



UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITES EXCHANGE ACT OF 1934

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

For fiscal year ended: December 31, 2005

☐ 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

(State or other jurisdiction of incorporation or organization)

16-1332767

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

14-16 North Main Street, Angola, New York

(Address of principal executive offices)

14006

(Zip Code)

(716) 926-2000

Registrant's telephone number (including area code)

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

Title of Each Class

None

Name of Exchange on Which Registered

N/A

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

Common Stock, Par Value \$.50 per share

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933.

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934.

Yes ☐ No ☒

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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. ☒

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 ☒

On June 30, 2005, the aggregate market value of the registrant’s common stock, \$.50 par value (the “Common Stock”), held by non-affiliates of the registrant was approximately \$48.7 million, based upon the closing price of a share of the registrant’s Common Stock as quoted by The Nasdaq National Market.

As of March 13, 2006, 2,719,636 shares of the registrant’s Common Stock were outstanding.

## **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's Proxy Statement relating to the registrant's 2006 Annual Meeting of Shareholders, to be held on April 27, 2006, which will be subsequently filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates, are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated.

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## **PART I**

### **FORWARD LOOKING STATEMENTS**

This Annual Report on Form 10-K 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 (“FASB”) 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-K, 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.

### **Item 1. BUSINESS**

#### **EVANS BANCORP, INC.**

Evans Bancorp, Inc. (the “Company”) is a New York business corporation which is registered as a financial holding company under the Bank Holding Company Act of 1956, as amended (the “BHCA”). The principal offices of the Company are located at 14-16 North Main Street, Angola, New York 14006 and its telephone number is (716) 926-2000. The Company was incorporated on October 28, 1988. 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 Company’s common stock is traded on the Nasdaq National Market system under the symbol “EVBN.”

At December 31, 2005, the Company had consolidated total assets of \$468.5 million, deposits of \$336.8 million and stockholders’ equity of \$36.9 million.

The Company’s primary business is the operation of its subsidiaries. It does not engage in any other substantial business activities. The Company has two direct wholly-owned subsidiaries: Evans National Bank (“Evans National Bank” or the “Bank”), which provides a full range of banking services to consumer and commercial customers in Western New York, and Evans National Financial Services, Inc. (“ENFS”), which owns 100% of the common stock of ENB Insurance Agency, Inc. (“ENBI”), which sells various premium-based insurance policies on a commission basis. At December 31, 2005, the Bank represented 97.3% and ENFS represented 2.7% of the consolidated assets of the Company. For further detail, see Note 17 to the Company’s Consolidated Financial Statements under Item 8 of this Report on Form 10-K.

#### **Evans National Bank**

The Bank is a nationally chartered bank that has its headquarters and full-service banking office at 14 North Main Street, Angola, New York, and a total of ten full-service banking offices in Erie County and Chautauqua County, New York – one in each of Amherst, Angola, Derby, Evans, Forestville, Hamburg, Lancaster, North Boston, North Buffalo and West Seneca, New York.

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At December 31, 2005, the Bank had total assets of \$456.0 million, security investments of \$160.0 million, net loans of \$256.8 million, deposits of \$336.8 million and stockholders' equity of \$31.1 million compared to total assets of \$416.4 million, security investments of \$169.9 million, net loans of \$217.6 million, deposits of \$301.9 million and stockholders' equity of \$30.6 million at December 31, 2004. The Bank's principal source of funding is deposits, which it reinvests in the community in the form of loans and investments. The Bank offers deposit products, which include checking and NOW accounts, passbook and statement savings, and certificates of deposit. The Bank's deposits are insured to the applicable limit by the Bank Insurance Fund (the "Insurance Fund") of the Federal Deposit Insurance Corporation ("FDIC"). The Bank offers a variety of loan products to its customers, including commercial and consumer loans and commercial and residential mortgage loans.

As is the case with banking institutions generally, the Bank's operations are significantly influenced by general economic conditions and by related monetary and fiscal policies of banking regulatory agencies, including the Federal Reserve Board ("FRB") and FDIC. The Bank is also subject to the supervision, regulation and examination of the Office of the Comptroller of the Currency of the United States of America (the "OCC").

### Other Subsidiaries

In addition to the Bank, the Company has the following direct and indirect wholly-owned subsidiaries:

*Evans National Leasing, Inc.* ("Evans National Leasing" or "ENL"). ENL, a wholly-owned subsidiary of the Bank, was organized in December 2004 to acquire the business and substantially all of the assets, and assume certain liabilities, of M&C Leasing of West Seneca, New York. ENL provides direct financing leasing of commercial small-ticket general business equipment to companies located throughout the contiguous 48 United States.

*Evans National Holding Corp.* ("ENHC"). ENHC was incorporated in February 2002, and is a wholly-owned subsidiary of the Bank. ENHC operates as a real estate investment trust ("REIT") that holds commercial real estate loans and residential mortgages, which provides additional flexibility and planning opportunities for the business of the Bank.

*Evans National Financial Services, Inc.* ("Evans National Financial Services" or "ENFS"). ENFS is located at One Grimsby Drive, Hamburg, New York. It was incorporated in September 2004, and is a wholly-owned subsidiary of the Company. ENFS's primary business is to own the business and assets of the Company's non-banking financial services segment subsidiaries.

*ENB Insurance Agency, Inc.* ("ENB Insurance Agency" or "ENBI"). ENBI, a wholly-owned subsidiary of ENFS, is an insurance agency which sells various premium-based insurance policies on a commission basis, including business and personal insurance, surety bonds, risk management, life, disability and long-term care coverage. ENBI has offices located in Angola, Cattaraugus, Derby, Eden, Gowanda, Hamburg, Lockport, North Boston, Randolph, Silver Creek, South Dayton, and West Seneca, New York.

*ENB Associates Inc.* ("ENB Associates" or "ENB"). ENB, a wholly-owned subsidiary of ENBI, offers non-deposit investment products, such as annuities and mutual funds.

*Frontier Claims Services, Inc.* ("FCS"). FCS is a wholly-owned subsidiary of ENBI and provides claims adjusting services to various insurance companies.

The Company also has two special purpose entities: Evans Capital Trust I, a statutory trust formed on September 29, 2004 under the Statutory Trust Act, solely for the purpose of issuing and selling certain securities representing undivided beneficial interests in the assets of the trust, investing the proceeds thereof in certain debentures of the Company and engaging in those activities necessary, advisable or incidental thereto; and ENB Employers Insurance Trust, a Delaware trust company formed in February 2003 for the sole purpose of holding life insurance policies under the Bank's bank-owned life insurance program.

The Company operates in two reportable segments – banking activities and insurance agency activities. See Note 17 to the Company's Consolidated Financial Statements included under Item 8 of this Report on Form 10-K for more information on the Company's reportable segments.

### MARKET AREA

The Company's primary market area is located in Erie County, Niagara County, northern Chautauqua County and northwestern Cattaraugus County, New York. This primary market area is the primary area where the Bank receives



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deposits and makes loans and ENBI sells insurance. Even though ENL conducts business outside of this defined market area, this activity is not deemed to expand the Company's primary market.

### AVERAGE BALANCE SHEET INFORMATION

The table presents the significant categories of the assets and liabilities of the Bank, interest income and interest expense, and the corresponding yields earned and rates paid in 2005, 2004 and 2003. The assets and liabilities are presented as daily averages. The average loan balances include both performing and non-performing loans. Interest income on loans does not include interest on loans for which the Bank has ceased to accrue interest. Securities are stated at fair value. Interest and yield are not presented on a tax-equivalent basis.

	2005			2004			2003		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
	(dollars in thousands)			(dollars in thousands)			(dollars in thousands)		
Assets									
Interest-earning assets:									
Loans, Net	\$236,754	\$16,171	6.83%	\$196,711	\$11,815	6.01%	\$167,145	\$10,737	6.42%
Taxable securities	124,774	4,663	3.74%	103,173	3,654	3.54%	72,464	2,226	3.07%
Tax-exempt securities	45,751	1,933	4.23%	49,514	2,130	4.30%	52,658	2,288	4.35%
Time deposits—other banks	215	3	1.40%	832	14	1.68%	721	18	2.50%
Federal funds sold	<u>4,462</u>	<u>113</u>	<u>2.53%</u>	<u>7,051</u>	<u>95</u>	<u>1.35%</u>	<u>5,017</u>	<u>61</u>	<u>1.22%</u>
Total interest-earning assets	411,956	22,883	5.55%	357,281	17,708	4.96%	298,005	15,330	5.14%
Non interest-earning assets:									
Cash and due from banks	11,183			11,163			9,118		
Premises and equipment, net	8,215			6,905			5,483		
Other assets	<u>26,160</u>			<u>18,140</u>			<u>13,743</u>		
Total Assets	<u>\$457,514</u>			<u>\$393,489</u>			<u>\$326,349</u>		
Liabilities & Stockholders' Equity									
Interest-bearing liabilities:									
NOW	\$ 11,976	22	0.18%	\$ 11,272	22	0.20%	\$ 10,753	23	0.21%
Regular savings deposits	94,841	804	0.85%	86,018	550	0.64%	73,816	422	0.57%
Muni-vest savings	51,300	1,454	2.83%	62,060	949	1.53%	36,185	600	1.66%
Time deposits	126,945	3,961	3.12%	102,164	2,526	2.47%	99,775	2,819	2.83%
Other borrowed funds	49,939	1,616	3.23%	28,429	872	3.07%	14,832	563	3.80%
Junior subordinated debentures	11,330	662	5.84%	2,765	132	4.77%	—	—	0.00%
Securities sold U/A to repurchase	<u>6,467</u>	<u>50</u>	<u>0.77%</u>	<u>7,160</u>	<u>60</u>	<u>0.84%</u>	<u>5,971</u>	<u>57</u>	<u>0.95%</u>
Total interest-bearing liabilities	352,798	8,569	2.43%	299,868	5,111	1.70%	241,332	4,484	1.86%
Non interest-bearing liabilities:									
Demand deposits	62,186			54,318			48,853		
Other	<u>6,419</u>			<u>4,953</u>			<u>4,299</u>		
Total liabilities	421,403			359,139			294,484		
Stockholders' equity	<u>36,111</u>			<u>34,350</u>			<u>31,865</u>		
Total Liabilities & Equity	\$457,514			\$393,489			\$326,349		

Net interest earnings	<u>\$14,314</u>	<u>\$12,597</u>	<u>\$10,846</u>
Net yield on interest earning assets	3.47%	3.53%	3.64%
Interest rate spread	3.12%	3.26%	3.28%

**SECURITIES ACTIVITIES**

The primary objective of the Bank’s securities portfolio is to provide liquidity while preserving safety of principal. Secondary objectives include: the investment of funds during periods of decreased loan demand, interest rate sensitivity considerations, providing collateral to secure local municipal deposits, supporting local communities through the

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purchase of tax-exempt securities and tax planning considerations. The Bank's Board of Directors is responsible for establishing overall policy and reviewing performance of the Bank's investments.

Under the Bank's policy, acceptable portfolio investments include: United States ("U.S.") Government obligations, obligations of federal agencies or U.S. Government-sponsored enterprises, mortgage backed securities, municipal obligations (general obligations, revenue obligations, school districts and non-rated issues from the Bank's general market area), banker's acceptances, certificates of deposit, Industrial Development Authority Bonds, Public Housing Authority Bonds, corporate bonds (each corporation limited to the Bank's legal lending limit), collateral mortgage obligations, Federal Reserve stock and Federal Home Loan Bank stock.

The Bank's general investment policy is that in-state securities must be rated at least Moody's BAA (or equivalent) at the time of purchase. Out-of-state issues must be rated at least Moody's AA (or equivalent) at the time of purchase. Bonds or securities rated below A are reviewed periodically to assure their continued credit worthiness. While purchase of non-rated municipal securities is permitted, such purchases are limited to bonds issued by municipalities in the Bank's general market area which, in the Bank's judgment, possess no greater credit risk than BAA (or equivalent) bonds. The financial statements of the issuers of non-rated securities are reviewed by the Bank and a credit file of the issuers is kept on each non-rated municipal security with relevant financial information. In addition, the Bank's loan policy permits the purchase of notes issued by various states and municipalities which have not been rated by Moody's or Standard & Poor's. The securities portfolio of the Bank is priced on a monthly basis.

Pursuant to Statement of Financial Accounting Standard ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities," which establishes accounting treatment for investments in securities, all securities in the Bank's investment portfolio are either designated as "held to maturity" or "available for sale."

Income from securities held in the Bank's investment portfolio represented approximately 28.8% of total interest income of the Company in 2005 as compared to 32.7% in 2004 and 29.4% in 2003. At December 31, 2005, the Bank's securities portfolio of \$160.0 million consisted primarily of U.S. and federal agency obligations, state and municipal securities and mortgage-backed securities, including collateralized mortgage obligations ("CMO's"), issued by the Government National Mortgage Association ("GNMA"), Federal National Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corp ("FHLMC").

The following table summarizes the Bank's securities with those designated as "available for sale" valued at fair value and securities designated as "held to maturity" valued at amortized cost as of December 31, 2005, 2004 and 2003:

	2005	2004 (in thousands)	2003
<b>Available for Sale:</b>			
Debt securities			
U.S. government agencies	\$ 36,604	\$ 29,257	\$ 20,911
States and political subdivisions	42,463	44,924	52,526
Total debt securities	\$ 79,067	\$ 74,181	\$ 73,437
Mortgage-backed securities			
FNMA	\$ 35,569	\$ 43,292	\$ 32,797
FHLMC	10,747	12,184	2,153
GNMA	1,334	1,741	—
CMO's	24,509	31,893	6,566
Total mortgage-backed securities	\$ 72,159	\$ 89,110	\$ 41,516
FRB and Federal Home Loan Bank Stock	4,384	3,526	1,854
Total securities designated as available for sale	\$155,610	\$166,817	\$116,807
<b>Held to Maturity:</b>			
U.S. government agencies	\$ 35	\$ 35	\$ 36
States and political subdivisions	4,307	3,027	3,713
Total securities designated as held to maturity	\$ 4,342	\$ 3,062	\$ 3,749
Total securities	\$159,952	\$169,879	\$120,556

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The following table sets forth the contractual maturities and weighted average interest yields of the Bank's securities portfolio (yields on tax-exempt obligations are not presented on a tax-equivalent basis) as of December 31, 2005:

	Maturing							
	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
(dollars in thousands)								
<b>Available for Sale:</b>								
<b>Debt Securities:</b>								
U.S. government agencies	\$ 5,949	3.18%	\$ 29,669	3.50%	\$ 987	5.00%	\$ —	—
States and political subdivisions	999	4.26%	12,106	4.53%	26,459	4.65%	2,904	4.84%
Total debt service	<u>\$ 6,948</u>	3.84%	<u>\$ 41,775</u>	3.80%	<u>\$ 27,446</u>	4.67%	<u>\$ 2,904</u>	4.84%
<b>Mortgage-backed Securities:</b>								
FNMA	\$ —	—	\$ 873	4.92%	\$ 6,934	4.71%	\$ 27,762	4.96%
FHLMC	—	—	1,107	5.17%	803	4.68%	8,835	4.82%
GNMA	—	—	—	—	—	—	1,329	5.00%
CMO's	—	—	277	4.25%	4,287	4.00%	19,946	4.39%
Total mortgage-backed securities	<u>\$ —</u>	—	<u>\$ 2,257</u>	4.96%	<u>\$ 12,024</u>	4.45%	<u>\$ 57,872</u>	4.74%
Total available for sale	<u>\$ 6,948</u>	3.84%	<u>\$ 44,032</u>	3.86%	<u>\$ 39,470</u>	4.60%	<u>\$ 60,776</u>	4.75%
<b>Held to Maturity:</b>								
U.S. government agencies	\$ —	—	\$ —	—	\$ 9	—	\$ 26	—
States and political subdivisions	\$ 1,853	3.67%	995	3.27%	628	4.68%	831	3.73%
Total held to maturity	<u>\$ 1,853</u>	3.67%	<u>995</u>	3.27%	<u>637</u>	4.61%	<u>857</u>	3.61%
Total securities	<u>\$ 8,801</u>	3.40%	<u>45,027</u>	3.85%	<u>40,107</u>	4.60%	<u>61,633</u>	4.73%

## LENDING ACTIVITIES

**General.** The Bank has a loan policy which is approved by its Board of Directors on an annual basis. The loan policy governs the conditions under which loans may be made, addresses the lending authorities of Bank officers, charge off policies and desired portfolio mix.

The Bank offers a variety of loan products to its customers, including residential and commercial real estate mortgage loans, commercial loans, direct financing leases, and installment loans. The Bank primarily extends loans to customers located within the Western New York area, except for direct financing leases, which are originated in all 48 contiguous states. Interest income on loans represented approximately 70.7% of the total interest income of the Company in 2005 and approximately 66.7% and 70.0% of total interest income in 2004 and 2003, respectively. The Bank's loan portfolio, after unearned discounts, loan origination costs and allowances for loan losses, totaled \$256.8 million and \$217.6 million at December 31, 2005 and December 31, 2004, respectively. At December 31, 2005, the Bank had \$3.2 million as an allowance for loan losses which is approximately 1.23% of total loans. This compares with approximately \$3.0 million at December 31, 2004 which was approximately 1.36% of total loans. The increase of the allowance for loan losses of \$0.2 million in 2005 reflects management's assessment of the portfolio composition, of which higher risk commercial real estate loans comprise a significant component, and its assessment of the New York State and local economy. The net loan portfolio represented approximately 54.8% and 50.7% of the Company's total assets at December 31, 2005 and December 31, 2004, respectively.

**Real Estate Loans.** Approximately 80.4% of the Bank's loan portfolio at December 31, 2005 consisted of real estate loans or loans collateralized by mortgages on real estate, including residential mortgages, commercial mortgages and other types of real estate loans. The Bank's real estate loan portfolio was \$209.1 million at December 31, 2005, compared to \$181.9 million at December 31, 2004. The real estate loan portfolio increased approximately 15.0% in 2005 over 2004 compared to an increase of 14.1% in 2004 over 2003.

The Bank offers fixed rate residential mortgage loans with terms of 10 to 30 years with, typically, up to an 80% loan-to-value ratio. Fixed rate residential mortgage loans outstanding totaled \$41.9 million at December 31, 2005, which was approximately 16.1% of total loans outstanding. In 1995, the Bank entered into a contractual arrangement with FNMA, pursuant to which the Bank sells mortgage loans to FNMA and the Bank retains the servicing rights as to those loans.

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In 2005, the Bank sold approximately \$2.5 million in mortgages to FNMA under this arrangement, compared to \$2.6 million in mortgages sold in 2004. The Bank currently retains the servicing rights on \$28.8 million in mortgages sold to FNMA. The Company has recorded no net servicing asset for such loans as it is considered immaterial. During the 2005 fiscal year, the Bank retained a larger percentage of fixed rate residential real estate loans with desired maturities, within the context of overall maturities in the loan portfolio, as a result of generally improving interest rates and the Bank's ability to absorb the corresponding interest rate risk within the Company's tolerance ranges.

Since 1993, the Bank has offered adjustable rate residential mortgage loans with terms of up to 30 years. Rates on these mortgage loans remain fixed for a predetermined time and are adjusted annually thereafter. On December 31, 2005, the Bank's outstanding adjustable rate residential mortgage loans were \$6.7 million or 2.6% of total loans. This balance did not include any construction mortgage loans, which are discussed below.

The Bank also offers commercial mortgage loans with up to a 80% loan-to-value ratio for up to 20 years on a variable and fixed rate basis. Many of these mortgage loans either mature or are subject to a rate call after three to five years. The Bank's outstanding commercial mortgage loans were \$123.7 million at December 31, 2005, which was approximately 47.6% of total loans outstanding. This balance included \$25.1 million in fixed rate and \$98.6 million in variable rate mortgage loans, which include rate calls.

The Bank also offers other types of loans collateralized by real estate such as home equity loans. The Bank offers home equity loans at variable and fixed interest rates with terms of up to 15 years and up to an 80% loan-to-value ratio. At December 31, 2005, the real estate loan portfolio included \$27.5 million of home equity loans outstanding, which represented approximately 10.6% of its total loans outstanding. This balance included \$21.7 million in variable rate and \$5.8 million in fixed rate loans.

The Bank also offers both residential and commercial real estate construction loans at up to an 80% loan-to-value ratio at fixed interest or adjustable interest rates and multiple maturities. At December 31, 2005, fixed rate real estate construction loans outstanding were \$1.9 million or 0.7% of the Bank's loan portfolio, and adjustable rate construction loans outstanding were \$7.4 million or 2.8% of the portfolio.

As of December 31, 2005, approximately \$0.7 million or 0.3% of the Bank's real estate loans were 30 to 90 days delinquent, and approximately \$0.6 million or 0.3% of real estate loans were non-accruing.

**Commercial Loans.** The Bank offers commercial loans on a secured and unsecured basis, including lines of credit and term loans at fixed and variable interest rates and multiple maturities. The Bank's commercial loan portfolio totaled \$29.9 million and \$28.8 million at December 31, 2005 and 2004, respectively. Commercial loans represented approximately 11.5% and 13.0% of the Bank's total loans at December 31, 2005 and 2004, respectively.

