June 30, 2005. At June 30, 2006, the Bank had a loan servicing portfolio principal balance of \$28.6 million upon which it earns servicing fees, as compared to \$28.9 million at March 31, 2006, and \$28.8 million at December 31, 2005.

---

**Table of Contents**

16

**Loan and Lease Portfolio Composition**

The following table presents selected information on the composition of the Company's loan and lease portfolio in dollar amounts and in percentages as of the dates indicated.

	June 30, 2006 (in thousands)	Percentage	December 31, 2005 (in thousands)	Percentage
<b>Commercial Loans and Leases</b>				
Real Estate	\$ 135,259	49.6%	\$ 135,425	52.1%
Installment	18,601	6.8%	18,588	7.1%
Direct Financing Leases	25,456	9.3%	16,945	6.5%
Lines of Credit	10,646	3.9%	11,603	4.5%
Cash Reserve	40	0.0%	38	0.0%
<b>Total Commercial Loans and Leases</b>	<b>190,002</b>	<b>69.6%</b>	<b>182,599</b>	<b>70.2%</b>
<b>Consumer Loans</b>				
Real Estate	45,322	16.7%	40,586	15.6%
Home Equity	33,527	12.3%	33,114	12.7%
Installment	2,477	0.9%	2,254	0.9%
Overdrafts	603	0.2%	219	0.1%
Credit Card	269	0.1%	307	0.1%
Other	136	0.0%	288	0.1%
<b>Total Consumer Loans</b>	<b>82,334</b>	<b>30.2%</b>	<b>76,768</b>	<b>29.5%</b>
Net Deferred Costs & Unearned Discounts	651	0.2%	654	0.3%
<b>Total Loans and Leases</b>	<b>272,987</b>	<b>100.0%</b>	<b>260,021</b>	<b>100.0%</b>
Allowance for Loan and Lease Losses	(3,604)		(3,211)	
<b>Loans and Leases, net</b>	<b>\$ 269,383</b>		<b>\$ 256,810</b>	

Net loan and lease recoveries were \$12 thousand in the three month period ended June 30, 2006 as compared to net charge-offs of \$202 thousand in the same period of 2005. Net charge-offs were \$117 thousand for the six month period ended June 30, 2006 as compared to \$173 thousand in the same period of 2005. Non-performing loans and leases, defined as accruing loans and leases greater than 90 days past due and non-accrual loans and leases, totaled 0.37% of total loans and leases outstanding at June 30, 2006 as compared to 0.38% at March 31, 2006 and 0.72% at December 31, 2005. The allowance for loan and lease losses totaled \$3.6 million or 1.32% of total loans and leases outstanding at June 30, 2006 as compared to \$3.4 million or 1.29% of total loans and leases at March 31, 2006 and \$3.2 million or 1.23% of total loans and leases outstanding at December 31, 2005.

The adequacy of the Company's allowance for loan and lease losses is reviewed quarterly by the Company's management with consideration given to loan and lease concentrations, charge-off history, delinquent loan and lease percentages, and general economic conditions. Management believes the allowance for loan and lease losses is adequate for losses from existing loans and leases.

**Table of Contents**

17

The following table sets forth information regarding non-performing loans and leases as of the dates specified.

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
	(in thousands)	
Non-accruing loans and leases:		
Mortgage loans on real estate		
Residential 1-4 family	\$	\$
Commercial and multi-family	160	600
Construction	100	
Second mortgages		
Home equity lines of credit		
Total mortgage loans on real estate	260	600
Direct financing leases		
Commercial loans	553	1,175
Consumer installment loans		
Personal		
Credit cards		
Other		
Total consumer installment loans		
Total non-accruing loans and leases	\$ 813	\$ 1,775
Accruing loans and leases 90+ days past due	199	95
Total non-performing loans and leases	1,012	1,870
Total non-performing loans and leases as a percentage of total assets	0.22%	0.41%
Total non-performing loans and leases as a percentage of total loans and leases	0.37%	0.72%

For the three and six month periods ended June 30, 2006, gross interest income that would have been reported on non-accruing loans and leases had they been current, was \$20 thousand and \$54 thousand, respectively. For the three and six month periods ended June 30, 2005, gross interest income that would have been reported on non-accruing loans and leases had they been current, was \$36 thousand and \$67 thousand, respectively. There was no interest income included in net income for the three and six month periods ended June 30, 2006 and 2005 on non-accruing loans and leases.