As of December 31, 2005, approximately \$0.1 million or 0.4% of the Bank's commercial loans were 30 to 90 days past due and \$1.2 million or 3.9% of its commercial loans were non-accruing, the latter due primarily to one borrower.

Commercial lending entails significantly more risk than real estate loans. Collateral, where applicable, may consist of inventory, receivables, equipment and other business assets. Approximately 69.5% of the Bank's commercial loans are at variable rates which are tied to the prime rate.

**Installment Loans.** The Bank's installment loan portfolio (which includes personal loans and revolving credit card balances) totaled \$2.7 million and \$2.8 million at December 31, 2005 and 2004, respectively, representing approximately 1.1% of the Bank's total loans at December 31, 2005 and 1.3% of the Bank's total loans at December 31, 2004. Traditional installment loans are offered at fixed interest rates with various maturities of up to 60 months, on a secured and unsecured basis. At December 31, 2005, the installment loan portfolio included \$0.2 million in fixed rate credit card balances at an interest rate of 10.0% and \$0.1 million in the variable rate option. As of December 31, 2005, approximately \$0.1 million or 1.9% of the Bank's installment loans were 30 to 90 days past due.

**Direct Financing Leases.** On December 31, 2004, the Company, together with its newly formed, indirect wholly-owned subsidiary, ENL, acquired M&C Leasing, a general business equipment leasing company located in West Seneca, New York. Direct financing leases totaled \$16.9 million and \$4.5 million at December 31, 2005 and 2004, respectively, representing approximately 6.5% and 2.1% of the Bank's total loans at December 31, 2005 and 2004, respectively. As of December 31, 2005, approximately \$0.1 million or 0.4% of the Bank's direct financing leases were 30-90 days past due.

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**Other Loans.** Other loans totaled \$0.6 million at December 31, 2005 and \$2.0 million at December 31, 2004. Other loans consisted primarily of: loans to municipalities, hospitals, churches and non-profit organizations, at fixed or variable interest rates with multiple maturities; and overdrafts, which totaled \$0.2 million and \$1.5 million December 31, 2005 and 2004, respectively.

The Bank's lending limit to any one borrower is subject to regulation by the OCC. The Bank continually monitors its loan portfolio to review compliance with new and existing regulations.

The following table summarizes the major classifications of the Bank's loans (net of deferred origination costs) as of the dates indicated.

	2005	2004	December 31, 2003 (in thousands)	2002	2001
<b>Mortgage loans on real estate:</b>					
Residential 1-4 family	\$ 48,580	\$ 38,491	\$ 30,160	\$ 26,712	\$ 31,035
Commercial and multi-family	123,727	107,392	99,684	77,919	70,853
Construction	9,270	8,188	5,090	2,174	1,520
Second mortgages	6,454	5,716	6,274	6,919	8,188
Home Equity lines of credit	21,082	22,108	18,262	13,780	10,684
<b>Total real estate loans</b>	<b>209,113</b>	<b>181,895</b>	<b>159,470</b>	<b>127,504</b>	<b>122,280</b>
Direct financing leases	16,945	4,546	—	—	—
Commercial loans	29,920	28,762	24,282	20,460	16,338
Consumer loans	2,747	2,832	2,569	2,352	3,093
Other	642	1,973	1,209	492	2,191
Net deferred loan origination costs	654	590	537	336	353
<b>Total loans</b>	<b>260,021</b>	<b>220,598</b>	<b>188,067</b>	<b>151,144</b>	<b>144,255</b>
Allowance for loan losses	(3,211)	(2,999)	(2,539)	(2,146)	(1,786)
<b>Net loans</b>	<b>\$256,810</b>	<b>\$217,599</b>	<b>\$185,528</b>	<b>\$148,998</b>	<b>\$142,469</b>

**Loan Maturities and Sensitivities of Loans in Interest Rates.** The following table shows the maturities of commercial and real estate construction loans outstanding as of December 31, 2005 and the classification of such loans due after one year according to sensitivity to changes in interest rates.

	Within One Year	After One But Within Five Years (in thousands)	After Five Years	Total
Commercial	\$ 2,656	\$ 13,838	\$ 13,426	\$ 29,920
Real estate construction	4,127	3,808	1,335	9,270
	<u>\$ 6,783</u>	<u>\$ 17,646</u>	<u>\$ 14,761</u>	<u>\$ 39,190</u>
Loans maturing after one year with:				
Fixed Rates		\$ 7,013	\$ 2,332	
Variable Rates		10,633	12,429	
		<u>\$ 17,646</u>	<u>\$ 14,761</u>	

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**Non-accrual, Past Due and Restructured Loans.** The following table summarizes the Bank's non-accrual and accruing loans 90 days or more past due as of the dates listed below. The Bank had no restructured loans as of those dates. Any loans classified for regulatory purposes as loss, doubtful, substandard or special mention that have not been disclosed do not (i) represent or result from trends or uncertainties which management reasonably expects will materially impact the Company's future operating results, liquidity or capital resources, or (ii) represent material credit about which management has serious doubts as to the ability of such borrowers to comply with the loan repayment terms. See Part II, Item 7 of this Report on Form 10-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Allowance for Loan Losses," for further information about the Company's non-accrual, past due and restructured loans.

	At December 31,				
	2005	2004	2003	2002	2001
	(in thousands)				
Non-accruing loans:					
Mortgage loans on real estate:					
Residential 1-4 family	\$ —	\$ —	\$ 30	\$ 30	\$ 70
Commercial and multi-family	600	278	176	1,074	475
Construction	—	—	—	—	—
Second mortgages	—	—	50	21	70
Home Equity lines of credit	—	—	—	—	—
Total mortgage loans on real estate	600	278	256	1,125	615
Direct financing leases	—	2	—	—	—
Commercial loans	1,175	1,375	40	72	109
Consumer installment loans Other	—	—	—	—	—
Total non-accruing loans	<u>\$ 1,775</u>	<u>\$ 1,655</u>	<u>\$ 296</u>	<u>\$ 1,197</u>	<u>\$ 724</u>
Accruing loans 90+ days past due	95	151	627	—	443
Total non-performing loans	<u>1,870</u>	<u>1,806</u>	<u>923</u>	<u>1,197</u>	<u>1,167</u>
Total non-performing loans to total assets	0.41%	0.42%	0.27%	0.41%	0.47%
Total non-performing loans to total loans	<u>0.72%</u>	<u>0.82%</u>	<u>0.49%</u>	<u>0.79%</u>	<u>0.81%</u>

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The following table summarizes the Bank's allowance for loan losses and changes in the allowance for loan losses by loan categories:

	2005	2004	2003 (in thousands)	2002	2001
BALANCE AT THE BEGINNING OF THE YEAR	\$ 2,999	\$ 2,539	\$ 2,146	\$ 1,786	\$ 1,428
CHARGE-OFFS:					
Commercial	(417)	(200)	(54)	(14)	(24)
Real estate mortgages	(25)	(6)	(30)	(42)	(42)
Direct financing leases	(108)	—	—	—	—
Installment loans	(86)	(9)	(11)	(20)	(14)
Overdrafted deposit accounts	(39)	—	—	—	—
TOTAL CHARGE-OFFS	(675)	(215)	(95)	(76)	(80)
RECOVERIES:					
Commercial	—	48	7	2	11
Real estate mortgages	40	8	—	—	1
Direct financing leases	56	—	—	—	—
Installment loans	11	4	1	14	6
Overdrafted deposit accounts	11	—	—	—	—
TOTAL RECOVERIES	118	60	8	16	18
NET CHARGE-OFFS	(557)	(155)	(87)	(60)	(62)
PROVISION FOR LOAN LOSSES	769	485	480	420	420
ADDITION OF ALLOWANCE FROM ACQUISITION	—	130	—	—	—
BALANCE AT END OF YEAR	<u>\$ 3,211</u>	<u>\$ 2,999</u>	<u>\$ 2,539</u>	<u>\$ 2,146</u>	<u>\$ 1,786</u>
RATIO OF NET CHARGE-OFFS TO AVERAGE NET LOANS OUTSTANDING	<u>0.23%</u>	<u>0.08%</u>	<u>0.05%</u>	<u>0.04%</u>	<u>0.05%</u>

Management's provision for loan losses reflects the continued growth trend in higher risk commercial loans and direct financing leases and management's assessment of the local and New York State economic environment. Both the local and New York State economies have lagged behind national prosperity, which remains unsettled. Marginal job growth, combined with a declining population base, has left the Bank's primary market more susceptible to potential credit problems. This is particularly true of commercial borrowers. Commercial loans represent a segment of significant past growth, as well as a concentration in the Company's commercial real estate portfolio. Commercial real estate values may be susceptible to decline in an adverse economy. Management believes that the provision for loan losses complies with the regulations of the OCC, and is reflective of its assessment of the local environment, as well as a continued trend in commercial loan activity and balance outstanding.

## SOURCES OF FUNDS — DEPOSITS

**General.** Customer deposits represent the primary source of the Bank's funds for lending and other investment purposes. In addition to deposits, other sources of funds include loan repayments, loan sales on the secondary market, interest and dividend income from investments, matured investments, and borrowings from the Federal Home Loan Bank ("FHLB") and from the First Tennessee Bank, which is a correspondent bank.

**Deposits.** The Bank offers a variety of deposit products, including checking, passbook, statement savings, NOW accounts, certificates of deposit and jumbo certificates of deposit. Bank deposits are insured up to the limits provided by the FDIC. At December 31, 2005, the Bank's deposits totaled \$336.8 million consisting of the following:



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	(In thousands)
Demand deposits	\$ 71,183
NOW accounts	12,401
Regular savings	86,558
Muni-vest savings	27,521
Time deposits, \$100,000 and over	64,949
Other time deposits	74,196
<b>Total</b>	<b>\$ 336,808</b>

The following table shows daily average deposits and average rates paid on significant deposit categories by the Bank (dollars in thousands):

	2005		2004		2003	
	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate
Demand deposits	\$ 62,186	0.00%	\$ 54,318	0.00%	\$ 48,853	0.00%
NOW accounts	11,976	0.18%	11,272	0.20%	10,753	0.21%
Regular Savings	94,841	0.85%	86,018	0.64%	73,816	0.57%
Muni-vest savings	51,300	2.83%	62,060	1.53%	36,185	1.66%
Time deposits	126,945	3.12%	102,164	2.47%	99,775	2.83%
<b>Total</b>	<b>\$347,248</b>	<b>1.80%</b>	<b>\$315,832</b>	<b>1.28%</b>	<b>\$269,382</b>	<b>1.43%</b>

**Federal Funds Purchased and Other Borrowed Funds.** Another source of the Bank's funds for lending and investing activities at December 31, 2005 consisted of short and long term borrowings from the Federal Home Loan Bank.

Other borrowed funds consisted of various advances from the Federal Home Loan Bank with both fixed and variable interest rate terms ranging from 2.24% to 5.34%. The maturities and weighted average rates of other borrowed funds at December 31, 2005 are as follows (dollars in thousands):

	Maturities	Weighted Average Rate
2006	\$ 39,994	4.11%
2007	2,762	2.86%
2008	661	3.17%
2009	14,051	2.96%
2010	—	—
Thereafter	13,000	3.46%
<b>Total</b>	<b>\$ 70,468</b>	<b>3.70%</b>

**Securities Sold Under Agreements to Repurchase.** The Bank enters into agreements with depositors to sell to the depositors securities owned by the Bank and repurchase the identical security, generally within one day. No physical movement of the securities is involved. The depositor is informed that the securities are held in safekeeping by the Bank on behalf of the depositor. Securities sold under agreements to repurchase totaled \$6.4 million at December 31, 2005 compared to \$7.3 million at December 31, 2004.

## MARKET RISK

For information about, and a discussion of, the Company's "Market Risks," see Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations — Market Risks" of this Report on Form 10-K.

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The following schedule sets forth the maturities of the Bank's time deposits as of December 31, 2005:

	Time Deposit Maturity Schedule (in thousands)				Total
	0-3 Mos.	3-6 Mos.	6-12 Mos.	Over 12 Mos.	
Time deposits — \$100,000 and over	\$ 35,554	\$ 11,987	\$ 7,487	\$ 9,921	\$ 64,949
Other time deposits	8,285	38,282	11,261	16,368	74,196
Total time deposits	<u>\$ 43,839</u>	<u>\$ 50,269</u>	<u>\$ 18,748</u>	<u>\$ 26,289</u>	<u>\$ 139,145</u>

## ENVIRONMENTAL MATTERS

In the course of its business, the Bank has acquired and may acquire in the future, property securing loans that are in default. There is a risk that the Bank could be required to investigate and clean-up hazardous or toxic substances or chemical releases at such properties after acquisition by the Bank, and that the Bank may be held liable to a governmental entity or third parties for property damage, personal injury and investigation and clean-up costs incurred by such parties in connection with such contamination. In addition, the owner or former owners of contaminated sites may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from such property.

To date, the Bank has not been required to perform any investigation or clean-up activities, nor has it been subject to any environmental claims. There can be no assurance, however, that this will remain the case in the future.

## COMPETITION

All phases of the Company's business are highly competitive. The Company competes actively with local, regional and national financial institutions, as well as with bank branches or insurance agency offices in the Company's market area of Erie County, Niagara County, northern Chautauqua County, and northwestern Cattaraugus County, New York. These Western New York counties have a high density of financial institutions, many of which are significantly larger and have greater financial resources than the Company. The Company faces competition for loans, direct financing leases and deposits from other commercial banks, savings banks, savings and loan associations, mortgage banking companies, credit unions, insurance companies and other financial services companies. The Company faces additional competition for deposits and insurance business from non-depository competitors such as the mutual fund industry, securities and brokerage firms, and insurance companies and brokerages. The Company attempts to be generally competitive with all financial institutions in its service area with respect to interest rates paid on time and savings deposits, service charges on deposit accounts, and interest rates charged on loans and leases.

## SUPERVISION AND REGULATION

Bank holding companies and banks are extensively regulated under both federal and state laws and regulations that are intended to protect depositors. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions. Any change in the applicable law or regulation, or a change in the way such laws or regulations are interpreted by regulatory agencies or courts, may have a material adverse effect on the Company's business, financial condition and results of operations.

### **Bank Holding Company Regulation**

As a financial holding company registered under the BHCA, the Company and its non-banking subsidiaries are subject to regulation and supervision under the BHCA by the FRB. The FRB requires periodic reports from the Company, and is authorized by the BHCA to make regular examinations of the Company and its subsidiaries.

The Company is required to obtain the prior approval of the FRB before acquiring direct or indirect ownership or control of more than 5% of the voting shares of a bank or bank holding company. The FRB will not approve any acquisition, merger or consolidation that would have a substantial anti-competitive result, unless the anti-competitive effects of the proposed transaction are outweighed by a greater public interest in meeting the needs and convenience of the public.

The FRB also considers managerial, capital and other financial factors in acting on acquisition or merger applications. A bank holding company may not engage in, or acquire direct or indirect control of more than 5% of the voting shares of any company engaged in any non-banking activity, unless such activity has been determined by the FRB to be closely related to banking or managing banks. The FRB has identified by regulation various non-banking activities in which a bank holding company may engage with notice to, or prior approval by, the FRB.

The FRB has enforcement powers over financial holding companies and their subsidiaries, among other things, to interdict activities that represent unsafe or unsound practices or constitute violations of law, rule, regulation, administrative orders, or written agreements with a federal bank regulator. These powers may be exercised through the issuance of cease and desist orders, civil monetary penalties or other actions.

Bank holding companies and their subsidiary banks are also subject to the provisions of the Community Reinvestment Act (“CRA”). Under the terms of the CRA, the FRB (or other appropriate bank regulatory agency, in the case of the Bank, the OCC) is required, in connection with its examination of a bank, to assess such bank’s record in meeting the credit needs of the communities served by that bank, including low- and moderate-income neighborhoods. Furthermore, such assessment is taken into account in evaluating any application made by a bank holding company or a bank for, among other things, approval of a branch or other deposit facility, office relocation, a merger or an acquisition of bank shares.

### **Supervision and Regulation of Bank Subsidiaries**

The Bank is a nationally chartered banking corporation subject to supervision, examination and regulation of the FRB, the FDIC and the OCC. These regulators have the power to enjoin “unsafe or unsound practices,” require affirmative action to correct any conditions resulting from any violation or practice, issue an administrative order that can be judicially enforced, direct an increase in capital, restrict the growth of a bank, assess civil monetary penalties, and remove a bank’s officers and directors.

The operations of the Bank are subject to numerous statutes and regulations. Such statutes and regulations relate to required reserves against deposits, investments, loans, mergers and consolidations, issuance of securities, payment of dividends, establishment of branches, and other aspects of the Bank’s operations. Various consumer laws and regulations also affect the operations of the Bank, including state usury laws, laws relating to fiduciaries, consumer credit and equal credit, fair credit reporting, and privacy of non-public financial information.

The Bank is subject to Sections 23A and 23B of the Federal Reserve Act and Regulation W thereunder, which govern certain transactions, such as loans, extensions of credit, investments and purchases of assets between member banks and their affiliates, including their parent holding companies. These restrictions limit the transfer from its subsidiaries, including the Bank, of funds to the Company in the form of loans, extensions of credit, investments or purchases of assets (collectively, “Transfers”), and they require that the Bank’s transactions with the Company be on terms no less favorable to the Bank than comparable transactions between the Bank and unrelated third parties. Transfers by the Bank to the Company are limited in amount to 10% of the Bank’s capital and surplus, and transfers to all affiliates are limited in the aggregate to 20% of the Bank’s capital and surplus. Furthermore, such loans and extensions of credit are also subject to various collateral requirements. These regulations and restrictions may limit the Company’s ability to obtain funds from the Bank for its cash needs, including funds for acquisitions, and the payment of dividends, interest and operating expenses.

The Bank is prohibited from engaging in certain tying arrangements in connection with any extension of credit, lease or sale of property or furnishing of services. For example, the Bank may not generally require a customer to obtain other services from the Bank or the Company, and may not require the customer to promise not to obtain other services from a competitor as a condition to an extension of credit. The Bank is also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal stockholders or any related interest of such persons. Extensions of credit: (i) must be made on substantially the same terms (including interest rates and collateral) as, and following credit underwriting procedures that are not less stringent than those prevailing at the time for comparable transactions with persons not covered above and who are not employees, and (ii) must not involve more than the normal risk of repayment or present other unfavorable features. The Bank is also subject to certain lending limits and restrictions on overdrafts to such persons. A violation of these restrictions may result in the assessment of substantial civil monetary penalties on the Bank or any officer, director, employee, agent or other person participating in the conduct of the affairs of the Bank or the imposition of a cease and desist order.

The deposits of the Bank are insured by the FDIC through the Insurance Fund to the extent provided by law. Under the FDIC’s risk-based insurance system, institutions insured through the Insurance Fund are currently assessed premiums based on eligible deposits and the institutions’ capital position and other supervisory factors. Legislation also provides

for assessments against institutions insured through the Insurance Fund which will be used to pay certain financing corporation (“FICO”) obligations. In addition to any Insurance Fund assessments, banks insured through the Insurance Fund are expected to make payments for the FICO obligations based on eligible deposits each year. The assessment is determined quarterly.

Regulations promulgated by the FDIC pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 place limitations on the ability of certain insured depository institutions to accept, renew or rollover deposits by offering rates of interest which are significantly higher than the prevailing rates of interest on deposits offered by other depository institutions having the same type of charter in such depository institutions’ normal market area. Under these regulations, well-capitalized institutions may accept, renew or rollover such deposits without restriction, while adequately capitalized institutions may accept, renew or rollover such deposits with a waiver from the FDIC (subject to certain restrictions on payment of rates). Undercapitalized institutions may not accept, renew or rollover such deposits.

Under the Financial Institutions Reform, Recovery and Enforcement Act of 1989, a depository institution insured by the FDIC can be held liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with: (i) the default of a commonly controlled FDIC-insured depository institution, or (ii) any assistance provided by the FDIC to a commonly controlled FDIC-insured institution in danger of default. “Default” is defined generally as the appointment of a conservator or receiver, and “in danger of Default” is defined generally as the existence of certain conditions indicating that a “default” is likely to occur in the absence of regulatory assistance.

The federal regulators have adopted regulations and examination procedures promoting the safety and soundness of individual institutions by specifically addressing, among other things: (i) internal controls, information systems and internal audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate exposure; (v) asset growth; (vi) ratio of classified assets to capital; (vii) minimum earnings; and (viii) compensation and benefits standards for management officials.

The FRB, the OCC and other federal banking agencies have broad enforcement powers, including the power to terminate deposit insurance, and impose substantial fines and other civil and criminal penalties and appoint a conservator or receiver for the assets of a regulated entity. Failure to comply with applicable laws, regulations and supervisory agreements could subject the Company or its subsidiaries, as well as officers, directors and other institution-affiliated parties of these organizations, to administrative sanctions and potential civil monetary penalties.