**Investing Activities**

Total securities declined to \$148.1 million at June 30, 2006, reflecting a \$5.4 million or 3.5% decrease from March 31, 2006, and an \$11.9 million or 7.4% decrease from December 31, 2005. The decline in the securities portfolio was due in part to available funds being used for increased lending. The Company monitors extension and prepayment risk in the portfolio to limit potential exposures. Management believes the average expected life of the portfolio is 3.7 years as of June 30, 2006, as compared to 3.6 years as of March 31, 2006 and 3.5 years as of December 31, 2005. Available-for-sale securities with a total fair value of \$137.6 million at June 30, 2006 were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

**Funding Activities**

Total deposits at June 30, 2006 were \$343.0 million, reflecting a \$25.2 million or 6.9% decrease from March 31, 2006. The decrease in deposits from March 31, 2006 was primarily attributable to a decrease in time deposits of \$30.9 million or 18.2%. Due to higher short-term rates, the Bank has elected to utilize, when favorable, short-term borrowings in place of higher cost time deposit funding. Short-term borrowing from other correspondent banks and the Federal Home Loan Bank of New York was \$32.2 million at June 30, 2006 as compared to no short-term borrowings at March 31, 2006 and \$37.1 million at December 31, 2005. Additionally, Muni-vest balances decreased \$3.6 million or 9.4% from March 31, 2006 as municipalities generally draw from these funds deposited in

---

**Table of Contents**

the first fiscal quarter of the year throughout the remainder of the year to pay for their expenditures. These decreases were partially offset by increases of \$5.0 million or 8.0% in demand deposits and \$4.2 million or 4.9% in savings deposits, respectively, from March 31, 2006. Total deposits increased \$6.2 million or 1.8% increase from December 31, 2005. The increase in deposits from December 31, 2005 was primarily attributable to an increase in muni-vest deposits of \$7.2 million or 26.0%, which was the result of municipal tax collections in the first fiscal quarter of 2006. Additionally, savings deposits increased \$3.2 million or 3.7% from December 31, 2005, while demand deposits decreased \$3.0 million or 4.2% from December 31, 2005

**ANALYSIS OF RESULTS OF OPERATIONS****Average Balance Sheet**

The following tables present the significant categories of the assets and liabilities of the Company, interest income and interest expense, and the corresponding yields earned and rates paid for the periods indicated. The assets and liabilities are presented as daily averages. The average loan and lease balances include both performing and non-performing loans and leases. Investments are included at amortized cost. Yields are presented on a non-tax-equivalent basis.

	Three Months Ended June 30, 2006			Three Months Ended June 30, 2005		
	Average Outstanding Balance (dollars in thousands)	Interest Earned/ Paid	Yield/ Rate	Average Outstanding Balance (dollars in thousands)	Interest Earned/ Paid	Yield/ Rate
<b>ASSETS</b>						
Interest-earning assets:						
Loans and leases, net	\$ 264,064	\$ 4,892	7.41%	\$ 232,111	\$ 3,886	6.70%
Taxable securities	106,830	1,075	4.03%	133,412	1,257	3.77%
Tax-exempt securities	45,151	483	4.28%	46,371	488	4.21%
Federal funds sold	1,458	19	5.21%	5,188	63	4.86%
Total interest-earning assets	417,503	6,469	6.20%	417,082	5,694	5.46%
Non interest-earning assets:						
Cash and due from banks	12,507			10,101		
Premises and equipment, net	8,194			8,326		
Other assets	28,865			26,157		
Total Assets	\$ 467,069			\$ 461,666		
<b>LIABILITIES &amp; STOCKHOLDERS EQUITY</b>						
Interest-bearing liabilities:						
NOW	\$ 11,659	\$ 6	0.21%	\$ 12,165	\$ 5	0.18%
Regular savings	87,352	220	1.01%	94,666	194	0.82%
Muni-Vest savings	43,123	458	4.25%	64,377	437	2.71%
Time deposits	142,847	1,442	4.04%	128,648	963	2.99%
Other borrowed funds	53,715	546	4.07%	42,611	332	3.12%
	11,330	206	7.27%	11,330	158	5.58%



Edgar Filing: EVANS BANCORP INC - Form 10-Q

Junior subordinated debentures						
Securities sold U/A to repurchase	6,373	11	0.69%	5,324	10	0.73%
Total interest-bearing liabilities	356,399	\$ 2,889	3.24%	359,121	\$ 2,099	2.34%
Noninterest-bearing liabilities:						
Demand deposits	66,149			60,958		
Other	7,598			5,962		
Total liabilities	\$ 430,146			\$ 426,041		
Stockholders' equity	36,923			35,625		
Total Liabilities and Equity	\$ 467,069			\$ 461,666		
Net interest earnings		\$ 3,580			\$ 3,595	
Net yield on interest earning assets			3.43%			3.45%
Interest rate spread			2.96%			3.12%

---

**Table of Contents**

19

	Six Months Ended June 30, 2006			Six Months Ended June 30, 2005		
	Average Outstanding Balance (dollars in thousands)	Interest Earned/ Paid	Yield/ Rate	Average Outstanding Balance (dollars in thousands)	Interest Earned/ Paid	Yield/ Rate
<b>ASSETS</b>						
Interest-earning assets:						
Loans and leases, net	\$ 260,986	\$ 9,507	7.29%	\$ 224,678	\$ 7,414	6.60%
Taxable securities	109,928	2,179	3.96%	128,704	2,402	3.73%
Tax-exempt securities	45,314	957	4.22%	45,814	978	4.27%
Time deposits other banks			0.00%	433	3	1.39%
Federal funds sold	1,320	30	4.55%	8,827	96	2.18%
Total interest-earning assets	417,548	12,673	6.07%	408,456	10,893	5.33%
Non interest-earning assets:						
Cash and due from banks	12,213			10,197		
Premises and equipment, net	8,175			8,179		
Other assets	28,507			25,562		
Total Assets	\$ 466,443			\$ 452,394		
<b>LIABILITIES &amp; STOCKHOLDERS EQUITY</b>						
Interest-bearing liabilities:						
NOW	\$ 11,611	\$ 11	0.19%	\$ 11,862	\$ 11	0.19%
Regular savings	88,484	408	0.92%	97,461	413	0.85%
Muni-Vest savings	38,648	788	4.08%	57,328	722	2.52%
Time deposits	146,104	2,814	3.85%	117,471	1,703	2.90%
Other borrowed funds	52,611	1,012	3.85%	50,495	762	3.02%
Junior subordinated debentures	11,330	398	7.03%	11,330	301	5.31%
Securities sold U/A to repurchase	7,216	28	0.78%	6,324	24	0.76%
Total interest-bearing liabilities	356,004	\$ 5,459	3.07%	352,271	\$ 3,936	2.23%
Noninterest-bearing liabilities:						
Demand deposits	65,978			58,785		
Other	7,304			5,709		
Total liabilities	\$ 429,286			\$ 416,765		

Edgar Filing: EVANS BANCORP INC - Form 10-Q

Stockholders equity	37,157	35,629
Total Liabilities and Equity	\$ 466,443	\$ 452,394
Net interest earnings	\$ 7,214	\$ 6,957
Net yield on interest earning assets	3.46%	3.41%
Interest rate spread	3.00%	3.10%

Net Income

Net income was \$1.1 million or \$0.39 per basic and diluted share for the three months ended June 30, 2006, as compared to \$1.2 million or \$0.44 per basic and diluted share for the same period in 2005. Net income represented a return on average assets of 0.92% and 1.02% for the three month periods ended June 30, 2006 and 2005, respectively. The return on average equity was 11.60% and 13.19% for the three month periods ended June 30, 2006 and 2005, respectively.

On a year-to-date basis, net income was \$2.5 million or \$0.91 per basic and diluted share for the six months ended June 30, 2006, as compared to \$2.4 million or \$0.90 per basic and diluted share for the same period in 2005. Net income represented a return on average assets of 1.06% and 1.08% for the six month periods ended June 30, 2006 and 2005, respectively. The return on average equity was 13.33% and 13.68% for the six month periods ended June 30, 2006 and 2005, respectively.

---

**Table of Contents**

20

**Other Operating Results**

Net interest income for the three and six month periods ended June 30, 2006 was \$3.6 million and \$7.2 million, respectively, flat with and an increase of \$0.3 million over the same periods in 2005. This is primarily a result of significant growth in the Bank's loan and lease portfolio along with higher yields on loans and leases, offset by increased interest expense on time deposits and short-term borrowings.