### **Capital Adequacy**

The FRB, the FDIC and the OCC have adopted risk-based capital adequacy guidelines for bank holding companies and banks under their supervision. Under these guidelines, the so-called “Tier 1 capital” and “Total capital” as a percentage of risk-weighted assets and certain off-balance sheet instruments must be at least 4% and 8%, respectively.

The FRB, the FDIC and the OCC have also imposed a leverage standard to supplement their risk-based ratios. This leverage standard focuses on a banking institution’s ratio of Tier 1 capital to average total assets, adjusted for goodwill and certain other items. Under these guidelines, banking institutions that meet certain criteria, including excellent asset quality, high liquidity, low interest rate exposure and good earnings, and that have received the highest regulatory rating must maintain a ratio of Tier 1 capital to total adjusted average assets of at least 3%.

Institutions not meeting these criteria, as well as institutions with supervisory, financial or operational weaknesses, along with those experiencing or anticipating significant growth, are expected to maintain a Tier 1 capital to total adjusted average assets ratio equal to at least 4%. As reflected in the following table, the risk-based capital ratios and leverage ratios of the Company and the Bank as of December 31, 2005 and 2004 exceeded the required capital ratios for classification as “well capitalized,” the highest classification under the regulatory capital guidelines.

Capital Components and Ratios at December 31,  
(dollars in thousands)

	2005		2004	
	Company	Bank	Company	Bank
Capital components				
Tier 1 capital	\$ 37,226	\$ 35,855	\$ 33,852	\$ 33,443
Total risk-based capital	40,437	39,055	36,840	36,431
Risk-weighted assets and off-balance sheet instruments	295,759	294,409	257,905	256,558
Risk-based capital ratio				
Tier 1 capital	12.6%	12.2%	13.1%	13.0%
Total risk-based capital	13.7%	13.3%	14.3%	14.2%
Leverage ratio	8.3%	8.0%	8.1%	8.0%

The federal banking agencies, including the FRB and the OCC, maintain risk-based capital standards in order to ensure that those standards take adequate account of interest rate risk, concentration of credit risk, the risk of non-traditional activities and equity investments in non-financial companies, as well as reflect the actual performance and expected risk of loss on certain multifamily housing loans. Bank regulators periodically propose amendments to the risk-based capital guidelines and related regulatory framework, and consider changes to the risk-based capital standards that could significantly increase the amount of capital needed to meet the requirements for the capital tiers described below. While the Company's management studies such proposals, the timing of adoption, ultimate form and effect of any such proposed amendments on the Company's capital requirements and operations cannot be predicted.

The federal banking agencies are required to take "prompt corrective action" in respect of depository institutions and their bank holding companies that do not meet minimum capital requirements. FDICIA established five capital tiers: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." A depository institution's capital tier, or that of its bank holding company, depends upon where its capital levels are in relation to various relevant capital measures, including a risk-based capital measure and a leverage ratio capital measure, and certain other factors.

Under the implementing regulations adopted by the federal banking agencies, a bank holding company or bank is considered "well capitalized" if it has: (i) a total risk-based capital ratio of 10% or greater; (ii) a Tier 1 risk-based capital ratio of 6% or greater; and (iii) a leverage ratio of 5% or greater; and is not subject to any order or written directive to meet and maintain a specific capital level for a capital measure. An "adequately capitalized" bank holding company or bank is defined as one that has: (i) a total risk-based capital ratio of 8% or greater; (ii) a Tier 1 risk-based capital ratio of 4% or greater; and (iii) a leverage ratio of 4% or greater (or 3% or greater in the case of a bank with a composite CAMELS rating of (1)). A bank holding company or bank is considered (A) "undercapitalized" if it has: (i) a total risk-based capital ratio of less than 8%; (ii) a Tier 1 risk-based capital ratio of less than 4%; or (iii) a leverage ratio of less than 4% (or 3% in the case of a bank with a composite CAMELS rating of (1)); (B) "significantly undercapitalized" if the bank has: (i) a total risk-based capital ratio of less than 6%; or (ii) a Tier 1 risk-based capital ratio of less than 3%; or (iii) a leverage ratio of less than 3%; and (C) "critically undercapitalized" if the bank has a ratio of tangible equity to total assets equal to or less than 2%. The FRB may reclassify a "well capitalized" bank holding company or bank as "adequately capitalized" or subject an "adequately capitalized" or "undercapitalized" institution to the supervisory actions applicable to the next lower capital category if it determines that the bank holding company or bank is in an unsafe or unsound condition or deems the bank holding company or bank to be engaged in an unsafe or unsound practice and not to have corrected the deficiency. The Company and the Bank currently meet the definition of "well capitalized" institutions.

"Undercapitalized" depository institutions, among other things, are subject to growth limitations; are prohibited, with certain exceptions, from making capital distributions; are limited in their ability to obtain funding from a Federal Reserve Bank; and are required to submit a capital restoration plan. The federal banking agencies may not accept a capital plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. In addition, for a capital restoration plan to be acceptable, the depository institution's parent holding company must guarantee that the institution will comply with such capital restoration plan and provide appropriate assurances of performance. If a depository institution fails to submit an acceptable plan, including if the holding company refuses or is unable to make the guarantee described in the previous sentence, it is treated as if it is "significantly undercapitalized." Failure to submit or implement an acceptable capital plan also is grounds for the appointment of a conservator or a receiver. "Significantly undercapitalized" depository institutions may be subject to a number of additional requirements and restrictions, including orders to sell sufficient voting stock to

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become “adequately capitalized,” requirements to reduce total assets and cessation of receipt of deposits from correspondent banks. Moreover, the parent holding company of a “significantly undercapitalized” depository institution may be ordered to divest itself of the institution or of non-bank subsidiaries of the holding company. “Critically undercapitalized” institutions, among other things, are prohibited from making any payments of principal and interest on subordinated debt, and are subject to the appointment of a receiver or conservator.

Each federal banking agency prescribes standards for depository institutions and depository institution holding companies relating to internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, a maximum ratio of classified assets to capital, minimum earnings sufficient to absorb losses, a minimum ratio of market value to book value for publicly traded shares and other standards as they deem appropriate. The FRB and the OCC have adopted such standards.

### **Financial Services Modernization and Other Recent Legislation**

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the “Riegle-Neal Act”) facilitates the interstate expansion and consolidation of banking organizations by permitting bank holding companies that are adequately capitalized and managed to acquire banks located in states outside their home states, regardless of whether such acquisitions are authorized under the law of the host state. The Riegle-Neal Act also permits interstate mergers of banks, with some limitations, and the establishment of new branches on an interstate basis, provided that such actions are authorized by the law of the host state.

The Gramm-Leach-Bliley Act of 1999 (the “GLB Act”) permits banks, securities firms and insurance companies to affiliate under a common holding company structure. In addition to allowing new forms of financial services combinations, the GLB Act clarifies how financial services conglomerates will be regulated by the different federal and state regulators. The GLB Act amended by the BHCA and expanded the permissible activities of certain qualifying bank holding companies, known as financial holding companies. In addition to engaging in banking and activities closely related to banking, as determined by the FRB by regulation or order, financial holding companies may engage in activities that are financial in nature or incidental to financial activities that are complementary to a financial activity and do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. Under the GLB Act, all financial institutions, including the Company and the Bank, are required to develop privacy policies, restrict the sharing of non-public customer data with non-affiliated parties at the customer’s request, and establish procedures and practices to protect customer data from unauthorized access.

### **USA Patriot Act**

The USA Patriot Act of 2002 (the “Patriot Act”) imposes additional obligations on U.S. financial institutions, including banks and broker-dealer subsidiaries, to implement policies, procedures and controls which are reasonably designed to prevent, detect and report instances of money laundering and the financing of terrorism. In addition, provisions of the Patriot Act require the federal financial institution regulatory agencies to consider the effectiveness of a financial institution’s anti-money laundering activities when reviewing bank mergers and bank holding company acquisitions.

### **Sarbanes-Oxley Act of 2002**

Since the enactment of the Sarbanes-Oxley Act of 2002 and the SEC’s implementing regulations of the same (collectively, the “Sarbanes-Oxley Act”), companies that have securities registered under the Exchange Act, including the Company, are subject to enhanced and more transparent corporate governance standards, disclosure requirements and accounting and financial reporting requirements. The Sarbanes-Oxley Act, among other things, (i) requires: a public company to establish and maintain audit committees, comprised solely of independent directors, which committee must be empowered to, among other things, engage, supervise and discharge the company’s auditors; that a public company’s financial statements be certified by the principal executive and principal financial officers of such company; increased and quicker public disclosure — real time - obligations by the company and its directors and officers, including disclosures of off-balance sheet transactions and accelerated reporting of transactions in company stock; and (ii) prohibits personal loans to company directors and officers, except certain loans made by insured financial institutions on non-preferential terms and in compliance with other bank regulatory requirements; and (iii) creates or provides for various new and increased civil and criminal penalties for violations of the securities laws.

### **Monetary Policy and Economic Control**

The commercial banking business is affected not only by general economic conditions, but also by the monetary policies of the FRB. Changes in the discount rate on member bank borrowing, availability of borrowing at the “discount window,” open market operations, the imposition of changes in reserve requirements against member banks’ deposits



and assets of foreign branches and the imposition of and changes in reserve requirements against certain borrowings by banks and their affiliates are some of the instruments of monetary policy available to the FRB. These monetary policies are used in varying combinations to influence overall growth and distributions of bank loans, investments and deposits, and this use may affect interest rates charged on loans or paid on deposits. The monetary policies of the FRB have had a significant effect on the operating results of commercial banks and are expected to continue to do so in the future. The monetary policies of these agencies are influenced by various factors, including inflation, unemployment, and short-term and long-term changes in the international trade balance and in the fiscal policies of the United States Government. Future monetary policies and the effect of such policies on the future business and earnings of the Company cannot be predicted.

### SUBSIDIARIES OF THE COMPANY

**Evans National Financial Services, Inc.** ENFS, a wholly-owned subsidiary of the Company, is a holding company for the financial services business of the Company, including ENBI.

**ENB Insurance Agency, Inc.** ENBI, a retail property and casualty insurance agency, is a wholly-owned subsidiary of ENFS, formed in connection with the acquisition of M&W Group, Inc. on September 1, 2000. ENBI is headquartered in Angola, New York, with offices located throughout Western New York in Derby, Eden, Gowanda, Hamburg, Lockport, North Boston, Silver Creek, South Dayton, Cattaraugus, Randolph and West Seneca. ENBI is a full-service insurance agency offering personal, commercial and financial services products. It also has a small consulting department. For the year ended December 31, 2005, ENBI had a premium volume of approximately \$42.1 million and commission revenue of \$6.4 million.

ENBI's primary market area is Erie, Chautauqua, Cattaraugus and Niagara counties. All lines of personal insurance are provided, including automobile, homeowner's, boat, recreational vehicle, landlord and umbrella coverages. Commercial insurance products are also provided, consisting of property, liability, automobile, inland marine, workers compensation, bonds, crop and umbrella insurance. ENBI also provides the following financial services products: life and disability insurance, Medicare supplements, long term care, annuities, mutual funds, retirement programs and New York State Disability.

ENBI has a small consulting division which does work almost exclusively with school districts. The majority of the work is done in preparing specifications for bidding and reviewing existing insurance programs. The majority of the consulting accounts are located in central and eastern New York.

In the personal insurance area, the majority of ENBI's competition comes from direct writers, as well as some small local agencies located in the same towns and villages in which ENBI has offices. In the commercial business segment, the majority of the competition comes from larger agencies located in and around Buffalo, New York. By offering the large number of carriers which it has available to its customers, ENBI has attempted to remain competitive in all aspects of its business.

ENBI is regulated by the New York State Insurance Department. It meets and maintains all licensing and continuing education requirements required by the State of New York.

**Frontier Claims Services, Inc.** FCS, a wholly-owned subsidiary of ENBI, provides insurance adjusting services for insurance companies. FCS is located in Buffalo, New York.

**ENB Associates Inc.** ENB, a wholly-owned subsidiary of ENBI, provides non-deposit investment products, such as mutual funds and annuities, to Bank customers at Bank branch locations. ENB has an investment services agreement with O'Keefe Shaw & Co., Inc., through which ENB can purchase and sell securities to its customers.

**Evans National Bank.** The Bank is a wholly-owned subsidiary of the Company. The Bank's business is described above.

**Evans National Leasing, Inc.** ENL, a wholly-owned subsidiary of the Bank, was organized in December 2004 to acquire the business and substantially all of the assets, and assume certain liabilities, of M&C Leasing of West Seneca, New York. ENL provides direct financing leasing of commercial small-ticket general business equipment to companies located throughout the contiguous 48 United States.

**Evans National Holding Corp.** ENHC, a wholly-owned subsidiary of the Bank, holds certain real estate loans and provides management services. ENHC is operated as a REIT, which provides additional flexibility and planning opportunities for the business of the Bank.

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**Evans Capital Trust I.** Evans Capital Trust I, a wholly-owned subsidiary of the Company, was organized solely to issue and sell certain securities representing undivided beneficial interests of the Trust and investing the proceeds thereof in certain debentures of the Company.

The Company currently operates in two reportable segments – banking and insurance. For the years ended December 31, 1999 and prior, the Company determined that its business was comprised of banking activity only. For disclosure of segmented operations, see Note 17 included in the Company's Consolidated Financial Statements in Item 8 of this Report on Form 10-K.

## EMPLOYEES

As of December 31, 2005, the Company had no direct employees. As of December 31, 2005, the following table summarizes the employment rosters of the Company's subsidiaries:

	Full Time	Part Time
Bank	108	15
ENL	8	—
ENBI	47	4
FCS	4	—
	<u>167</u>	<u>19</u>

The Company's subsidiaries have good relationships with their employees.

## AVAILABLE INFORMATION

The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished by the Company pursuant to Section 13(a) or 15(d) of the Exchange Act, are available without charge on the Company's website, [www.evansbancorp.com](http://www.evansbancorp.com) — SEC filings section, as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. The Company is providing the address to its Internet site solely for the information of investors. The Company does not intend the address to be an active link or to otherwise incorporate the contents of the website into this Report on Form 10-K or into any other report filed with or furnished to the SEC.

## Item 1A. RISK FACTORS

The following factors identified by the Company's management represent significant potential risks that the Company faces in its operations.

### ***Commercial Real Estate and Commercial Business Loans Expose the Company to Increased Lending Risks.***

At December 31, 2005, the Company's portfolio of commercial real estate loans totaled \$123.7 million, or 47.6% of total gross loans and the Company's portfolio of commercial business loans totaled \$29.9 million, or 11.5% of total gross loans. The Company plans to continue to emphasize the origination of commercial loans. Commercial loans generally expose a lender to greater risk of non-payment and loss than one-to four-family residential mortgage loans because repayment of commercial real estate and business loans often depends on the successful operations and the income stream of the borrowers. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to four-family residential mortgage loans. Also, many of the Company's borrowers have more than one commercial real estate or commercial business loan outstanding with the Company. Consequently, an adverse development with respect to one loan or one credit relationship can expose the Company to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan.

### ***Continuing Concentration of Loans in the Company's Primary Market Area May Increase the Company's Risk.***

The Company's success depends primarily on the general economic conditions in western New York State. Unlike larger banks that are more geographically diversified, the Company provides banking and financial services to customers primarily in western New York State. The Company's business lending and marketing strategies focus on loans to small- to medium-sized businesses in this geographic region. Moreover, the Company's assets are heavily concentrated in



mortgages on properties located in western New York State. Accordingly, the Company's business and operations are vulnerable to downturns in the economies of western New York State. The concentration of the Company's loans in this geographic region subjects the Company to risk that a downturn in the economy or recession in this region could result in a decrease in loan originations and increases in delinquencies and foreclosures, which would more greatly affect the Company than if the Company's lending were more geographically diversified. In addition, the Company may suffer losses if there is a decline in the value of properties underlying the Company's mortgage loans which would have a material adverse impact on the Company's operations.

***In the Event the Company's Allowance for Loan Losses is Not Sufficient to Cover Actual Loan Losses, the Company's Earnings Could Decrease.***

The Company maintains an allowance for loan losses in order to mitigate the effect of possible losses inherent in its loan portfolio. There is a risk that the Company may experience significant loan losses which could exceed the allowance for loan losses the Company has currently set aside. In determining the amount of the Company's allowance, the Company makes various assumptions and judgments about the collectibility of its loan portfolio, including the creditworthiness of its borrowers, the effect of changes in the local economy on the value of the real estate and other assets serving as collateral for the repayment of loans, the effects on the Company's loan portfolio of current economic indicators and their probable impact on borrowers, and the Company's loan quality reviews. In addition, bank regulators periodically review the Company's loan portfolio and credit underwriting procedures, as well as its allowance for loan losses, and may require the Company to increase its provision for loan losses or recognize further loan charge-offs. At December 31, 2005, the Company had a net loan portfolio of approximately \$260.0 million and the allowance for loan losses was approximately \$3.2 million, which represented 1.23% of the total amount of gross loans. If the Company's assumptions and judgments prove to be incorrect or bank regulators require the Company to increase its provision for loan losses or recognize further loan charge-offs, the Company may have to increase its allowance for loan losses or loan charge-offs which could have an adverse effect on the Company's operating results and financial condition. There can be no assurances that the Company's allowance for loan losses will be adequate to protect the Company against loan losses that it may incur.

***Changes in Interest Rates Could Adversely Affect the Company's Business, Results of Operations and Financial Condition.***

The Company's results of operations and financial condition may be significantly affected by changes in interest rates. The Company's results of operations depend substantially on its net interest income, which is the difference between the interest income earned on its interest-earning assets and the interest expense paid on its interest-bearing liabilities. Because the Company's interest-bearing liabilities generally re-price or mature more quickly than its interest-earning assets, an increase in interest rates generally would tend to result in a decrease in its net interest income.

Changes in interest rates also affect the value of the Company's interest-earning assets, and in particular, the Company's securities portfolio. Generally, the value of securities fluctuates inversely with changes in interest rates. At December 31, 2005, the Company's securities available for sale totaled \$155.6 million. Net unrealized losses on securities available for sale, net of tax, amounted to \$1.3 million and are reported as a separate component of stockholders' equity. Decreases in the fair value of securities available for sale, therefore, could have an adverse effect on stockholders' equity or earnings.

The Company also is subject to reinvestment risk associated with changes in interest rates. Changes in interest rates may affect the average life of loans and mortgage-related securities. Decreases in interest rates can result in increased prepayments of loans and mortgage-related securities, as borrowers refinance to reduce borrowing costs. Under these circumstances, the Company is subject to reinvestment risk to the extent that it is unable to reinvest the cash received from such prepayments at rates that are comparable to the rates on existing loans and securities. Additionally, increases in interest rates may decrease loan demand and make it more difficult for borrowers to repay adjustable rate loans.

***Strong Competition Within the Company's Market Area May Limit its Growth and Profitability.***

Competition in the banking and financial services industry is intense. The Company competes with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms operating locally within the Company's market area and elsewhere. Many of these competitors (whether regional or national institutions) have substantially greater resources and lending limits than the Company does, and may offer certain services that the Company does not or cannot provide. The Company's profitability depends upon its continued ability to successfully compete in this market area.

***The Company Operates in a Highly Regulated Environment and May Be Adversely Affected By Changes in Laws and Regulations.***

The Company is subject to regulation, supervision and examination by the OCC, FRB, and by the FDIC, as insurer of its deposits. Such regulation and supervision govern the activities in which a bank and its holding company may engage and are intended primarily for the protection of the deposit insurance funds and depositors. Regulatory requirements affect the Company's lending practices, capital structure, investment practices, dividend policy and growth. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of a bank, the classification of assets by a bank and the adequacy of a bank's allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, could have a material adverse impact on the Bank, the Company and its business, financial condition and results of operations.

**Item 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

**Item 2. PROPERTIES**

The Bank conducts its business from its administrative office and ten branch offices as of December 31, 2005. The administrative office is located at One Grimsby Drive in Hamburg, New York, and was purchased in June 2004. The administrative office facility is 26,000 square feet and is owned by the Bank. This facility is occupied by the Office of the President and Chief Executive Officer of the Company, as well as the Administrative and Loan Divisions of the Bank.

The Bank's locations are as follows:

<u>Use</u>	<u>Location</u>	<u>Ownership</u>
Bank branch	14 North Main Street, Angola, NY	Own building and land
Bank branch	8599 Erie Road, Evans, NY	Own building and land
Bank branch	25 Main Street, Forestville, NY	Own building and land
Bank branch	6840 Erie Road, Derby, NY	Own building and land
Bank branch	7205 Boston State Road, North Boston, NY	Own building and land
Bank branch	5999 South Park Avenue, Hamburg, NY	Building lease
Bank branch	938 Union Road, West Seneca, NY	Building lease
Bank branch	3388 Sheridan Drive, Amherst, NY	Own building, lease land
Bank branch	4979 Transit Road, Lancaster, NY	Own building, lease land
Bank branch	2670 Delaware Avenue, Buffalo, NY	Own building, lease land

The Bank also operates in-school branch banking facilities in the West Seneca East High School, 4760 Seneca Street, West Seneca, New York and the West Seneca West High School, 3330 Seneca Street, West Seneca, New York. The in-school branches each have a cash dispensing style ATM located at the sites. There are no lease payments required.