The net interest margin for the three and six month periods ended June 30, 2006 was 3.43% and 3.46%, respectively, as compared to 3.45% and 3.41% for the same periods in 2005. The return on interest earning assets increased 74 basis points in the three and six month periods ended June 30, 2006 mainly due to higher rates on loans and a greater concentration of higher-yielding leases. Interest free funds also contributed 47 basis points and 46 basis points in the three and six month periods ended June 30, 2006, respectively, due to an increase in average demand deposits, compared to a 33 basis point and 31 basis point contribution in the same periods of 2005. This strong growth of loans and leases and demand deposits was offset by an increase in the Bank's cost of interest-bearing liabilities, which increased to 3.24% and 3.07% in the three and six month periods ended June 30, 2006, respectively, from 2.34% and 2.23% in the same periods of 2005. The rise in short-term interest rates on federal funds purchased and time deposits, as a result of the Federal Reserve Bank Open Market Committee's policy decisions, were the primary drivers of this increase in cost of funds.

The provision for loan and lease losses for the three and six month periods ended June 30, 2006 increased to \$228 thousand and \$510 thousand, respectively, from \$188 thousand and \$339 thousand for the same periods in 2005. The increase was a result of continued consumer and commercial loan growth, particularly the Bank's expanding direct financing lease portfolio, through Evans National Leasing, which tends to have a higher credit risk than consumer loans and commercial loans collateralized by real estate.

Non-interest income was \$2.5 million for the three month period ended June 30, 2006, which is comparable to the \$2.5 million in the same period of 2005. Non-interest income was \$5.7 million for the six month period ended June 30, 2006, an increase of \$0.2 million or 2.9% from the same period of 2005. Fee income on the expanding loan and lease portfolio, including a \$45 thousand commercial prepayment penalty, along with increased ATM and interchange fee revenue from an increased ATM network contributed to non-interest income in the three and six month periods ended June 30, 2006. This was offset by a \$0.1 million decrease in life insurance proceeds which were received in the second quarter of 2005, but not 2006. In the six month period ended June 30, 2006, increased insurance fee revenue of \$0.1 million was primarily the result of increased profit sharing revenue at ENBI in the first quarter of 2006. This increase was offset by a \$0.1 million decline in gains on sales of securities from the six month period ended June 30, 2005 to 2006.

Non interest expense was \$4.5 million for three month period ended June 30, 2006, an increase of \$0.2 million or 4.2% from the same period in 2005. Non interest expense was \$9.0 million for six month period ended June 30, 2006, an increase of \$0.2 million or 2.1% from the same period in 2005. Salary and employee benefit expense for the three and six month periods ended June 30, 2006 increased \$0.2 million and \$0.3 million, respectively, from the same periods in 2005, due to Company growth, including a new director of internal audit, and merit pay increases awarded in early 2006. Advertising and public relations expense for the three month period ended June 30, 2006 increased \$0.1 million from the same period in 2005 for expenses related to the Bank's redesigned retail deposit product suite. Professional services expense for the six month period ended June 30, 2006 declined \$0.2 million from the same period in 2005 mainly due to expenses for certain revenue enhancement projects in the same period of 2005. Other expense for the six month period ended June 30, 2006 increased \$0.1 million from the same period in 2005, mainly due to Company growth.

Income tax expense totaled \$336 thousand and \$952 thousand for the three and six month periods ended June 30, 2006, respectively, compared to \$437 and \$929 thousand for the same periods in 2005. The effective tax rate for the three and six month periods ended June 30, 2006 was 23.9% and 27.8%, respectively, compared to 27.1% and 27.6% for the same periods in 2005. The decrease in effective tax rate in 2006 is primarily due to the higher composition of tax advantaged banking division income in the second quarter of 2006.

**CAPITAL**

The Bank has consistently maintained regulatory capital ratios at, or above, federal well capitalized standards. Equity as a percentage of assets was 8.0% at June 30, 2006 and 7.9% at both March 31, 2006 and December 31, 2005. Book value per common share was \$13.65 at June 30, 2006, compared to \$13.41 at March 31, 2006 and \$13.51 at December 31, 2005. Total stockholders' equity was \$37.2 million at June 30, 2006, up from \$36.5 million at March 31, 2006 and \$36.9 million at December 31, 2005. The increase is primarily attributable to net income of \$1.1 million and \$2.5 million in the three and six month periods ended June 30, 2006, offset by \$0.9

---

**Table of Contents**

21

million in dividends in the six month period ended June 30, 2006 and an increase in unrealized losses in the investment portfolio of \$0.5 million and \$1.2 million in the three and six month periods ended June 30, 2006.