During fiscal 2004, ENL operated from its leased offices at 1050 Union Road, Suite 2, West Seneca, New York. In February 2005, ENL relocated their offices to One Grimsby Drive, Hamburg, New York.

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ENBI operates from its headquarters, a 9,300 square foot office located at 16 North Main Street, Angola, New York, which is owned by the Bank, and retail locations as follows:

Use	Location	Ownership
Retail location	5 Commercial Street, Angola, NY	Building lease
Retail location	265 Central Avenue, Silver Creek, NY	Building lease
Retail location	11 Main Street, Cattaraugus, NY	Building lease
Retail location	213 Pine Street, South Dayton, NY	Building lease
Retail location	7 Bank Street, Randolph, NY	Building lease
Retail location	8226 North Main Street, Eden, NY	Building lease
Retail location	25 Buffalo Street, Gowanda, NY	Own building and land
Retail location	2628 Main Street, Lockport, NY	Building lease
Retail location	6840 Erie Road, Derby, NY	Bank-owned building and land
Retail location	5999 South Park Avenue, Hamburg, NY	Bank building lease
Retail location	938 Union Road, West Seneca, NY	Bank building lease
Retail location	7205 Boston State Road, North Boston, NY	Bank-owned building

### Item 3. LEGAL PROCEEDINGS

The nature of the Company's business generates a certain amount of litigation involving matters arising in the ordinary course of business. However, in the opinion of management of the Company, there are no proceedings pending to which the Company is a party or to which its property is subject, which, if determined adversely, would have a material effect on the Company's results of operations or financial condition.

### Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of shareholders during the fourth quarter of fiscal 2005.

## PART II

### Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

**Market Information.** The Company's common stock is quoted on The Nasdaq National Market system ("Nasdaq") under the symbol EVBN, and has been quoted on Nasdaq since July 9, 2001. The Company distributed a 5% stock dividend on December 30, 2004 to shareholders of record on December 9, 2004, and a 5% stock dividend on December 7, 2005 to shareholders of record on November 15, 2005. All share and per share data contained in this Report on Form 10-K have been adjusted to reflect these stock dividends.

The following table shows, for the periods indicated, the high and low closing prices per share of the Company's common stock as reported on Nasdaq for fiscal 2005 and 2004.

QUARTER	2005		2004	
	High	Low	High	Low
FIRST	\$24.48	\$20.51	\$23.14	\$19.66
SECOND	\$24.29	\$19.78	\$22.49	\$20.09
THIRD	\$21.91	\$20.24	\$22.17	\$18.52
FOURTH	\$23.00	\$19.07	\$25.87	\$21.36

**Holders.** The approximate number of holders of record of the Company's common stock at March 13, 2006 was 1,444.

**Cash Dividends.** The Company paid the following cash dividends on shares of the Company's common stock during fiscal 2004 and 2005:

- A cash dividend of \$0.30 per share on April 6, 2004 to holders of record on March 16, 2004.
- A cash dividend of \$0.31 per share on October 4, 2004 to holders of record on September 10, 2004.
- A cash dividend of \$0.32 per share on April 4, 2005 to holders of record on March 14, 2005.
- A cash dividend of \$0.33 per share on October 3, 2005 to holders of record on September 9, 2005.

In addition, the Company declared a cash dividend of \$0.34 per share payable on April 3, 2006 to holders of record as of March 13, 2006.

All per share amounts have been adjusted to reflect the stock dividends described above. As a result of these adjustments, the amounts reported have been rounded for presentation purposes.

The amount and type (cash or stock), if any, of future dividends will be determined by the Company's Board of Directors and will depend upon the Company's earnings, financial conditions and other factors considered by the Board of Directors to be relevant. The Bank pays a dividend to the Company in order to provide funds for debt service on the junior subordinated debentures, a portion of the proceeds of which were contributed to the Bank as capital, dividends the Company pays, treasury stock purchases, and other expenses. There are also various legal limitations with respect to the Bank supplying funds to the Company. In particular, under Federal Banking Law, the prior approval of the FRB and OCC may be required in certain circumstance, prior to the payment of dividends by the Company or Bank. See Notes 8 and 19 to the Company's Consolidated Financial Statements included in Part II, Item 8 to this Report on Form 10-K for additional information concerning contractual and regulatory restrictions on the payment of dividends.

**Purchases of Equity Securities by the Issuer and Affiliated Purchasers.** The following table includes all Company repurchases, including those made pursuant to publicly announced plans or programs during the quarter ended December 31, 2005.

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
October 2005 (October 1, 2005 through October 31, 2005)	2,415	\$21.51	2,415	69,225
November 2005 (November 1, 2005 through November 30, 2005)	615	\$22.56	615	72,065
December 2005 (December 1, 2005 through December 31, 2005)	600	\$21.67	600	71,465
Total	<u>3,630</u>	<u>\$21.71</u>	<u>3,630</u>	

All 3,630 shares were purchased in open market transactions. On August 18, 2005, the Company announced that its Board of Directors had authorized a new common stock repurchase program, pursuant to which the Company may repurchase up to 75,000 shares of the Company's common stock over the next two years, unless the program is terminated earlier. This program supersedes and replaces the Company's stock repurchase program approved by the Company's Board of Directors on October 21, 2003, pursuant to which a maximum of 50,000 shares of common stock were authorized for repurchase. The Company did not make any repurchases during the quarter ended December 31, 2005, other than pursuant to this publicly announced program, and there were no other publicly announced plans or programs outstanding as of December 31, 2005. The number of shares and average price paid per share have been retroactively restated to give effect to the 5% stock dividend issued on December 7, 2005. The Company has placed such repurchased shares in the treasury and accounts for such shares on a first-in-first-out basis. All shares acquired during the fourth quarter of 2005, prior to November 15, 2005, the record date for the 5% stock dividend, were affected by such stock dividend.

**Item 6. SELECTED CONSOLIDATED FINANCIAL DATA**

(Dollars in thousands except per share data)

	2005	As of and for the year ended December 31,			
		2004	2003	2002	2001
<b>Balance Sheet Data</b>					
Assets	\$468,546	\$429,042	\$334,677	\$288,711	\$248,722
Interest-earning assets	419,973	391,462	308,722	267,142	231,120
Investment securities	159,952	169,879	120,556	106,672	84,065
Loans, net	256,810	217,599	185,528	148,998	142,469
Deposits	336,808	301,928	266,325	239,507	204,260
Borrowings	81,798	79,364	25,388	8,111	9,661
Stockholders' equity	36,876	35,474	33,324	30,862	26,961
<b>Income Statement Data</b>					
Net interest income	\$ 14,314	\$ 12,597	\$ 10,846	\$ 10,395	\$ 9,110
Non-interest income	10,439	8,572	7,666	5,474	4,528
Non-interest expense	17,404	14,779	12,739	10,650	9,531
Net income	4,819	4,509	4,069	3,606	2,579
<b>Per Share Data</b>					
Earnings per share – basic	\$ 1.77	\$ 1.65	\$ 1.51	\$ 1.34	\$ 0.96
Earnings per share – diluted	1.77	1.65	1.51	1.34	0.96
Cash dividends	0.65	0.61	0.57	0.49	0.40
Book value	13.51	13.03	12.37	11.42	10.08
<b>Performance Ratios</b>					
Return on average assets	1.05%	1.15%	1.25%	1.36%	1.09%
Return on average equity	13.34	13.13	12.77	12.51	9.82
Net interest margin	3.47	3.53	3.64	4.27	4.18
Efficiency ratio *	68.23	68.00	67.91	66.61	67.39
Dividend payout ratio	36.58	36.77	37.71	36.18	41.44
<b>Capital Ratios</b>					
Tier I capital to average assets	8.29%	8.05%	8.30%	9.30%	9.60%
Equity to assets	7.87	8.27	9.96	10.69	10.84
<b>Asset Quality Ratios</b>					
Total non-performing assets to total assets	0.41%	0.42%	0.27%	0.51%	0.66%
Total non-performing loans to total loans	0.72	0.82	0.49	0.79	0.81
Net charge-offs to average loans	0.23	0.08	0.05	0.04	0.05
Allowance for loan losses to total loans	1.23	1.36	1.35	1.42	1.24
Allowance for loan losses to non-performing loans	171.71	166.05	276.47	179.27	153.04

See Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and Item 8, “Consolidated Financial Statements and Supplementary Data,” of this Report on Form 10-K for further information and analysis of changes in the Company’s financial condition and results of operations.

\* The calculation of the efficiency ratio excludes amortization of intangibles and goodwill, for comparative purposes. The amounts excluded are \$515 thousand, \$385 thousand, \$168 thousand, \$79 thousand, and \$340 thousand for 2005, 2004, 2003, 2002 and 2001, respectively.

**Item 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**OVERVIEW**

This discussion is intended to compare the performance of the Company for the years ended December 31, 2005, 2004 and 2003. The review of the information presented should be read in conjunction with Part I, “Item 1: Business” and Part II, “Item 6: Selected Financial Data” and “Item 8: Financial Statements and Supplementary Financial Data” of this Report on Form 10-K.

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The Company is a financial holding company registered under the BHCA. During 2004, the Company reorganized its corporate structure by creating a mid-tier wholly-owned subsidiary, ENFS, which was formed by a dividend in-kind of all of the assets and liabilities of ENBI from the Bank. The Company currently conducts its business through its two direct wholly-owned subsidiaries: the Bank and the Bank's subsidiaries, ENL and ENHC; and ENFS and its subsidiaries, ENBI and ENB. The Company does not engage in any other substantial business. Unless the context otherwise requires, the term "Company" refers to Evans Bancorp, Inc. and its subsidiaries.

The Company's financial objectives are focused on earnings growth and return on average equity. Over the last five years, the Company's compounded annual net income growth has been 8.4%. The compounded annual growth rate for gross loans and deposits for the last five years were 14.8% and 12.5%, respectively. To sustain future growth and to meet the Company's financial objectives, the Company has defined a number of strategies. Five of the more important strategies include:

- Expanding Bank market reach and penetration through de-novo branching and potential acquisitions;
- Continuing growth of non-interest income through insurance agency internal growth and potential acquisitions;
- Focusing on profitable customer segments;
- Leveraging technology to improve efficiency and customer service; and
- Maintaining a community based approach.

The Company's strategies are designed to direct tactical investment decisions supporting its financial objectives. The Company's most significant revenue source continues to be net interest income, defined as total interest income less interest expense. Interest income accounted for approximately 69% of total income in 2005. To produce net interest income and consistent earnings growth over the long-term, the Company must generate loan and deposit growth at acceptable margins within its market of operation. To generate and grow loans and deposits, the Company must focus on a number of areas including, but not limited to, the economy, branch expansion, sales practices, customer and employee satisfaction and retention, competition, evolving customer behavior, technology, product innovation, interest rates, credit performance of its customers and vendor relationships.

The Company also considers non-interest income important to its continued financial success. Fee income generation is partly related to the Company's loan and deposit operations, such as deposit service charges, as well as selling financial products, such as commercial and personal insurance through ENBI, non-deposit investment products through ENB and private wealth management services through a strategic alliance with Mellon Financial Services Corp.

While the Company reviews and manages all customer segments, it has focused increased efforts on four targeted segments: (1) high value consumers, (2) smaller businesses with credit needs under \$250,000, (3) medium-sized commercial businesses with credit needs over \$250,000 up to \$5.8 million, and (4) commercial real estate and construction-related businesses. These efforts have resulted in material growth in the commercial and home equity portfolios, as well as core deposits during fiscal 2004 and 2005.

To support growth in targeted customer segments, the Bank opened three de-novo branches during fiscal 2003 through fiscal 2005. With all new and existing branches, the Company has strived to maintain a local community based philosophy. The Bank has emphasized hiring local branch and lending personnel with strong ties to the specific local communities it enters and serves.

The Company has expanded through acquisition, especially in its Insurance Agency segment, where ENBI acquired four companies in 2005 and 2004, including the Truax Agency in July 2005, and Ulrich & Company in October 2004 and Ellwood and Easy PA agencies in January 2004. The Company will typically enter a new market for the insurance agency segment through acquisition of an existing book of business.

The Company also entered the commercial small ticket direct financing lease business through the Bank's acquisition of M&C Leasing on December 31, 2004. Operated as Evans National Leasing, the Company's leasing business is active throughout the 48 contiguous United States.

The Bank serves its market through 10 banking offices in Western New York, located in Amherst, Angola, Derby, Evans, Forestville, Hamburg, Lancaster, North Boston, West Seneca and North Buffalo. The Company's principal source of funding is through deposits, which it reinvests in the community in the form of loans and investments. Deposits are insured to the applicable limit by the Insurance Fund of the FDIC. The Bank is regulated by the OCC. The Company operates in two reportable segments – banking activities and insurance agency activities.

All share and per share information presented is stated after giving effect to a 5% stock dividend paid on December 1, 2003 to shareholders of record on October 14, 2003; a 5% stock dividend paid on December 30, 2004 to shareholders of



record on December 9, 2004; and a 5% stock dividend paid on December 7, 2005 to shareholders of record on November 15, 2005.

### APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The Company's 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 Consolidated Financial Statements and Notes. These estimates, assumptions and judgments are based on information available as of the date of the Consolidated Financial Statements. Accordingly, as this information changes, the 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 Consolidated Financial Statements included in Item 8 of this Report on Form 10-K. These policies, along with the disclosures presented in the other Notes to the Company's Consolidated Financial Statements contained in this Report on Form 10-K and in this financial review, provide information on how significant assets and liabilities are valued in the Company's Consolidated Financial Statements and how those values are determined.

#### Allowance for Loan Losses

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 for loan 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.

The allowance for loan losses represents management's estimate of probable losses in the Bank's loan portfolio. Determining the amount of the allowance for loan 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, estimated losses on pools of homogeneous loans based on historical loss experience and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the consolidated balance sheets. Note 1 to the Consolidated Financial Statements included in Item 8 of this Report on Form 10-K describes the methodology used to determine the allowance for loan losses.

#### Goodwill

The amount of goodwill reflected in the Company's 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.

### RECENT ACCOUNTING PRONOUNCEMENTS AND DEVELOPMENTS

Note 1 to the Company's Consolidated Financial Statements included in Item 8 of this Report on Form 10-K discusses new accounting policies adopted by the Company during fiscal 2005 and the expected impact of accounting policies recently issued or proposed but not yet required to be adopted. To the extent management believes the adoption of new accounting standards materially affects the Company's financial condition, results of operations, or liquidity, the impacts are discussed in the applicable sections of this Management's Discussion and Analysis of Financial Condition and Results of Operations and the Notes to the Company's Consolidated Financial Statements included in Item 8 of this Report on Form 10-K.

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In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised 2004), “Share-Based Payment,” (“SFAS No. 123R”), an amendment of SFAS No. 123 which supersedes Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees,” and its related implementation guidance. SFAS No. 123R establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. SFAS No. 123R also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity’s equity instruments or that may be settled by the issuance of such equity instruments. SFAS No. 123R requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost is to be recognized over the period during which an employee is required to provide services in exchange for the award. Additionally, in March 2005, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin No. 107 (“SAB No. 107”). SAB No. 107 expresses the SEC staff’s views regarding the valuation of share-based payment arrangements for public companies and the interaction between SFAS No. 123R and certain SEC rules and regulations.

The Company recognizes expense for stock-based compensation using the fair value method of accounting described in SFAS No. 123. Management believes the adoption of SFAS No. 123R will not have a material effect on the Company’s Consolidated Financial Statements.

## RESULTS OF OPERATIONS FOR YEARS ENDED DECEMBER 31, 2005 AND DECEMBER 31, 2004

### Net Interest Income

Net interest income, the difference between interest income and fee income on earning assets, such as loans and securities, and interest expense on deposits and borrowings, provides the primary basis for the Company’s results of operations. These results are also impacted by non-interest income, the provision for loan losses, non-interest expense and income taxes. Net income of \$4.8 million in 2005 consists of \$4.0 million related to the Company’s banking activities and \$0.8 million related to the Company’s insurance agency activities. The total net income of \$4.8 million or \$1.77 per share, basic and diluted in 2005 compares to \$4.5 million or \$1.65 per share, basic and diluted for 2004. All per share data reflects the 5% stock dividend paid on December 7, 2005.

Net interest income is dependent on the amounts and yields earned on interest earning assets as compared to the amounts of and rates paid on interest bearing liabilities.

The following table segregates changes in interest earned and paid for the past two years into amounts attributable to changes in volume and changes in rates by major categories of assets and liabilities. The change in interest income and expense due to both volume and rate has been allocated in the table to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

	2005 Compared to 2004 Increase (Decrease) Due to			2004 Compared to 2003 Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
(in thousands)						
Interest earned on:						
Loans	\$ 2,602	\$ 1,754	\$ 4,356	\$ 1,830	\$ (752)	\$ 1,078
Taxable securities	798	211	1,009	1,021	407	1,428
Tax-exempt securities	(160)	(37)	(197)	(135)	(23)	(158)
Federal funds sold	(44)	62	18	25	9	34
Time deposits in other banks	(9)	(2)	(11)	2	(6)	(4)
Total interest-earning assets	<u>\$ 3,187</u>	<u>\$ 1,988</u>	<u>\$ 5,175</u>	<u>\$ 2,743</u>	<u>\$ (365)</u>	<u>\$ 2,378</u>
Interest paid on:						
NOW accounts	\$ 1	\$ (1)	\$ 0	\$ 1	\$ (2)	\$ (1)
Savings deposits	61	193	254	75	53	128
Muni-vest	(188)	693	505	399	(50)	349
Time deposits	690	745	1,435	60	(353)	(293)
Federal funds purchased & other borrowings	<u>1,139</u>	<u>125</u>	<u>1,264</u>	<u>583</u>	<u>(139)</u>	<u>444</u>
Total interest-bearing liabilities	<u>\$ 1,703</u>	<u>\$ 1,755</u>	<u>\$ 3,458</u>	<u>\$ 1,118</u>	<u>\$ (491)</u>	<u>\$ 627</u>



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Net interest income, before the provision for loan losses, increased \$1.7 million or 13.6% to \$14.3 million in 2005, as compared to \$12.6 million in 2004. The increase in 2005 was attributable to the increase in average interest-earning assets of \$54.7 million, and an increase of \$52.9 million in average interest-bearing liabilities over 2004. This increase accounts, as indicated in the table above, for an increase in net interest income due to volume of approximately \$1.5 million. The increase in net interest income due to volume increase on average earning assets was \$3.2 million. The two most significant factors for the increase in average earning assets included higher average securities and loans outstanding, which totaled \$170.5 million and \$236.8 million in 2005, up 11.7% and 20.4%, respectively, from 2004's averages of \$152.7 million and \$196.7 million.

The growth in average securities was largely attributable to the Company's leverage strategy in September 2004, which involved borrowing \$30.0 million at various maturities from the FHLB and corresponding purchases of securities.

Loan growth continues to be driven by commercial loan growth, which increased 20.8%, from \$139.0 million average balance for 2004 to \$167.8 million average balance in 2005. Consumer loans increased 19.2% from \$60.0 million average balance in 2004 to \$71.5 million in 2005.

The increase of \$3.2 million in net interest income due to volume increases in average earning assets was offset by a \$1.7 million decrease in net interest income from an increase in average interest-bearing liabilities in 2005. The increase in 2005 in interest-bearing liabilities was largely attributable to an increase of \$24.8 million or 24.3% in average time deposits from \$102.2 million in 2004 to \$126.9 million in 2005. The largest increase in time deposits was in time deposits \$100,000 and over, due to successful bidding on municipal deposits, along with some runoff of Muni-vest into time deposits.

Additionally, average other borrowed funds, including FHLB advances and trust preferred securities, increased 96.4% or by \$30.1 million in 2005 compared to 2004. As discussed above, the increase in other borrowed funds was largely due to \$30.0 million borrowed from the FHLB in September 2004, thus impacting average borrowed funds for all of 2005. Additionally, on October 1, 2004, the Company raised \$11.3 million through the issuance of Junior Subordinated Debentures, which again impacted average borrowed funds for all of 2005. See Note 8 to the Consolidated Financial Statements included in Item 8 of this Report on Form 10-K for discussion of the Junior Subordinated Debentures.

In addition to changes in the composition of the Company's earning assets and interest-bearing liabilities, changes in interest rates and spreads can impact net interest income. Net interest spread, or the difference between yield on earning assets and rate on interest-bearing liabilities, was 3.12% in 2005, down slightly from 3.26% in 2004. The yield on interest-earning assets increased 59 basis points from 4.96% in 2004 to 5.55% in 2005, while the cost of interest-bearing liabilities increased 73 basis points, from 1.70% in 2004 to 2.43% in 2005.

Net interest-free funds consist largely of non-interest-bearing deposit accounts and stockholders' equity, offset by bank-owned life insurance and non-interest-earning assets, including goodwill and intangible assets. Average net interest-free funds totaled \$59.2 million in 2005 compared to \$57.4 million in 2004. The contribution of net interest-free funds to net interest margin was 0.35% in 2005, compared with 0.27% in 2004. This increase is primarily due to strong growth in non-interest bearing demand deposits in 2005.

Reflecting the changes to the net interest spread and the contribution of interest-free funds as described above, the Company's net interest margin decreased from 3.53% during 2004 to 3.47% during 2005.

During 2005, the FRB took numerous steps to increase the level of interest rates by increasing its benchmark overnight federal funds target rate by 200 basis points, which is in addition to the 125 basis point increase in 2004. The Company believes the continued efforts by the FRB to mitigate potential inflation through raising short-term interest rates, and flattened steepness of the treasury yield curve, will continue to challenge the Company's net interest margin in 2006.

The Bank regularly monitors its exposure to interest rate risk. Management believes that the proper management of interest-sensitive funds will help protect the Bank's earnings against extreme changes in interest rates. The Bank's Asset/Liability Management Committee ("ALCO") meets monthly for the purpose of evaluating the Bank's short-range and long-range liquidity position and the potential impact on capital and earnings as a result of changes in interest rates. The Bank has adopted an asset/liability policy that specifies minimum limits for liquidity and capital ratios. This policy includes setting ranges for the negative impact acceptable on net interest income and on the fair value of equity as a result of a shift in interest rates. The asset/liability policy also includes guidelines for investment activities and funds management. At its monthly meetings, ALCO reviews the Bank's status and formulates its strategies based on current economic conditions, interest rate forecasts, loan demand, deposit volatility and the Bank's earnings objectives.

**Allowance for Loan Losses**

The allowance for loan losses represents the amount charged against the Bank's earnings to establish a reserve or allowance sufficient to absorb probable loan losses based on management's evaluation of the Bank's loan portfolio. Factors considered by the Bank's management in establishing the allowance include the collectibility of individual loans, current loan concentrations, charge-off history, delinquent loan 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 losses. In making this determination, the Bank's management analyzes the ultimate collectibility of the loans in the Bank's portfolio by considering feedback provided by internal loan staff, the Bank's loan review function and information provided by examinations performed by regulatory agencies.

The analysis of the allowance for loan losses is composed of three components: specific credit allocation, general portfolio allocation and a subjectively determined allocation. The specific credit allocation includes a detailed review of each loan in accordance with 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 Disclosure," and an allocation is made based on this analysis. The general portfolio allocation consists of an assigned reserve percentage based on the internal credit rating of each loan, using the Bank's historical loss experience and industry loss experience where the Bank does not have adequate or relevant experience.

The subjective portion of the allowance reflects management's current assessment of the New York State and Western New York economies. Both have lagged behind national prosperity, which continues to remain unsettled. Marginal job growth, in conjunction with a declining population base, has left the Bank's primary market more susceptible to potential credit problems. This is particularly true of commercial borrowers. Commercial loans represent a segment of significant past growth, as well as an area of concentration in the Bank's real estate portfolio. Commercial real estate values may be susceptible to decline in an adverse economy. The Bank's management believes that the Bank's loan loss allowance complies with United States Generally Accepted Accounting Principles and regulations promulgated by the OCC, and is reflective of its assessment of the local environment, as well as a continued growth trend in commercial loans. For further information, see Note 1 to the Company's Consolidated Financial Statements included in Item 8 of this Report on Form 10-K.

The Company's provision for loan losses was \$0.8 million and \$0.5 million in 2005 and 2004, respectively. Total non-performing loans amounted to \$1.9 million and \$1.8 million at December 31, 2005 and 2004, respectively.

The following table provides an analysis of the allowance for loan losses, the total of charge-offs, non-performing loans and total allowance for loan losses as a percentage of total loans outstanding for the five years ended December 31:

	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>
	(in thousands)				
Balance, beginning of year	\$ 2,999	\$ 2,539	\$ 2,146	\$ 1,786	\$ 1,428
Provisions for loan losses	769	485	480	420	420
Addition to allowance from acquisition	—	130	—	—	—
Recoveries	118	60	8	16	18
Loans charged off	(675)	(215)	(95)	(76)	(80)
Balance, end of year	<u>\$ 3,211</u>	<u>\$ 2,999</u>	<u>\$ 2,539</u>	<u>\$ 2,146</u>	<u>\$ 1,786</u>
Net Charge-offs to total loans	0.21%	0.07%	0.05%	0.04%	0.04%
Non-performing loans to total loans	0.72%	0.82%	0.49%	0.79%	0.81%
Allowance for loan losses to total loans	1.23%	1.36%	1.35%	1.42%	1.24%

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An allocation of the allowance for loan losses by portfolio type over the past five years follows (dollars in thousands):

	Balance at 12/31/2005 Attributable to:	Percent of loans in each category to total loans:	Balance at 12/31/2004 Attributable to:	Percent of loans in each category to total loans:	Balance at 12/31/2003 Attributable to:	Percent of loans in each category to total loans	Balance at 12/31/2002 Attributable to:	Percent of loans in each category to total loans	Balance at 12/31/2001 Attributable to:	Percent of loans in each category to total loans
Real estate Loans	\$ 1,463	80.4%	\$ 1,768	82.5%	\$ 1,619	85.1%	\$ 844	84.6%	\$ 455	85.0%
Commercial Loans	851	11.5%	618	13.0%	384	12.9%	259	13.5%	96	11.3%
Consumer Loans	183	1.1%	187	1.3%	147	1.4%	72	1.6%	74	2.2%
All other Loans	34	0.5%	—	1.1%	—	0.6%	—	0.3%	—	1.5%
Direct financing leases	470	6.5%	130	2.1%	—	—%	—	—%	—	—%
Unallocated	210	—%	296	—%	389	—%	971	—%	1,161	—%
<b>Total</b>	<b>\$ 3,211</b>	<b>100.0%</b>	<b>\$ 2,999</b>	<b>100.0%</b>	<b>\$ 2,539</b>	<b>100.0%</b>	<b>\$ 2,146</b>	<b>100.0%</b>	<b>\$ 1,786</b>	<b>100.0%</b>

Both the total increase in allowance for loan losses and allocation of the allowance to commercial loans and direct financing leases are in response to the higher risk associated with the increase in commercial loans and direct financing leases. The increased allowance to commercial categories addresses the Bank's strategic decision to continue growing this product, as well as the local economy, which has lagged the national economy. Commercial loans are more susceptible to decreases in credit quality in cyclical downturns and the larger individual balances of commercial loans expose the Bank to larger losses. The increased allowance for direct financing leases is in response to the growth of that portfolio during 2005, following the December 31, 2004 acquisition of M&C Leasing by ENL. Similar to commercial loans, direct financing leases are susceptible to decreases in credit quality in cyclical downturns in the economy. The direct financing lease portfolio increased to \$16.9 million or 6.5% of total loans at December 31, 2005 from \$4.5 million or 2.1% of total loans at December 31, 2004.

The allowance for loan losses is based on management's estimate, and ultimate losses will vary from current estimates. Factors underlying the determination of the allowance for loan losses are continually evaluated by management based on changing market conditions and other known factors. Some factors underlying the allocation of loan losses have changed in 2005 as a result of the evaluation of underlying risk factors within each loan category. The underlying methodology to determine the adequacy of the allowance for loan losses is consistent with prior years.

### **Non-Interest Income**

Total non-interest income increased approximately \$1.9 million or 21.8% in 2005 over 2004. This compares to an increase of approximately \$0.9 million or 11.8% in 2004 over 2003. Bank service charge income in 2005 increased \$0.2 million over 2004, mainly as a result of higher overdraft fee income.

Insurance fee revenue in 2005 increased \$1.3 million over 2004. The increased insurance fee revenue was primarily the result of a full year of income from an acquisition on October 1, 2004.

Additionally, there was \$0.2 million in fee income from ENL, which was acquired on December 31, 2004; \$0.1 million in life insurance proceeds from a former director; and a \$0.2 million increase in bank owned life insurance in 2005.

### **Non-Interest Expense**

Total non-interest expense increased approximately \$2.6 million or 17.8% in 2005 over 2004. The ratio of non-interest expense to average assets was 3.80% in 2005 compared to 3.76% in 2004. Non-interest expense categories include those most impacted by branch expansion, the ENL acquisition and the increased operations of ENBI due to acquisitions: salaries and benefits, occupancy, advertising, and supplies, among others. Salary and benefit expense increased 17.8% during 2005 over 2004. Of the \$1.4 million increase in salary and benefit expense in 2005 over 2004, the Bank's operations represented approximately \$1.0 million, of which \$0.4 million was related to the ENL acquisition, and ENBI represented approximately \$0.4 million. The North Buffalo branch of the Bank, ENL, increased loan staffing, ENBI expansion and merit increases contributed to the increased salary costs. The first full operating year of an acquisition which was acquired on October 1, 2004, contributed to ENBI's increased salary and benefit expense in 2005.

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Occupancy and repair and maintenance expense increased approximately \$0.3 million or 12.8% from 2004 to 2005, primarily due to ENBI's acquisition growth and the Bank's new branch in North Buffalo, and the first full operating year of the new administrative offices in Hamburg, New York.

Professional services expense increased \$0.3 million, or 34.3%, in 2005 over 2004, mainly due to services for revenue enhancement and incentive compensation, among other projects.

Other expenses increased \$0.4 million or approximately 14.0% in 2005. Expenses associated with Internet banking, ATM expense, telephone and data line costs, postage costs, maintenance on foreclosed properties, director fees and correspondent bank service charges fall under miscellaneous expenses. The increase reflects other transaction-based expenses related to the increased size and volume of the Bank's business.

Amortization of intangibles has increased approximately \$0.1 million, reflecting the three insurance agency acquisitions completed in 2004 and one in 2005.

### **Taxes**

The provision for income taxes in 2005 of \$1.8 million reflects an effective tax rate of approximately 26.8%. This compares to \$1.4 million or 23.6% in 2004. The increase in effective tax rate is mainly a result of decreased investment in tax advantaged municipal bonds as the Company has shifted those funds to higher yielding loan products. The proposed 2006 New York State budget bill contains a provision that would disallow the exclusion of dividends paid by a real estate investment trust subsidiary ("REIT"). The bill, if enacted as proposed, would be effective for taxable years beginning on or after January 1, 2006, and the Company would lose the tax benefit associated with the REIT. Until there is resolution to this proposal, the Company may have to increase the 2006 tax provision by approximately \$0.2 million as compared to 2005 and may have to begin recording the increased provision in the first quarter of 2006. Additionally, the proposed legislation would reduce the statutory tax rate on the taxable income base from 7.5% to 6.75% phased in over a multi-year period.

## **RESULTS OF OPERATIONS FOR YEARS ENDED DECEMBER 31, 2004 AND DECEMBER 31, 2003**

### **Net Interest Income**

Net interest income, before the provision for loan losses, increased \$1.8 million or 16.1% to \$12.6 million in 2004, as compared to \$10.8 million in 2003. The increase in 2004 was attributable to the increase in average interest-earning assets of \$59.3 million, and an increase of \$58.5 million in average interest-bearing liabilities over 2003. This accounts, as indicated in the table above, for a net increase in net interest income due to volume of approximately \$1.7 million in net interest income. The increase in net interest income due to volume increase on average earning assets was \$2.7 million. The two most significant factors for the increase in average earning assets included higher average securities and loans outstanding, which totaled \$152.7 million and \$196.7 million in 2004, up 22.1% and 17.7%, respectively, from 2003's averages of \$125.1 million and \$167.1 million.

### **Allowance for Loan Losses**

The Company's provision for loan losses was \$0.5 million in 2004 and 2003. Total non-performing loans amounted to \$1.8 million at December 31, 2004, as compared to \$0.9 million at December 31, 2003.

Both the total increase in allowance for loan losses and allocation of the allowance to commercial loans are in response to the increase in total higher risk commercial loans. Commercial real estate mortgages represented 59.0% or \$107.4 million of total real estate mortgages at December 31, 2004, as compared to 62.5% or \$99.7 million at December 31, 2003. Commercial real estate contains mortgage loans to developers and owners of commercial real estate. Additionally, commercial loans, which represent loans to a wide variety of businesses, small and moderate across varying industries, comprised 13.0% of total loans or \$28.8 million at December 31, 2004, as compared to 12.9% or \$24.3 million at December 31, 2003. The increased allowance to commercial categories addresses the Bank's strategic decision to continue growing this segment, as well as the local economy, which has lagged the national economy. Commercial loans are more susceptible to decreases in credit quality in cyclical downturns and the larger individual balances of commercial loans expose the Bank to larger losses. In addition, growth in the size of the commercial loan portfolio during 2004, and the increase in non-accrual loans at December 31, 2004, required additional allowance to provide for probable losses in these loans.

### **Non-Interest Income**

Total non-interest income increased approximately \$0.9 million or 11.8% in 2004 over 2003. This compared to an increase of approximately \$2.2 million or 40.0% in 2003 over 2002. Bank service charge income in 2004 remained consistent with 2003.

Insurance fee revenue in 2004 increased \$1.4 million over 2003. The increased insurance fee revenue was primarily the result of acquisitions made during the first and fourth quarters of fiscal 2004.

Other year-to-date non-interest income decreased in 2004 by \$0.2 million over 2003. Commission fees and premium on loans sold also decreased in 2004 compared to 2003. These decreases are primarily attributed to the competitive interest rate environment during 2003, which resulted in more prepayment fees collected on refinanced loans and lower loan originations and sales volume in secondary markets compared to 2003, which was a high point in a historic refinancing period.

In 2004, the Bank continued to grow its ATM network, with the addition of 3 new offsite locations. Also, the Bank joined MoneyPass, a surcharge-free ATM network. This affiliation provides surcharge-free access to funds at a number of nationwide locations for Bank customers.

Gains realized on the sales of securities, totaled approximately \$0.2 million in 2004 versus approximately \$0.3 million in 2003.

### **Non-Interest Expense**

Total non-interest expense increased approximately \$2.0 million or 16.0% in 2004 over 2003. In 2004, the ratio of non-interest expense to average assets was 3.76% compared to 3.90% in 2003 and 4.01% in 2002. Non-interest expense categories include those most impacted by branch expansion and the increased operations of ENBI due to acquisitions: salaries and benefits, occupancy, advertising, and supplies, among others. Salary and benefit expense increased 16.4% during 2004 over 2003. Of the \$1.1 million increase in salary and benefit expense in 2004 over 2003, the Bank's operations represented approximately \$0.6 million and ENBI represented approximately \$0.5 million. The full operating year of the Lancaster branch of the Bank, increased loan staffing, ENBI expansion and merit increases contributed to the increased salary costs. ENBI acquired the business, assets and certain liabilities of the Easy PA and Ellwood insurance agencies, both located in Hamburg, New York, on January 2, 2004. During the fourth quarter 2004, ENBI acquired a retail property and casualty insurance agency located in Lockport, New York, which contributed to ENBI's salary and benefit increased expense in 2004.

Occupancy expense increased approximately \$0.4 million or 24.1% from 2003 to 2004, primarily due to ENBI's acquisition growth and the Bank's new branch in Lancaster, New York and new administrative offices in Hamburg, New York.

Other expenses increased \$0.1 million or approximately 5.9% in 2004 over 2003. Expenses associated with Internet banking, ATM expense, telephone and data line costs, postage costs, maintenance on foreclosed properties, director fees and correspondent bank service charges fall under miscellaneous expenses. The increase reflects other transaction-based expenses related to the increased size and volume of the Bank's business.

Amortization of intangibles has increased approximately \$0.2 million, reflecting three insurance agency acquisitions completed by the Company in 2004.

### **Taxes**

The provision for income taxes in 2004 of \$1.4 million reflected an effective tax rate of approximately 23.6%. This compared to \$1.2 million or 23.1% in 2003. The Company continued to maintain a substantial investment in tax-advantaged municipal bonds, which contributed to its favorable tax position. Additionally, the Company benefited from favorable tax positions due to ENHC's structure as a REIT and bank-owned life insurance income, which is not taxed.

### **FINANCIAL CONDITION**

The Company had total assets of \$468.5 million at December 31, 2005, an increase of \$39.5 million or 9.2% over \$429.0 million at December 31, 2004. Net loans of \$256.8 million increased 18.0% or \$39.2 million over 2004. Securities decreased \$9.9 million or 5.8% from 2004. Deposits grew by \$34.9 million or 11.6%. Stockholders' equity increased \$1.4 million or 4.0%. Net unrealized gains on investment securities held by the Bank of \$1.0 million at December 31,

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2004 decreased \$3.1 million in 2005 to a net unrealized loss of \$2.1 million at December 31, 2005, due to an increasing interest rate environment, which reduced the fair value of the Bank's securities portfolio.

### **Loans**

Loans comprised 57.5% and 55.1% of the Company's total average earning assets in 2005 and 2004, respectively. Actual year-end balances increased 17.9% in 2005, as compared to an increase of 17.3% in 2004. The Company continues to focus its lending on commercial and residential mortgages, commercial loans, home equity loans and direct financing leases. Commercial mortgages make up the largest segment of the portfolio at 47.6% of total loans. Residential mortgages comprise 18.7% of the loan portfolio and 8.1% are home equity loans. Other commercial loans account for 11.5% of outstanding loans. Commercial loans total \$29.9 million at December 31, 2005, reflecting a 4.0% or \$1.2 million increase in 2005 over 2004. Residential mortgages totaled \$48.6 million at December 31, 2005, reflecting a 26.2% or \$10.1 million increase in 2005 over 2004. Prior to fiscal 2004, a significant portion of fixed rate residential mortgages originated were sold to the secondary market in order to minimize interest rate risk in the Bank's portfolio. In 2004 and 2005, the Bank originated and retained fixed rate residential real estate loans with shorter maturities, reflecting the improving interest rate environment.

At December 31, 2005, the Bank had a loan/deposit ratio of 76.2%. This compares to a loan/deposit ratio of 72.1% at December 31, 2004.

At December 31, 2005, the Bank retained the servicing rights to \$28.8 million in long-term mortgages sold to the FNMA. This compares to a loan servicing portfolio principal balance of \$29.2 million at December 31, 2004. The arrangement that the Bank has with FNMA allows it to offer long-term mortgages without exposure to the associated interest rate risks, while retaining customer account relationships. In 2005 and 2004, the Bank sold loans to FNMA totaling approximately \$2.5 million and \$2.6 million, respectively. The Bank did not record any related asset to the servicing portfolio rights as management determined it is immaterial.

### **Securities and Federal Funds Sold**

Securities and federal funds sold made up 42.5% of the Bank's total average interest earning assets in 2005 compared to 44.7% in 2004. These categories provide the Bank with additional sources of liquidity and income. The Bank's securities portfolio outstanding balances declined 5.8% in 2005 from 2004. It continues to have a large concentration in tax-advantaged municipal bonds, which make up 29.3% of the portfolio at December 31, 2005 versus 28.2% at December 31, 2004; U.S. government-sponsored mortgage-backed securities, which make up 45.1% of the portfolio at December 31, 2005 versus 52.5% at December 31, 2004; and U.S. government-sponsored agency bonds of various types, which comprise 22.9% of the total at December 31, 2005 versus 17.2% at December 31, 2004. As a member of both the Federal Reserve System and the Federal Home Loan Bank, the Bank is required to hold stock in those entities. These investments made up 2.7% of the portfolio at December 31, 2005 versus 2.1% of the portfolio at December 31, 2004. The credit quality of the securities portfolio is believed to be strong, with 97.3% of the securities portfolio carrying the equivalent of a Moody's rating of AAA.

Since 2004, the largest security portfolio concentration has been Government-sponsored mortgage-backed securities. The Bank determined the benefit of cash flows from mortgage-backed securities offers benefits in the current interest rate environment.

All fixed and adjustable rate mortgage pools contain a certain amount of risk related to the uncertainty of prepayments of the underlying mortgages. Interest rate changes have a direct impact on prepayment rates. The Company uses a third-party developed computer simulation model to monitor the average life and yield volatility of mortgage pools under various interest rate assumptions.

Federal funds sold balances are largely maintained for liquidity purposes. The average balance maintained in federal funds sold declined in 2005 to 1.1% of total average earning assets from 2.0% in 2004. At December 31, 2005, the Company was in a federal funds purchased position of \$37.1 million, which is reported as part of "other borrowed funds" on the Company's Consolidated Balance Sheets included under Item 8 of this Report on Form 10-K.

The Company manages its available for sale securities portfolio on a total return basis. Management regularly reviews the performance of the Company's securities and sells specific securities to enhance net interest income and net interest margin. The Company realized \$0.1 million in net gains on these sales in 2005 and \$0.2 million in net gains in 2004.

SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," outlines accounting and reporting requirements for investment securities. The Company designates all securities at the time of purchase as either "held to



maturity” or “available for sale.” Securities designated as held to maturity are stated on the Company’s Consolidated Balance Sheets included under Item 8 of this Report on Form 10-K at amortized cost. Those designated as available for sale are reported at fair market value. At December 31, 2005, \$4.3 million in securities were designated as held to maturity. These bonds are primarily municipal investments that the Bank has made in its local trade area.