**LIQUIDITY**

The Bank utilizes cash flows from the investment portfolio and federal funds sold balances to manage the liquidity requirements related to loan demand and deposit fluctuations. The Bank also has many borrowing options. As a member of the Federal Home Loan Bank ( FHLB ) the Bank is able to borrow funds at competitive rates. Advances of up to \$45.0 million can be drawn on the FHLB via an Overnight Line of Credit Agreement between the Bank and the FHLB. An amount equal to 25% of the Bank's total assets could be borrowed through the advance programs under certain qualifying circumstances. The Bank also has the ability to purchase up to \$14.0 million in federal funds from its correspondent banks. By placing sufficient collateral in safekeeping at the Federal Reserve Bank, the Bank could also borrow at the discount window. Additionally, the Company has access to capital markets as a funding source.

Cash flows from the Bank's investment portfolio are laddered, so that securities mature at regular intervals, to provide funds from principal and interest payments at various times as liquidity needs may arise. Contractual maturities are also laddered, with consideration as to the volatility of market prices, so that securities are available-for-sale from time-to-time without the need to incur significant losses. At June 30, 2006, approximately 8.3% of the Bank's securities had contractual maturity dates of one year or less and approximately 32.6% had maturity dates of five years or less. Available assets of \$149.1 million, less public and purchased funds of \$195.3 million, resulted in a long-term liquidity ratio of 76% at June 30, 2006, versus 85% at March 31, 2005 and 90% at December 31, 2005.

The Company's liquidity needs can also be met by more aggressively pursuing municipal deposits, which are normally awarded on the basis of competitive bidding. The Company believes that the Bank maintains a sufficient level of U.S. government and government agency securities and New York State municipal bonds that can be pledged as collateral for these deposits.

**ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Additional information responsive to this Item is contained in the Liquidity section of Management's Discussion and Analysis of Financial Condition and Results of Operations, which information is incorporated herein by reference.

Market risk is the risk of loss from adverse changes in market prices and/or interest rates of the Bank's financial instruments. The primary market risk the Company is exposed to is interest rate risk. The core banking activities of lending and deposit-taking expose the Bank to interest rate risk, which occurs when assets and liabilities reprice at different times and by different amounts as interest rates change. As a result, net interest income earned by the Bank is subject to the effects of changing interest rates. The Bank measures interest rate risk by calculating the variability of net interest income in the future periods under various interest rate scenarios using projected balances for interest-earning assets and interest-bearing liabilities. Management's philosophy toward interest rate risk management is to limit the variability of net interest income to changes in net interest rates. The balances of financial instruments used in the projections are based on expected growth from forecasted business opportunities, anticipated prepayments of loans, and investment securities and expected maturities of investment securities, loans and deposits. Management supplements the modeling technique described above with analysis of market values of the Bank's financial instruments and changes to such market values given changes in the interest rates.

The Bank's Asset Liability Committee, which includes members of senior management, monitors the Bank's interest rate sensitivity with the aid of a computer model that considers the impact of ongoing lending and deposit taking activities, as well as interrelationships in the magnitude and timing of the repricing of financial instruments, including the effect of changing interest rates on expected prepayments and maturities. When deemed prudent, management has taken actions, and intends to do so in the future, to mitigate exposure to interest rate risk through the use of on- or off-balance sheet financial instruments. Possible actions include, but are not limited to, changing the pricing of loan and deposit products, and modifying the composition of interest-earning assets and interest-bearing liabilities, and other financial instruments used for interest rate risk management purposes.

**Table of Contents**

22

The following table demonstrates the possible impact of changes in interest rates on the Bank's net interest income over a 12 month period of time:

**SENSITIVITY OF NET INTEREST INCOME  
TO CHANGES IN INTEREST RATES**

	Calculated (decrease) increase in projected annual net interest income (in thousands)	
	June 30, 2006	December 31, 2005
Changes in interest rates		
+200 basis points	(808)	(777)
+100 basis points	(401)	(386)
-100 basis points	373	337
-200 basis points	606	542