The available for sale portfolio totaled \$155.6 million or approximately 97.3% of the Bank’s securities portfolio at December 31, 2005. Net unrealized gains and losses on available for sale securities resulted in a net unrealized loss of \$2.1 million at December 31, 2005, as compared to a gain of \$1.0 million at December 31, 2004. Unrealized gains and losses on available for sale securities are reported, net of taxes, as a separate component of shareholders’ equity. At December 31, 2005, the impact to equity was a net unrealized loss of approximately \$1.3 million.

Management has assessed the securities available for sale in an unrealized loss position at December 31, 2005 and determined the decline in fair value below amortized cost to be temporary. In making this determination, management considered the period of time the securities were in a loss position, the percentage decline in comparison to the securities amortized cost, the financial condition of the issuer (primarily government or government-sponsored enterprises) and the Company’s ability and intent to hold these securities until their fair value recovers to their amortized cost. Management believes the decline in fair value is primarily related to market interest rate fluctuations and not to the credit deterioration of the individual issuer.

### **Deposits**

Total deposits increased \$34.9 million or 11.6% in 2005 over 2004. Core deposit growth has been an area the Bank has focused on, and its success is reflected in the 31.8% increase in demand deposits and 6.4% increase in NOW accounts.

Savings deposits declined 14.8% in 2005, and time deposits of less than \$100,000 increased 32.8%, as short term interest rates favored time deposits during 2005.

Certificates of deposit in excess of \$100,000 increased 68.2%. These funds are generally not considered core deposits. Many of these deposits are obtained from municipalities through the competitive bidding process. The large increase in these deposits is due to the Bank’s successful bidding on large municipal funds, and a roll-off of funds from Muni-vest, which decreased 31.6%.

### **Pension**

The Company maintains a qualified defined benefit pension plan, which covers substantially all employees. Additionally, the Company has entered into individual retirement agreements with certain of its executive officers providing for unfunded supplemental pension benefits under the Company’s Supplemental Executive Retirement Plan (the “SERP”). The Company’s pension expense for the defined benefit pension plan, and the SERP, approximated \$0.6 million, \$0.5 million and \$0.5 million for each of the years ended December 31, 2005, 2004 and 2003, respectively, and is calculated based upon a number of actuarial assumptions, including an expected long-term rate of return on the Company’s plan assets of 7.50% both in 2005 and 2004 and 6.75% in 2003; compensation rate increases of 4.75% in 2005, 2004 and 2003 for the defined benefit pension plan and 5.00% in 2005, 2004 and 2003 for the SERP.

The expected long-term rate of return on pension plan assets assumption was determined based on historical returns earned by equity and fixed income securities, adjusted to reflect future return expectations based on pension plan targeted asset allocation. In evaluating compensation rate increases, the Company evaluated historical salary data as well as expected future increases. The Company will continue to evaluate its actuarial assumptions, including its expected rate of return and compensation rate increases at least annually, and will adjust as necessary.

The Company bases its determination of pension expense or income on a market-related valuation of assets, which reduces year-to-year volatility. This market-related valuation recognizes investment gains or losses over a three-year period from the year in which they occur. Investment gains or losses for this purpose are the difference between the expected return calculated using the market-related value of assets and the actual return based on the market-related value of assets. Since the market-related value of assets recognizes gains or losses over a three-year period, the future value of assets will be impacted as previously deferred gains or losses are recorded.

The discount rate utilized by the Company for determining future pension obligations is based on a review of long-term bonds that receive one of the two highest ratings given by a recognized rating agency. The discount rate determined on this basis has decreased from 6.00% at September 30, 2004, for purposes of the Company’s defined benefit pension plan and at December 31, 2004, for purposes of the SERP, both of which are the measurement dates, to 5.50% for both plans at September 30, 2005 and December 31, 2005, respectively.

**Liquidity**

The Company utilizes cash flows from its investment portfolio and federal funds sold balances to manage the liquidity requirements it experiences due to loan demand and deposit fluctuations. The Bank also has many borrowing options. As a member of the 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 the Bank's Overnight Line of Credit Agreement. 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 \$10.0 million in federal funds from one of its correspondent banks. By placing sufficient collateral in safekeeping at the Federal Reserve Bank, the Bank could also borrow at the FRB's discount window. Additionally, the Bank has access to capital markets as a funding source.

The cash flows from the 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 December 31, 2005, approximately 5.7% of the Bank's debt securities had maturity dates of one year or less, and approximately 34.6% had maturity dates of five years or less. At December 31, 2005, the Bank had net short-term liquidity of \$18.7 million as compared to \$2.4 million at December 31, 2004. The increase in short-term liquidity at December 31, 2005 compared to December 31, 2004 was primarily due to the Bank's overnight line of credit agreement with the FHLB, offset by an increase in the federal funds purchased position from \$21.1 million on December 31, 2004 to \$37.1 million on December 31, 2005, which is reported as a part of "other borrowed funds" on the Company's Consolidated Balance Sheets included in the Company's Consolidated Financial Statements included in Item 8 of this Report on Form 10-K. The Company was in a more heavily borrowed position as a result of deposit runoff, primarily in the second half of fiscal 2005, as savings account funds decreased. Additionally, seasonal fluctuations in municipal deposits are typically lowest at the end of the fiscal year until county tax receipts are received in February. Available assets of \$162.0 million, less public and purchased funds of \$180.3 million, resulted in a long-term liquidity ratio of 90% at December 31, 2005, versus 102% at December 31, 2004.

Management, on an ongoing basis, closely monitors the Company's liquidity position for compliance with internal policies, and believes that available sources of liquidity are adequate to meet funding needs in the normal course of business. Management does not anticipate engaging in any activities, either currently or the long-term, for which adequate funding would not be available and would therefore result in significant pressure on liquidity.

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

**Contractual Obligations**

The Company is party to contractual financial obligations, including repayment of borrowings, operating lease payments and commitments to extend credit. The table below presents certain future financial obligations.

	<i>Payments due within time period at December 31, 2005</i>				
	(in thousands)				
	0-12 Months	1-3 Years	4-5 Years	Due After 5 Years	Total
Securities sold under agreement to repurchase	\$ 6,435	\$ —	\$ —	\$ —	\$ 6,435
Operating lease obligations	384	650	587	3,364	4,985
Other borrowed funds	39,994	3,423	14,051	13,000	70,468
Junior subordinated debentures	—	—	—	11,330	11,330
<b>Total</b>	<b>\$ 46,813</b>	<b>\$ 4,073</b>	<b>\$ 14,638</b>	<b>\$ 27,694</b>	<b>\$ 93,218</b>
Interest expense on fixed rate debt	\$ 979	\$ 1,774	\$ 1,211	\$ 1,333	\$ 5,297

The Company's variable rate debt included in other borrowed funds is related to short-term funding which is used only to cover seasonal funding needs, which are undeterminable for a particular year.



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At December 31, 2005, the Company had commitments to extend credit of \$68.5 million compared to \$60.9 million at December 31, 2004. For additional information regarding future financial commitments, this disclosure should be read in conjunction with Note 15 to the Company's Consolidated Financial Statements included in Item 8 of this Report on Form 10-K.

### **Capital**

The Company and Bank have consistently maintained regulatory capital ratios at, or above, well capitalized standards. For further detail on capital and capital ratios, see Note 19 to the Company's Consolidated Financial Statements included under Item 8 of this Report on Form 10-K.

Total Company stockholders' equity was \$36.9 million at December 31, 2005, up from \$35.5 million at December 31, 2004. Equity as a percentage of assets was 7.9% at December 31, 2005, compared to 8.3% at December 31, 2004. Book value per share of common stock rose to \$13.51 at December 31, 2005, up from \$13.03 at December 31, 2004.

Included in stockholders' equity was accumulated other comprehensive income which reflects the net after-tax impact of unrealized gains or losses on investment securities classified as available for sale. Net unrealized losses were \$1.3 million, or \$0.47 per share of common stock, at December 31, 2005, as compared to net unrealized gains on available-for-sale investment securities of \$0.6 million, and \$0.22 per share of common stock, at December 31, 2004. Such unrealized gains are generally due to changes in interest rates and represent the difference, net of applicable income tax effect, between the estimated fair value and amortized cost of investment securities classified as available-for-sale.

On August 18, 2005, the Company announced that its Board of Directors had authorized a new common stock repurchase program, pursuant to which the Company may repurchase up to 75,000 shares of the Company's common stock over the next two years, unless the program is terminated earlier. This program supersedes and replaces the Company's stock repurchase program approved by the Company's Board of Directors on October 21, 2003, pursuant to which a maximum of 50,000 shares of common stock were authorized for repurchase. Shares are held for reissue in connection with the Company's Stock Dividend Reinvestment Plan, the Company's Employee Stock Purchase Plan, the Company's 1999 Stock Option and Long-Term Incentive Plan, as amended, and general corporate purposes. During 2005 and 2004, under these two plans, the Company repurchased 20,907 shares and 32,852 shares at a cost of \$0.5 million and \$0.7 million, respectively, and as adjusted for the effect of all stock dividends. Subject to ongoing capital and investment considerations, management intends to continue to repurchase shares in 2006 on an opportunistic basis pursuant to the repurchase plan.

The Company paid cash dividends per share of common stock of \$0.65 in 2005 and \$0.61 in 2004. The dividend payout is continually reviewed by management and the Company's Board of Directors. The dividend payout ratio, which represents cash dividends paid, divided by net income, was 36.58% and 36.77% for the years 2005 and 2004, respectively.

### **Market Risk**

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 re-price 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. 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 the analysis of market values of the Bank's financial instruments and changes to such market values given changes in interest rates.

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

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limited to, changes in the pricing of loan and deposit products, modifying the composition of interest-earning assets and interest-bearing liabilities, and other financial instruments used for interest rate risk management purposes.

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

Changes in interest rates	Calculated (decrease) increase in projected annual net interest income (in thousands)	
	December 31, 2005	December 31, 2004
+200 basis points	\$(777)	\$(497)
+100 basis points	(386)	(255)
-100 basis points	337	51
-200 basis points	542	(425)

Many assumptions are utilized by the Bank to calculate the impact that changes in interest rates may have on 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 also assumes immediate changes in rates, including 100 and 200 basis point rate changes. In the event that a 100 or 200 basis point rate change 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/re-pricing 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.

Financial instruments with off-balance sheet risk at December 31, 2005 included \$19.9 million in undisbursed lines of credit at an average interest rate of 5.8%; \$7.7 million in fixed rate loan origination commitments at 5.8%; \$38.9 million in adjustable rate loan origination commitments at 7.5%; and \$2.0 million in adjustable rate letters of credit at an average rate of 7.5%.

The following table represents expected maturities of interest-bearing assets and liabilities and their corresponding average interest rates.

Expected maturity year ended December 31,	2006	2007	2008	2009	2010	Thereafter	Total	Fair Value
(dollars in thousands)								
<b>Interest-Assets</b>								
Net loans receivable	\$ 34,749	\$25,206	\$25,638	\$19,451	\$16,904	\$134,862	\$256,810	\$252,280
Average interest	8.18%	8.55%	8.48%	6.93%	6.65%	6.70%	7.27%	7.27%
Investment securities	8,809	10,753	11,335	8,879	8,478	111,698	159,952	159,952
Average interest	3.40%	3.34%	3.67%	4.03%	4.33%	4.58%	4.32%	4.32%
<b>Interest — Liabilities</b>								
Interest bearing deposits	239,335	16,780	8,452	596	425	37	265,625	266,067
Average interest	2.45%	3.66%	3.88%	3.45%	3.71%	7.50%	2.57%	2.57%
<b>Borrowed funds &amp; Securities sold under agreements to repurchase</b>								
	46,429	2,761	661	14,052	—	13,000	76,903	75,317
Average interest	3.65%	2.86%	3.17%	2.96%	—	3.46%	3.46%	3.46%
<b>Junior subordinated debentures</b>								
	—	—	—	—	—	11,330	11,330	11,330
Average interest	—	—	—	—	—	7.03%	7.03%	7.03%

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When rates rise or fall, the market value of the Company's rate-sensitive assets and liabilities increases or decreases. As a part of the Company's asset/liability policy, the Company has set limitations on the negative impact to the market value of its balance sheet that would be acceptable. The Bank's securities portfolio is priced monthly and adjustments are made on the balance sheet to reflect the market value of the available for sale portfolio per SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." At December 31, 2005, the impact to equity as a result of marking available for sale securities to market was an unrealized loss of \$1.3 million. On a monthly basis, the available for sale portfolio is shocked for immediate rate increases of 200 basis points. At December 31, 2005, the Company determined it would take an immediate increase in rates in excess of 200 basis points to eliminate the current capital cushion in excess of regulatory requirements. The Company's and the Bank's capital ratios are also reviewed on a quarterly basis.

### **Capital Expenditures**

The Company has approved the construction and furnishing of a new branch office in 2006. The cost to the Company is expected to be approximately \$1.0 million. Other planned expenditures include a new customer relationship system, replacing a number of personal computers, replacing and adding automated teller machines (ATMs) and miscellaneous other equipment. The Company believes it has a sufficient capital base to support these known and potential capital expenditures with current assets and retained earnings.

### **Impact of Inflation and Changing Prices**

There will continually be economic events, such as changes in the economic policies of the FRB that will have an impact on the profitability of the Company. Inflation may result in impaired asset growth, reduced earnings and substandard capital ratios. The net interest margin can be adversely impacted by the volatility of interest rates throughout the year. Since these factors are unknown, management attempts to structure the balance sheet and re-pricing frequency of assets and liabilities to avoid a significant concentration that could result in a negative impact on earnings.

### **Segment Information**

In accordance with the provisions of SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information," the Company's reportable segments have been determined based upon its internal profitability reporting system, which are comprised of banking activities and insurance agency activities.

The banking activities segment includes all of the activities of the Bank in its function as a full-service commercial bank. This includes the operations of ENL, which provides direct financing leasing. Net income from banking activities was \$4.0 million in 2005, which represents a \$0.1 million or 2.7% increase over 2004. The increase in net income from banking activities was driven by increases in net interest income. Total assets of the banking activities segment increased \$39.6 million or 9.5% during 2005 to \$456.0 million at December 31, 2005, due primarily to growth in loans during 2005.

The insurance activities segment includes activities of ENBI, which is a retail property and casualty insurance agency with twelve locations in the Western New York area. This includes the operations at ENB, which provides non-deposit investment products. Net income from insurance activities was \$0.8 million in 2005, which represents a \$0.2 million or 33.6% increase from 2004. Total assets of the insurance activities segment were \$12.5 million at December 31, 2005, which compares to \$12.6 million at December 31, 2004. Total revenues increased \$1.3 million, or 26.2% over 2004, mainly due to the first full operating year of an acquisition, consummated in the fourth quarter of fiscal 2004.

### **Fourth Quarter Results**

Net income was \$1.1 million, or \$0.41 per basic and diluted share, for the quarter ended December 31, 2005, as compared to \$1.2 million, or \$0.44 per basic and diluted share, for the quarter ended December 31, 2004. The decrease is primarily attributable to a decrease of \$0.1 million in insurance revenue in the fourth quarter of 2005, as compared to the fourth quarter of 2004, and \$77 thousand in investment gains realized in the fourth quarter of 2004. The insurance revenues were impacted by a softening market, causing lower premium rates in 2005, as compared to 2004, especially in consumer product lines.

Net interest income for the three month period ended December 31, 2005 was \$3.6 million, an increase of \$0.4 million over the same period in 2004, and is primarily a result of growth in interest-earning assets and the Company's entry into the small ticket leasing business through ENL.

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The net interest margin for the three month period ended December 31, 2005 was \$3.47%, as compared to 3.29% for the same period in 2004. This increase is primarily due to higher yields on loans resulting from prime rate increases and a higher earned yield on increasing balances of lease receivables, which offset the Bank's increase in the cost of interest-bearing liabilities in the three month period ended December 31, 2005. Muni-vest deposits, time deposits, borrowings, and interest on the Company's junior subordinated debentures were the primary drivers of this increase in the cost of funds.

Non-interest income was \$2.4 million for the three month period ended December 31, 2005, an increase of \$0.1 million, or 5.6% over the same period in 2004.

Non-interest expense was \$4.3 million for the three month period ended December 31, 2005, an increase of \$0.4 million, or 11.3% over the same period in 2004. Salary and employee benefit expense for the three month period ended December 31, 2005 increased \$0.2 million from the same period in 2004 due to Company growth and merit pay increases awarded in early 2005. Additionally, in the three month period ended December 31, 2005, other expenses increased \$0.1 million primarily due to Company growth and expenses related to ENL.

### **Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Response to this item is included in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations "Liquidity" and "Market Risk," and is incorporated by reference into this item.

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**Item 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

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<a href="#">Consolidated Balance Sheets – December 31, 2005 and 2004</a>	44
<a href="#">Consolidated Statements of Income – Years Ended December 31, 2005, 2004 and 2003</a>	45
<a href="#">Consolidated Statements of Stockholders’ Equity – Years Ended December 31, 2005, 2004 and 2003</a>	46
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## **Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Evans Bancorp, Inc.:

We have audited the accompanying consolidated balance sheets of Evans Bancorp, Inc. and subsidiaries as of December 31, 2005 and 2004, 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, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Evans Bancorp, Inc. and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

March 8, 2006  
Buffalo, New York

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### EVANS BANCORP, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2005 AND 2004

(in thousands, except share and per share amounts)

	2005	2004
<b>ASSETS</b>		
Cash and cash equivalents:		
Cash and due from banks	\$ 15,635	\$ 8,124
Interest bearing deposits at other banks	—	984
Securities:		
Available for sale, at fair value	155,610	166,817
Held to maturity, at amortized cost	4,342	3,062
Loans, net of allowance for loan losses of \$3,211 in 2005 and \$2,999 in 2004	256,810	217,599
Properties and equipment, net	8,151	7,747
Goodwill	9,639	9,219
Intangible assets	2,728	3,170
Bank-owned life insurance	9,586	7,943
Other assets	6,045	4,377
<b>TOTAL ASSETS</b>	<b><u>\$468,546</u></b>	<b><u>\$429,042</u></b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Deposits:		
Demand	\$ 71,183	\$ 54,013
NOW	12,401	11,650
Regular savings	86,558	101,540
Muni-vest	27,521	40,235
Time	139,145	94,490
Total deposits	<u>336,808</u>	<u>301,928</u>
Other borrowed funds	70,468	68,034
Junior subordinated debentures	11,330	11,330
Securities sold under agreements to repurchase	6,435	7,306
Other liabilities	6,629	4,970
Total liabilities	<u>431,670</u>	<u>393,568</u>
<b>CONTINGENT LIABILITIES AND COMMITMENTS</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Common stock, \$.50 par value, 10,000,000 shares authorized; 2,745,338 and 2,745,338 shares issued, respectively, and 2,729,779 and 2,722,044 shares outstanding, respectively	1,373	1,307
Capital surplus	26,155	23,361
Retained earnings	11,087	10,808
Accumulated other comprehensive (loss) income, net of tax	(1,387)	563
Less: Treasury stock, at cost (15,559 and 23,294 shares, respectively)	(352)	(565)
Total stockholders' equity	<u>36,876</u>	<u>35,474</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b><u>\$468,546</u></b>	<b><u>\$429,042</u></b>

See Notes to Consolidated Financial Statements.

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### EVANS BANCORP, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF INCOME YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

(in thousands, except share and per share amounts)

	2005	2004	2003
<b>INTEREST INCOME:</b>			
Loans	\$ 16,171	\$ 11,815	\$ 10,737
Federal funds sold/Interest bearing deposits at other banks	116	109	79
Securities:			
Taxable	4,663	3,654	2,226
Non-taxable	1,933	2,130	2,288
Total interest income	22,883	17,708	15,330
<b>INTEREST EXPENSE</b>			
Deposits	6,241	4,047	3,864
Other borrowings	1,666	932	620
Junior subordinated debentures	662	132	—
Total interest expense	8,569	5,111	4,484
<b>NET INTEREST INCOME</b>	14,314	12,597	10,846
<b>PROVISION FOR LOAN LOSSES</b>	769	485	480
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	13,545	12,112	10,366
<b>NON-INTEREST INCOME:</b>			
Bank charges	2,077	1,890	1,812
Insurance service and fees	6,377	5,053	3,767
Net gain on sales of securities	107	245	271
ORE loss	—	—	(27)
Premium on loans sold	18	17	124
Bank-owned life insurance	513	356	460
Life insurance proceeds	95	—	—
Other	1,252	1,011	1,259
Total non-interest income	10,439	8,572	7,666
<b>NON-INTEREST EXPENSE:</b>			
Salaries and employee benefits	9,338	7,927	6,813
Occupancy	1,978	1,805	1,454
Supplies	337	290	282
Repairs and maintenance	553	439	377
Advertising and public relations	464	337	263
Professional services	986	734	711
Amortization of intangibles	515	385	168
Other insurance	368	349	298
Other	2,865	2,513	2,373
Total non-interest expense	17,404	14,779	12,739
<b>INCOME BEFORE INCOME TAXES</b>	6,580	5,905	5,293
<b>INCOME TAXES</b>	1,761	1,396	1,224
<b>NET INCOME</b>	\$ 4,819	\$ 4,509	\$ 4,069
Net income per common share — basic	\$ 1.77	\$ 1.65	\$ 1.51
Net income per common share — diluted	\$ 1.77	\$ 1.65	\$ 1.51
Weighted average number of basic common shares	2,722,644	2,725,469	2,701,494
Weighted average number of diluted shares	2,723,960	2,727,363	2,701,706

See Notes to Consolidated Financial Statements.