Many assumptions were utilized by management to calculate the impact that changes in the interest rates may have on the Bank's net interest income. The more significant assumptions related to the rate of prepayments of mortgage-related assets, loan and deposit volumes and pricing, and deposit maturities. The Bank assumed immediate changes in rates including 200 basis point rate changes. In the event that the 200 basis point rate changes cannot be achieved, the applicable rate changes are limited to lesser amounts such that interest rates cannot be less than zero. These assumptions are inherently uncertain and, as a result, the Bank cannot precisely predict the impact of changes in interest rates on net interest income. Actual results may differ significantly due to the timing, magnitude, and frequency of interest rate changes in market conditions and interest rate differentials (spreads) between maturity/repricing categories, as well as any actions such as those previously described, which management may take to counter such changes. In light of the uncertainties and assumptions associated with the process, the amounts presented in the table and changes in such amounts are not considered significant to the Bank's projected net interest income.

**ITEM 4 CONTROLS AND PROCEDURES**

**DISCLOSURE CONTROLS AND PROCEDURES**

The Company's management, with the participation of the Company's principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on that evaluation, the Company's principal executive and principal financial officers concluded that the Company's disclosure controls and procedures as of June 30, 2006 (the end of the period covered by this Report) have been designed and are functioning effectively to provide reasonable assurance that the information required to be disclosed by the Company in its reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

**CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

No changes in the Company's internal control over financial reporting were identified in the fiscal quarter ended June 30, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents**

23

**PART II OTHER INFORMATION****ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****Issuer Purchases of Equity Securities**

The following table includes all Company repurchases of its common stock, \$0.50 par value, made on a monthly basis during the period covered by this Report, including those made pursuant to publicly announced plans or programs.

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
April 2006 (April 1, 2006 through April 30, 2006)	2,500	\$ 20.54	2,500	58,865
May 2006 (May 1, 2006 through May 31, 2006)	3,850	\$ 22.62	3,850	55,015
June 2006 (June 1, 2006 through June 30, 2006)	1,600	\$ 22.85	1,600	53,415
Total	7,950	\$ 22.01	7,950	

All of the foregoing shares were purchased in open market transactions. On August 18, 2005, the Company announced that its Board of Directors authorized a common stock repurchase program, pursuant to which the Company may repurchase of up to 75,000 shares of the Company's common stock over the next two years, unless the program is terminated earlier. The Company did not make any repurchases during the quarter ended June 30, 2006 other than pursuant to this publicly announced program, and there were no other publicly announced plans or programs outstanding during the quarter ended June 30, 2006.

**ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The 2006 Annual Shareholders meeting of the registrant was held on April 27, 2006. At the meeting LaVerne G. Hall, Robert G. Miller, Jr, John R. O'Brien, and James Tilley were re-elected as directors for a term of three years. The following table reflects the tabulation of votes with respect to each director who was elected at the 2006 annual meeting.

Director Nominees:	Number of Votes	
	For:	Withheld:
LaVerne G. Hall	1,880,975	23,214
Robert G. Miller, Jr.	1,825,343	78,846
John R. O'Brien	1,839,560	64,629
James Tilley	1,874,370	29,819

The following directors also continue their terms as directors of the company following the 2006 annual meeting:

William F. Barrett  
James E. Biddle, Jr.



Phillip Brothman  
Kenneth C. Kirst  
Mary Catherine Militello  
David M. Taylor  
Nancy W. Ware  
Thomas H. Waring, Jr

---

**Table of Contents**

24

**ITEM 6 EXHIBITS**

Exhibit No.	Name	Page No.
31.1	Certification of Principal Executive Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.	27
31.2	Certification of the Principal Financial Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.	28
32.1	Certification of Principal Executive Officer pursuant to 18 USC Section 1350 Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	29
32.2	Certification of Principal Financial Officer pursuant to 18 USC Section 1350 Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	30

---

**Table of Contents**

**SIGNATURES**

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

Evans Bancorp, Inc.

DATE  
August 4, 2006

/s/James Tilley

James Tilley  
President and CEO  
(On Behalf of the Registrant and  
as Principal Executive Officer)

DATE  
August 4, 2006

/s/Mark DeBacker

Mark DeBacker  
Treasurer  
(Principal Financial Officer)

---

**Table of Contents**

**Exhibit Index**

Exhibit No.	Name	Page No.
31.1	Certification of Principal Executive Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.	27
31.2	Certification of the Principal Financial Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.	28
32.1	Certification of Principal Executive Officer pursuant to 18 USC Section 1350 Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	29
32.2	Certification of Principal Financial Officer pursuant to 18 USC Section 1350 Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	30