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### EVANS BANCORP, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY YEARS ENDED DECEMBER 31, 2005, 2004 and 2003 (in thousands, except share and per share)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
<b>BALANCE — December 31, 2002</b>	1,167	16,579	11,180	1,942	(6)	30,862
Comprehensive income:						
2003 net income			4,069			4,069
Unrealized loss on available for sale securities, net of re-classification adjustment and tax effect				(185)		(185)
Additional minimum pension liability, net of tax effect — \$102				161		161
Total comprehensive income						4,045
Cash dividends (\$.57 per common share)			(1,534)			(1,534)
Stock option expense		103				103
Fractional shares paid in cash on stock dividend			(28)			(28)
Issued 8,618 shares under dividend reinvestment plan	5	185				190
Purchase of 26,295 shares for treasury					(576)	(576)
Re-issuance of 4,618 shares under Employee Stock Purchase Plan			(20)		101	81
Re-issuance of 7,948 shares under dividend reinvestment plan			8		173	181
Stock dividend 5 percent	58	2,492	(2,530)		(20)	—
<b>BALANCE — December 31, 2003</b>	1,230	19,359	11,145	1,918	(328)	33,324
Comprehensive income:						
2004 net income			4,509			4,509
Unrealized loss on available for sale securities, net of reclassification adjustment and tax effect				(1,320)		(1,320)
Additional minimum pension liability, net of tax effect — \$22				(35)		(35)
Total comprehensive income						3,154
Cash dividends (\$.61 per common share)			(1,659)			(1,659)
Stock option expense		165				165
Re-issuance of 14,947 shares under dividend reinvestment plan			18		340	358
Issued 31,942 shares for Ellwood and Easy PA acquisition	15	708				723
Re-issuance of 8,602 shares under Employee Stock Purchase Plan			(31)		200	169
Fractional shares paid in cash on stock dividend			(16)			(16)
Stock dividend 5 percent	62	3,129	(3,158)		(33)	—
Purchase of 30,000 shares for treasury					(744)	(744)
<b>BALANCE – December 31, 2004</b>	\$ 1,307	\$23,361	\$10,808	\$ 563	\$ (565)	\$35,474
Comprehensive income:			4,819			4,819
Unrealized loss on available for sale securities, net of reclassification adjustment and tax effect				(1,874)		(1,874)
Additional minimum pension liability, net of tax effect — \$51				(76)		(76)

Total comprehensive income						<u>2,869</u>
Cash dividends (\$.65 per common share)			(1,764)			(1,764)
Stock option expense	183					183
Re-issuance of 15,856 shares under dividend reinvestment plan	(37)	2		400		365
Re-issuance of 11,312 shares under Employee Stock Purchase Plan	(45)	(23)		274		206
Re-issuance of 800 shares under Directors Stock Option Plan		(3)		19		16
Fractional shares paid in cash on stock dividend		(13)				(13)
Stock dividend 5 percent	66	2,693	(2,739)	(20)		—
Purchase of 19,900 shares for treasury				(460)		(460)
<b>BALANCE — December 31, 2005</b>	<u>\$ 1,373</u>	<u>\$26,155</u>	<u>\$11,087</u>	<u>\$ (1,387)</u>	<u>\$ (352)</u>	<u>\$36,876</u>

*See Notes to Consolidated Financial Statements.*

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### EVANS BANCORP, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003 (in thousands)

	2005	2004	2003
<b>OPERATING ACTIVITIES:</b>			
Interest received	\$ 23,490	\$ 17,971	\$ 16,087
Fees received	9,834	8,266	7,015
Interest paid	(8,241)	(5,106)	(4,541)
Cash paid to employees and suppliers	(14,186)	(13,298)	(12,046)
Income taxes paid	(1,799)	(1,772)	(1,174)
Net cash provided by operating activities	9,098	6,061	5,341
<b>INVESTING ACTIVITIES:</b>			
Available for sale securities:			
Purchases	(23,225)	(97,341)	(100,522)
Proceeds from sales	7,070	17,235	26,908
Proceeds from maturities	24,612	27,664	59,955
Held to maturity securities:			
Purchases	(1,992)	(3,994)	(3,126)
Proceeds from maturities	820	3,796	3,018
Cash paid for bank-owned life insurance	(1,700)	(264)	(6,200)
Additions to properties and equipment	(1,238)	(2,497)	(1,005)
Increase in loans, net of repayments	(43,313)	(30,594)	(52,541)
Proceeds from sales of loans	2,474	2,553	15,732
Proceeds from sale of other real estate owned	—	—	248
Proceeds from bank-owned life insurance	665	—	—
Cash paid on earn-out agreements	(420)	—	—
Acquisitions	(133)	(12,537)	(254)
Net cash used in investing activities	(36,380)	(95,979)	(57,787)
<b>FINANCING ACTIVITIES:</b>			
Proceeds from borrowing	23,485	53,845	19,609
Proceeds from junior subordinated debentures	—	11,330	—
Repayment of long-term borrowings	(9,601)	(7,003)	(2,332)
Repayment of short-term borrowings	(12,321)	(2,350)	(1,083)
Increase in deposits	34,880	35,603	26,878
Dividends paid	(1,764)	(1,659)	(1,534)
Fractional shares paid in cash on stock dividends	(13)	(16)	(28)
Purchase of treasury stock	(460)	(744)	(576)
Re-issuance of treasury stock	587	527	262
Net cash provided by financing activities	34,793	89,533	41,196
Net increase (decrease) in cash and cash equivalents	7,511	(385)	(11,250)
<b>CASH AND CASH EQUIVALENTS:</b>			
Beginning of year	8,124	8,509	19,759
End of year	15,635	\$ 8,124	\$ 8,509

(Continued)

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**EVANS BANCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003**  
(in thousands)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:</b>			
Net income	\$ 4,819	\$ 4,509	\$ 4,069
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,901	1,670	1,246
Deferred (benefit) tax expense	(102)	(54)	171
Provision for loan losses	769	485	480
Net gain on sales of assets	(107)	(239)	(244)
Premiums on loans sold	(18)	(17)	(124)
Stock options expense	183	165	103
Changes in assets and liabilities affecting cash flow:			
Other assets	(125)	953	(261)
Other liabilities	<u>1,778</u>	<u>(1,411)</u>	<u>(99)</u>
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b><u>\$ 9,098</u></b>	<b><u>\$ 6,061</u></b>	<b><u>\$ 5,341</u></b>
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTMENTS AND FINANCIAL ACTIVITIES:</b>			
Acquisition of insurance agencies:			
Fair value of			
Assets acquired, non-cash	\$ —	\$ 861	\$ 256
Liabilities assumed	—	—	256
Securities issued	—	723	—

*See Notes to Consolidated Financial Statements.*

(Concluded)

**EVANS BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003**

**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization and General** - Evans Bancorp, Inc. (the "Company") was organized as a New York business corporation and incorporated under the laws of the State of New York on October 28, 1988 for the purpose of becoming a bank holding company. Through August 2004, the Company was registered with the Federal Reserve Board as a bank holding company under the Bank Holding Company Act of 1956, as amended. In August 2004, the Company filed for, and was approved as, a Financial Holding Company under the Bank Holding Company Act. Subsequent to this change, the Company reorganized its corporate structure by creating a mid-tier wholly-owned subsidiary, Evans National Financial Services, Inc., which was formed by a dividend in-kind of all of the assets and liabilities of ENB Insurance Agency, Inc. from Evans National Bank. During 2005, the Company further reorganized by the Bank contributing as a dividend in-kind to ENB Insurance Agency, Inc. ("ENBI"), all the assets and liabilities of ENB Associates Inc. ("ENB"). The Company currently conducts its business through its two subsidiaries: Evans National Bank (the "Bank"), a nationally chartered bank, and its subsidiaries, Evans National Leasing, Inc. ("ENL") and Evans National Holding Corp. ("ENHC"); and Evans National Financial Services, Inc. ("ENFS") and its subsidiary, ENBI. Unless the context otherwise requires, the term "Company" refers to Evans Bancorp, Inc. and its subsidiaries. The Company conducts its business through its subsidiaries. It does not engage in any other substantial business.

**Regulatory Requirements** - The Company is subject to the rules, regulations, and reporting requirements of various regulatory bodies, including the Federal Reserve Board ("FRB"), the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), and the Securities and Exchange Commission ("SEC").

**Principles of Consolidation** - The consolidated financial statements include the accounts of the Company, the Bank, ENBI and their subsidiaries. All material inter-company accounts and transactions are eliminated in consolidation.

**Accounting Estimates** - The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

**Securities** - Securities which the Bank has the positive intent and ability to hold to maturity are classified as held to maturity and are stated at cost, adjusted for discounts and premiums that are recognized in interest income over the period to the earlier of the call date or maturity using a method that approximates level yield. These securities represent debt issuances of local municipalities in the Bank's market area for which market prices are not readily available. The amortized cost of the securities approximates market value. Management periodically evaluates the financial condition of the municipalities for impairment.

Securities classified 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. Gains and losses on sales of securities are computed using the specific identification method.

Securities which have experienced an other-than-temporary decline in fair value are written down to a new cost basis with the amount of the write-down included in earnings as a realized loss. The new cost basis is not changed for subsequent recoveries in fair value. Factors which management considers in determining whether an impairment in value of an investment is other than temporary include the issuer's financial performance and near term prospects, the financial condition and prospects for the issuer's geographic region and industry, and recoveries in fair value subsequent to the balance sheet date.

The Bank does not engage in securities trading activities.

**Derivative Instruments and Hedging Activities** - The Company follows the Statement of Financial Accounting Standards (“SFAS”) No. 133, “Accounting for Derivative Instruments and Hedging Activities,” as amended. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities, which require that an entity recognize all derivatives as either assets or liabilities on a balance sheet and measure those instruments at fair value. Changes in the fair value of derivatives must be recognized in earnings when they occur, unless the derivative qualifies as a hedge. If a derivative qualifies as a hedge, a company can elect to use hedge accounting to eliminate or reduce income statement volatility that would arise from reporting changes in a derivative’s fair value in income.

**Loans** – The Bank grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout Erie, Chautauqua and Niagara counties. The ability of the Bank’s debtors to honor their contracts is dependent upon numerous factors, including the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or pay-off, generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on those loans at the time they were originated. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method of accounting.

The Bank considers a loan to be impaired when, based on current information and events, it is probable that it will be unable to collect principal or interest due according to the contractual terms of the loan. Loan impairment is measured based on the present value of expected cash flows discounted at the loan’s effective interest rate or, as a practical expedient, at the loan’s observable market price or the fair value of the collateral if the loan is collateral dependent.

Payments received on impaired loans are applied against the recorded investment in the loan. For loans other than those that the Bank expects repayment through liquidation of the collateral, when the remaining recorded investment in the impaired loan is less than or equal to the present value of the expected cash flows, income is recorded on a cash basis.

The accrual of interest on commercial loans and mortgages is discontinued at the time the loan is 90 days delinquent, unless the credit is well secured and in process of collection. In all cases, loans are placed on non-accrual status and are subject to charge-off at an earlier date if collection of principal or interest is considered doubtful.

All interest due but not collected for loans that are placed on non-accrual status or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until it again qualifies for an accrual basis. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current, the adverse circumstances which resulted in the delinquent payment status are resolved, and payments are made in a timely manner for a period of time sufficient to reasonably assure their future dependability.

**Leases** – The Bank’s leasing operations consists principally of the leasing of various types of small ticket commercial equipment. The Company follows Statement of Financial Accounting Standards No. 13, “Accounting for Leases” for all of its direct financing leases. The net investment in direct financing leases is the sum of all minimum lease payments and estimated residual values, less unearned income. All of the Bank’s leases are classified as direct financing leases.

**Allowance for Loan Losses** – The allowance for loan losses represents the amount charged against the Bank’s earnings to establish a reserve or allowance sufficient to absorb probable loan losses based on the Bank’s management’s evaluation of the loan portfolio. Factors considered by the Bank’s management in establishing the allowance include: the collectibility of individual loans, current loan concentrations, charge-off history, delinquent loan 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 losses. In making this determination, the Bank’s management analyzes the ultimate collectibility of the loans in its portfolio by considering feedback provided by internal loan staff, an independent loan review function and information provided by examinations performed by regulatory agencies.

The analysis of the allowance for loan losses is composed of three components: specific credit allocation, general portfolio allocation and a subjectively determined allocation. The specific credit allocation includes a detailed review of the loan in accordance with 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 credit rating of each loan.

The subjective portion of the allowance for loan losses 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 or portfolio segments. The conditions evaluated in connection with this element include the following: industry and regional conditions, seasoning of the loan portfolio and changes in the composition of and growth in the loan portfolio, the strength and duration of the business cycle, existing general economic and business conditions in the lending areas, credit quality trends in non-accruing loans, historical loan charge-off experience, and the results of Bank regulatory examinations.

**Foreclosed Real Estate** – Foreclosed real estate is initially recorded at the lower of book or fair value (net of costs of disposal) at the date of foreclosure. Costs relating to development and improvement of property are capitalized, whereas costs relating to the holding of property are expensed. Assessments are periodically performed by management, and an allowance for losses is established by a charge to operations if the carrying value of a property exceeds fair value. Foreclosed real estate is classified as other assets on the Consolidated Balance Sheets.

**Goodwill and Other Intangible Assets** – Goodwill represents the excess of the purchase price over the fair value of the identifiable net assets acquired in connection with certain company acquisitions. The Company accounts for goodwill and other intangible assets in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," which revised the accounting for purchased intangible assets, and in general, requires that goodwill not be amortized, but rather that it be tested for impairment at least annually. Other acquired intangible assets with finite lives are required to be amortized over their estimated lives. Intangible assets are amortized over estimated useful lives ranging from five to ten years. The Company periodically assesses whether events or changes in circumstances indicate that the carrying amounts of intangible assets may be impaired.

**Bank-Owned Life Insurance** – The Bank has purchased insurance on the lives of Company directors and certain members of Bank's, ENBI's and ENB's management. The policies accumulate asset values to meet future liabilities, including the payment of employee benefits, such as retirement benefits. Increases in the cash surrender value are recorded as other income in the consolidated statements of income.

**Properties and Equipment** – Properties and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from 3 to 39 years. Impairment losses on properties and equipment are realized if the carrying amount is not recoverable from its undiscounted cash flows and exceeds its fair value.

**Loan Servicing** – The Bank, in its normal course of business, sells certain residential mortgages which it originates to the FNMA. The Company maintains servicing rights on the loans that it sells to FNMA and earns a fee thereon. At December 31, 2005 and 2004, the Company had approximately \$28.8 million and \$29.2 million, respectively, in unpaid principal balances of loans that it services for FNMA. For the years ended December 31, 2005 and 2004, the Company sold \$2.5 million and \$2.6 million, respectively, in loans to FNMA. The Company did not record any related asset to the servicing portfolio rights as management determined it immaterial.

**Income Taxes** – Income taxes are accounted for under the asset and liability method under SFAS No. 109, "Accounting for Income Taxes." Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the periods in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through income tax expense.

**Net Income Per Share** – Net income per common share is based on the weighted average number of shares outstanding during each year, retroactively adjusted for stock splits and stock dividends. Dilutive earnings per common share is based on increasing the weighted-average number of shares of common stock by the number of shares of common stock that would be issued assuming the exercise of stock options. Such adjustments to weighted-average number of shares of common stock outstanding are made only when such adjustments are expected to dilute earnings per common share. Basic and diluted earnings per share are the same for December 31, 2005, 2004, and 2003. The Company's potential dilutive securities included 1,316, 1,894 and 212 shares of common stock for the years ended December 31, 2005, 2004 and 2003, respectively. All share and per share information presented is stated after giving effect to stock dividends. 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 December 31, 2005 and 2004, there were 59 thousand and 27 thousand shares, respectively, that are not included in calculating diluted earnings per share because their effect was anti-dilutive. As of December 31, 2003, there were no such anti-dilutive shares.

**Stock Dividends** – A 5% stock dividend was declared on October 18, 2005, for shareholders of record on November 15, 2005. The stock dividend resulted in the issuance of 130,215 shares of common stock and a payment of \$13 thousand for fractional shares, and was issued on December 7, 2005. A 5% stock dividend was declared on November 16, 2004 for shareholders of record on December 9, 2004. The stock dividend resulted in the issuance of 128,779 shares of common stock and the payment of \$16 thousand for fractional shares, and was issued on December 30, 2004. A 5% stock dividend was declared on September 16, 2003 for shareholders of record on October 14, 2003. The stock dividend resulted in the issuance of 122,281 shares of common stock and the payment of \$16 thousand for fractional shares, and was issued on December 1, 2003. All share data and per share data contained in this document have been adjusted to reflect the stock dividends, except for the share data contained in the Consolidated Statements of Stockholders' Equity.

**Comprehensive Income** – Comprehensive income includes both net income and other comprehensive income, including the change in unrealized gains and losses on securities available for sale and the change in additional minimum liability related to pension costs, net of tax.

**Employee Benefits** – The Bank maintains a non-contributory, qualified, defined benefit pension plan ("Pension Plan") that covers substantially all employees who meet certain age and service requirements. The actuarially determined pension benefit in the form of a life annuity is based on the employee's combined years of service, age and compensation. The Bank's policy is to fund the minimum amount required by government regulations.

The Bank maintains a defined contribution 401(k) plan and accrues contributions due under this plan as earned by employees. In addition, the Bank maintains a non-qualified Supplemental Executive Retirement Plan for certain members of senior management, a non-qualified Deferred Compensation Plan for directors and certain members of management, and a non-qualified Executive Incentive Retirement Plan for certain members of management, as described more fully in Note 11 to these "Notes to Consolidated Financial Statements."

**Stock-Based Compensation** – At December 31, 2005 the Company had stock-based employee and non-employee compensation plans, which are described more fully in Note 12. The Company accounts for these plans under SFAS No. 123, "Accounting for Stock Based Compensation." Under SFAS No. 123, the fair value of the stock options granted to employees are recognized in salaries and employee benefits expense, and the fair value of the stock options granted to directors are recognized in other non-interest expense in the Consolidated Statements of Income.

**Financial Instruments with Off-Balance Sheet Risk** – In the ordinary course of business, the Bank has entered into off-balance sheet financial arrangements consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when the transactions are executed.

**Cash and Cash Equivalents** – For purposes of reporting cash flows, cash and cash equivalents include cash due from banks and federal funds sold. Generally, federal funds sold are purchased for one-day periods.

Cash due from banks includes reserve balances that the Bank is required to maintain with Federal Reserve Banks. The required reserves are based upon deposits outstanding, and were approximately \$3.3 million and \$1.9 million at December 31, 2005 and 2004, respectively.

**Reclassifications** – Certain reclassifications have been made to the 2004 and 2003 financial statements to conform with the 2005 presentation.



## 2. SECURITIES

The amortized cost of securities and their approximate fair value at December 31 were as follows:

	2005			
		(in thousands)		
	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
Available for Sale:				
Debt securities:				
U.S. government agencies	\$ 37,655	\$ —	\$ (1,051)	\$ 36,604
States and political subdivisions	41,141	1,366	(44)	42,463
Total debt securities	\$ 78,796	\$ 1,366	\$ (1,095)	\$ 79,067
Mortgage-backed securities:				
FNMA	36,602	21	(1,054)	35,569
FHLMC	11,025	8	(286)	10,747
GNMA	1,378	—	(44)	1,334
CMO's	25,515	—	(1,006)	24,509
Total mortgage-backed securities	\$ 74,520	29	(2,390)	72,159
FRB and FHLB Stock	4,384	—	—	4,384
Total	<u>\$157,700</u>	<u>\$ 1,395</u>	<u>\$ (3,485)</u>	<u>\$155,610</u>
Held to Maturity:				
Debt securities:				
States and political subdivisions	\$ 4,307	\$ —	\$ —	\$ 4,307
U.S. government agencies	35	—	—	35
Total	<u>\$ 4,342</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4,342</u>

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	2004			
	(in thousands)			
	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
Available for Sale:				
Debt securities:				
U.S. government agencies	\$ 29,768	\$ 2	\$ (513)	\$ 29,257
States and political subdivisions	42,513	2,411	—	44,924
Total debt securities	\$ 72,281	\$ 2,413	\$ (513)	\$ 74,181
Mortgage-backed securities:				
FNMA	43,571	17	(296)	43,292
FHLMC	12,276	1	(93)	12,184
GNMA	1,758	—	(17)	1,741
CMO's	32,426	1	(534)	31,893
Total mortgage-backed securities	\$ 90,031	19	(940)	89,110
FRB and FHLB Stock	3,526	—	—	3,526
Total	\$165,838	\$ 2,432	\$ (1,453)	\$166,817

### Held to Maturity:

Debt securities:				
States and political subdivisions	\$ 3,027	\$ —	\$ —	\$ 3,027
U.S. government agencies	35	—	—	35
Total	<u>\$ 3,062</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,062</u>

Available for sale securities with a total fair value of \$139.0 million at December 31, 2005 were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

The scheduled maturities of debt and mortgage-backed securities at December 31, 2005 are summarized below. All maturity amounts are contractual maturities. Actual maturities may differ from contractual maturities because certain issuers have the right to call or prepay obligations with or without call premiums.

	Available for Sale Securities		Held to Maturity Securities	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in thousands)		(in thousands)	
Due in one year or less	\$ 7,001	\$ 6,948	\$ 1,853	\$ 1,853
Due after year one through five years	44,847	44,032	995	995
Due after five years through ten years	38,971	39,470	637	637
Due after ten years	62,497	60,776	857	857
Total	<u>\$153,316</u>	<u>\$151,226</u>	<u>\$ 4,342</u>	<u>\$ 4,342</u>

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Realized gains and losses from \$7.0 million, \$17.2 million and \$26.9 million gross sales on securities for the years ended December 31, 2005, 2004 and 2003, respectively, are summarized as follows:

	2005	2004 (in thousands)	2003
Gross gains	\$ 113	\$ 344	\$ 447
Gross losses	(6)	(99)	(176)
Net gain	<u>\$ 107</u>	<u>\$ 245</u>	<u>\$ 271</u>

Management has assessed the securities available for sale in an unrealized loss position at December 31, 2005 and 2004 and determined the decline in fair value below amortized cost to be temporary. In making this determination, management considered the period of time the securities were in a loss position, the percentage decline in comparison to the securities amortized cost, the financial condition of the issuer (primarily government or government-sponsored enterprises) and the Company's ability and intent to hold these securities until their fair value recovers to their amortized cost. Management believes the decline in fair value is primarily related to market interest rate fluctuations and not to the credit deterioration of the individual issuer.

Information regarding unrealized losses within the Company's available for sale securities is summarized below. The securities are all US government-guaranteed agency securities or fully insured municipal securities. All unrealized losses are considered temporary and related to market interest rate fluctuations.

Description of Securities	Less than 12 months		2005 12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)		(in thousands)		(in thousands)	
<b>Debt securities</b>						
U.S. government agencies	\$10,892	\$ (103)	\$25,712	\$ (948)	\$ 36,604	\$ (1,051)
States and political subdivisions	6,721	(44)	—	—	6,721	(44)
Total debt securities	\$17,613	\$ (147)	\$25,712	\$ (948)	\$ 43,325	\$ (1,095)
<b>Mortgage-backed securities</b>						
FNMA	\$13,144	\$ (340)	\$21,189	\$ (714)	\$ 34,333	\$ (1,054)
FHLMC	111	(1)	9,305	(285)	9,416	(286)
GNMA	—	—	1,334	(44)	1,334	(44)
CMO's	196	(3)	24,309	(1,003)	24,505	(1,006)
Total mortgage-backed securities	\$13,451	\$ (344)	\$56,137	\$ (2,046)	\$ 69,588	\$ (2,390)
<b>Total temporarily impaired Securities</b>	<u>\$31,064</u>	<u>\$ (491)</u>	<u>\$81,849</u>	<u>\$ (2,994)</u>	<u>\$112,913</u>	<u>\$ (3,485)</u>

Description of Securities	Less than 12 months		2004 12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)		(in thousands)		(in thousands)	
<b>Debt securities</b>						
U.S. government agencies	\$28,195	\$ (513)	\$ —	\$ —	\$ 28,195	\$ (513)
States and political subdivisions	—	—	—	—	—	—
Total debt securities	\$28,195	\$ (513)	\$ —	\$ —	\$ 28,195	\$ (513)
<b>Mortgage-backed securities</b>						
FNMA	\$22,405	\$ (199)	\$10,078	\$ (97)	\$ 32,483	\$ (296)
FHLMC	8,947	(75)	2,886	(18)	11,833	(93)
GNMA	1,741	(17)	—	—	1,741	(17)
CMO's	28,172	(467)	3,455	(67)	31,627	(534)
Total mortgage-backed securities	\$61,265	\$ (758)	\$16,419	\$ (182)	\$ 77,684	\$ (940)
<b>Total temporarily impaired Securities</b>	<u>\$89,460</u>	<u>\$ (1,271)</u>	<u>\$16,419</u>	<u>\$ (182)</u>	<u>\$105,879</u>	<u>\$ (1,453)</u>

### 3. LOANS, NET

Major categories of loans at December 31, 2005 and 2004 are summarized as follows:

	<u>2005</u>	<u>2004</u>
	(in thousands)	
Mortgage loans on real estate:		
Residential 1-4 family	\$ 48,580	\$ 38,491
Commercial and multi-family	123,727	107,392
Construction	9,270	8,188
Second mortgages	6,454	5,716
Home equity lines of credit	21,082	22,108
Total real estate loans	<u>209,113</u>	<u>181,895</u>
Direct financing leases	16,945	4,546
Commercial loans	29,920	28,762
Consumer loans	2,747	2,832
Other	642	1,973
Net deferred loan origination costs	654	590
	<u>260,021</u>	<u>220,598</u>
Allowance for loan losses	<u>(3,211)</u>	<u>(2,999)</u>
Loans, net	<u>\$256,810</u>	<u>\$217,599</u>

Other loans include \$0.2 million and \$1.5 million at December 31, 2005 and 2004, respectively, of overdrawn deposit accounts reclassified as loans.

Changes in the allowance for loan losses for the years ended December 31, 2005, 2004 and 2003 were as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	(in thousands)		
Balance, beginning of year	\$ 2,999	\$ 2,539	\$ 2,146
Provision for loan losses	769	485	480
Addition of allowance from acquisition	—	130	—
Recoveries	118	60	8
Loans charged off	<u>(675)</u>	<u>(215)</u>	<u>(95)</u>
Balance, end of year	<u>\$ 3,211</u>	<u>\$ 2,999</u>	<u>\$ 2,539</u>

Non-accrual loans, for which an allowance for loan impairment was not required under SFAS No. 114, "Accounting by Creditors for Impairment of a Loan" due to the adequacy of related collateral values, totaled approximately \$1.8 million and \$1.7 million at December 31, 2005 and 2004, respectively. The average recorded investment in these loans during 2005, 2004 and 2003 was approximately \$1.6 million; \$0.3 million and \$0.1 million, respectively. If such loans had been in an accruing status, the Bank would have recorded additional interest income of approximately \$128 thousand; \$38 thousand and \$20 thousand in 2005, 2004 and 2003, respectively. Actual interest recognized on consolidated statements of income on non-accrual loans was \$140 thousand, \$68 thousand and \$13 thousand in 2005, 2004 and 2003, respectively.

The Bank had no loan commitments to borrowers in non-accrual status at December 31, 2005.

As of December 31, 2005 and 2004, the Bank had no other loans which were impaired as defined by SFAS No. 114.

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The following lists the components of the net investment in direct financing leases as of December 31:

	<u>2005</u>	<u>2004</u>
	(in thousands)	
Direct financing lease payments receivable	\$ 20,785	\$ 5,498
Estimated residual value of leased assets	199	78
Unearned income	<u>(4,039)</u>	<u>(1,030)</u>
Net investment in direct financing leases	<u>\$ 16,945</u>	<u>\$ 4,546</u>

At December 31, 2005, minimum future lease payments to be received are as follows:

Year Ending December 31:	
2006	\$ 6,806
2007	5,764
2008	4,429
2009	2,681
2010	1,105
Thereafter	—
	<u>\$ 20,785</u>

As of December 31, 2005, there were \$30.7 million in loans pledged to FHLB.

### 4. PROPERTIES AND EQUIPMENT

Properties and equipment at December 31 were as follows:

	<u>2005</u>	<u>2004</u>
	(in thousands)	
Land	\$ 268	\$ 268
Buildings and improvements	8,714	7,575
Equipment	6,313	5,859
Construction in progress	<u>3</u>	<u>358</u>
	15,298	14,060
Less accumulated depreciation	<u>(7,147)</u>	<u>(6,313)</u>
Properties and equipment, net	<u>\$ 8,151</u>	<u>\$ 7,747</u>

Depreciation expense totaled \$834 thousand in 2005, \$730 thousand in 2004 and \$680 thousand in 2003.

### 5. OTHER ASSETS

Other assets at December 31, were as follows:

	<u>2005</u>	<u>2004</u>
	(in thousands)	
Net deferred tax asset	\$ 2,509	\$ 1,161
Accrued interest receivable	2,044	1,801
Prepaid expenses	405	472
Other	<u>1,087</u>	<u>943</u>
Total	<u>\$ 6,045</u>	<u>\$ 4,377</u>

## 6. GOODWILL AND INTANGIBLE ASSETS

The Company applies the provisions of SFAS No. 142, “Goodwill and Other Intangible Assets,” and discloses goodwill separate from other intangible assets in the Consolidated Balance Sheets.

The Company evaluates the carrying amount of goodwill for potential impairment on at least an annual basis.

Changes in the carrying amount of goodwill for the twelve-month period ended December 31, 2005 and 2004, by operating segment, are as follows:

	<b>Banking Activities</b>	<b>Insurance Agency Activities</b> (in thousands)	<b>Total</b>
Balance as of January 1, 2005	\$ 1,453	\$ 7,766	\$ 9,219
Goodwill acquired during the period	85	335	420
Balance as of December 31, 2005	<u>\$ 1,538</u>	<u>\$ 8,101</u>	<u>\$ 9,639</u>
	<b>Banking Activities</b>	<b>Insurance Agency Activities</b> (in thousands)	<b>Total</b>
Balance as of January 1, 2004	\$ —	\$ 2,945	\$ 2,945
Goodwill acquired during the period	1,453	4,821	6,274
Balance as of December 31, 2004	<u>\$ 1,453</u>	<u>\$ 7,766</u>	<u>\$ 9,219</u>

Information regarding the Company’s other intangible assets at December 31 follows:

<b>2005</b>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b> (in thousands)	<b>Net</b>	<b>Weighted Average Amortization Period</b>
Non-compete agreements	\$ 604	\$ (382)	\$ 222	5 years
Intangible asset related to pension plan	429	—	429	N/A
Insurance expirations	<u>2,867</u>	<u>(790)</u>	<u>2,077</u>	8 years
Total	<u>\$ 3,900</u>	<u>\$ (1,172)</u>	<u>\$ 2,728</u>	7 years
<b>2004</b>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b> (in thousands)	<b>Net</b>	<b>Weighted Average Amortization Period</b>
Non-compete agreements	\$ 594	\$ (263)	\$ 331	5 years
Intangible asset related to pension plan	489	—	489	N/A
Insurance expirations	<u>2,744</u>	<u>(394)</u>	<u>2,350</u>	8 years
Total	<u>\$ 3,827</u>	<u>\$ (657)</u>	<u>\$ 3,170</u>	7 years

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Amortization expense related to intangibles for the years ended December 31, 2005, 2004 and 2003 were \$515 thousand; \$385 thousand and \$168 thousand, respectively. Estimated amortization expense for each of the five succeeding fiscal years is as follows:

<b>Year Ending December 31</b>	<b>Amount (in thousands)</b>
2006	\$515
2007	456
2008	366
2009	190
2010	174

### 7. DEPOSITS

Time deposits, with minimum denominations of \$100 thousand each, totaled \$64.9 million and \$38.6 million at December 31, 2005 and 2004, respectively.

At December 31, 2005, the scheduled maturities of time deposits are as follows:

	(in thousands)
2006	\$ 112,855
2007	16,780
2008	8,452
2009	596
2010	425
2011	37
	<u>\$ 139,145</u>

### 8. OTHER BORROWED FUNDS AND JUNIOR SUBORDINATED DEBENTURES

Other borrowed funds include \$70.5 million of borrowings at December 31, 2005. The borrowings mainly consisted of various advances from the Federal Home Loan Bank with interest rates ranging from 2.24% to 5.34%. The FHLB advances are collateralized by certain qualifying assets. The maturities of other borrowed funds are as follows:

	(in thousands)
2006	\$ 39,994
2007	2,762
2008	661
2009	14,051
2010	—
Thereafter	<u>13,000</u>
Total	<u>\$ 70,468</u>

Short-term borrowings outstanding at December 31, 2005 of \$37.1 million consisted of an overnight line of credit with the Federal Home Loan Bank and federal funds purchased from one of the Bank's correspondent banks. The Bank has the ability to borrow additional funds with the Federal Home Loan Bank based on the available securities collateral of the Bank.

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The amounts and interest rates of short-term borrowings were as follows:

	Federal Funds Purchased	Other Short-Term Borrowings	Total
	(dollars in thousands)		
At December 31, 2005			
Amount Outstanding	37,135	—	37,135
Weighted-average interest rate	4.19%	—	4.19%
For the year ended December 31, 2005			
Highest amount at a month-end	37,135	4,000	
Daily average amount outstanding	8,287	647	8,934
Weighted-average interest rate	3.89%	2.49%	3.79%
At December 31, 2004			
Amount outstanding	21,100	4,000	25,100
Weighted-average interest rate	2.46%	2.43%	2.46%
For the year ended December 31, 2004			
Highest amount at a month-end	21,100	4,000	
Daily average amount outstanding	2,243	1,027	3,270
Weighted-average interest rate	1.28%	2.20%	1.57%
At December 31, 2003			
Amount outstanding	13,450	—	13,450
Weighted-average interest rate	1.10%	—	1.10%
For the year ended December 31, 2003			
Highest amount at a month-end	13,450	—	
Daily average amount outstanding	2,283	—	2,283
Weighted-average interest rate	1.26%	—	1.26%

On October 1, 2004, Evans Capital Trust I, a statutory business trust wholly-owned by the Company (the “Trust”), issued \$11.0 million in aggregate principal amount of floating rate preferred capital securities due November 23, 2034 (the “Capital Securities”) classified on the Company’s consolidated balance sheets as Junior Subordinated Debentures. The distribution rate on the Capital Securities of the Trust adjust quarterly based on changes in the three-month London Interbank Offered Rate (“LIBOR”) and was 7.03% at December 31, 2005.

The Capital Securities have a distribution rate of LIBOR plus 2.65%, and the distribution dates are February 23, May 23, August 23 and November 23.

The common securities of the Trust (the “Common Securities”) are wholly-owned by the Company and are the only class of each Trust’s securities possessing general voting powers. The Capital Securities represent preferred undivided interests in the assets of the corresponding Trust. Under the Federal Reserve Board’s current risk-based capital guidelines, the Capital Securities are includable in the Company’s Tier 1 (Core) capital.

The proceeds from the issuances of the Capital Securities and Common Securities were used by the Trust to purchase \$11,330 thousand aggregate liquidation amount of floating rate junior subordinated deferrable interest debentures (“Junior Subordinated Debentures”) of the Company, due October 1, 2037, comprised of \$11.0 million of capital securities and \$330 thousand of common securities. The \$330 thousand of common securities represent the initial capital contribution of the Company to the Trust, which, in accordance with the provision of FIN 46r “Consolidation of Variable Interest Entities,” has not been consolidated.

The Junior Subordinated Debentures represent the sole assets of the Trust, and payments under the Junior Subordinated Debentures are the sole source of cash flow for the Trust. The interest rate payable on the Junior Subordinated Debentures was 7.03% at December 31, 2005.

Holders of the Capital Securities receive preferential cumulative cash distributions on each distribution date at the stated distribution rate, unless the Company exercises its right to extend the payment of interest on the Junior Subordinated Debentures for up to twenty quarterly periods, in which case payment of distributions on the respective Capital Securities



will be deferred for comparable periods. During an extended interest period, in accordance with terms as defined in the indenture relating to the Capital Securities, the Company may not pay dividends or distributions on, or repurchase, redeem or acquire any shares of its capital stock. The agreements governing the Capital Securities, in the aggregate, provide a full, irrevocable and unconditional guarantee by the Company of the payment of distributions on, the redemption of, and any liquidation distribution with respect to the Capital Securities. The obligations under such guarantee and the Capital Securities are subordinate and junior in right of payment to all senior indebtedness of the Company.

The Capital Securities will remain outstanding until the Junior Subordinated Debentures are repaid at maturity, are redeemed prior to maturity or are distributed in liquidation to the Trust. The Capital Securities are mandatorily redeemable in whole, but not in part, upon repayment at the stated maturity dates of the Junior Subordinated Debentures or the earlier redemption of the Junior Subordinated Debentures in whole upon the occurrence of one or more events ("Events") set forth in the indentures relating to the Capital Securities, and in whole or in part at any time after the stated optional redemption date of November 23, 2009, contemporaneously with the optional redemption of the related Junior Subordinated Debentures in whole or in part. The Junior Subordinated Debentures are redeemable prior to their stated maturity dates at the Company's option: (i) on or after the stated optional redemption dates, in whole at any time or in part from time to time; or (ii) in whole, but not in part, at any time within 90 days following the occurrence and during the continuation of one or more of the Events, in each case subject to possible regulatory approval. The redemption price of the Capital Securities and the related Junior Subordinated Debentures upon early redemption would be at the liquidation amount plus accumulated but unpaid distributions.

## **9. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE**

The Bank enters into agreements with depositors to sell to the depositors securities owned by the Bank and repurchase the identical security, generally within one day. No physical movement of the securities is involved. The depositor is informed the securities are held in safekeeping by the Bank on behalf of the depositor.

## **10. COMPREHENSIVE (LOSS) INCOME**

The following tables display the components of other comprehensive (loss) income:

	<b>Before-tax Amount</b>	<b>2005 Income Taxes (in thousands)</b>	<b>Net</b>
Unrealized losses on investment securities:			
Unrealized holding losses during period	\$ (2,962)	\$ 1,152	\$ (1,810)
Less: reclassification adjustment for gains realized in net income	107	(43)	64
Net unrealized loss	(3,069)	1,195	(1,874)
Increase in additional minimum pension liability	(127)	51	(76)
Net other comprehensive loss	<u>\$ (3,196)</u>	<u>\$ 1,246</u>	<u>\$ (1,950)</u>

	<b>2004</b>		
	<b>Before-tax Amount</b>	<b>Income Taxes</b>	<b>Net</b>
		(in thousands)	
Unrealized losses on investment securities:			
Unrealized holding losses during period	\$ (1,918)	\$ 745	\$ (1,173)
Less: reclassification adjustment for gains realized in net income	245	(98)	147
Net unrealized loss	(2,163)	843	(1,320)
Increase in additional minimum pension liability	(57)	22	(35)
Net other comprehensive loss	\$ (2,220)	\$ 865	\$ (1,355)
	<b>2003</b>		
	<b>Before-tax Amount</b>	<b>Income Taxes</b>	<b>Net</b>
		(in thousands)	
Unrealized losses on investment securities:			
Unrealized holding losses during period	\$ (32)	\$ 13	\$ (19)
Less: reclassification adjustment for gains realized in net income	271	(105)	166
Net unrealized loss	(303)	118	(185)
Decrease in additional minimum pension liability	263	(102)	161
Net other comprehensive loss	\$ (40)	\$ 16	\$ (24)

#### 11. EMPLOYEE BENEFITS AND DEFERRED COMPENSATION PLANS

**Employees' Pension Plan** — The Bank has a defined benefit pension plan covering substantially all 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 amortization method the Bank is using recognizes the prior service cost and net gains or losses over the average remaining service period of active employees which exceeds the required amortization.

The following are reconciliations of the benefit obligation and the fair value of Pension Plan assets, the funded status of the Pension Plan, the amounts not recognized in the Consolidated Balance Sheets, and the amounts recognized in the Consolidated Balance Sheets.

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	<u>2005</u>	<u>2004</u>
	(in thousands)	
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 2,935	\$ 2,687
Service cost	290	217
Interest cost	175	155
Assumption change	232	108
Actuarial gain	—	(190)
Benefits paid	<u>(188)</u>	<u>(42)</u>
Benefit obligations at end of year	<u>3,444</u>	<u>2,935</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	2,478	2,281
Actual return on plan assets	309	239
Employer contributions	401	—
Benefits paid	<u>(188)</u>	<u>(42)</u>
Fair value of plan assets at end of year	<u>3,000</u>	<u>2,478</u>
Funded status	(444)	(457)
Unrecognized net actuarial loss	449	336
Unrecognized prior service cost	<u>(144)</u>	<u>(159)</u>
Accrued benefit liabilities	<u>(139)</u>	<u>(280)</u>

The Plan's assets are primarily invested in equity and fixed income mutual funds. Valuations of the Pension Plan as shown above were conducted as of September 30, 2005 and 2004. Assumptions used by the Bank in the determination of Pension Plan information consisted of the following:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Weighted-average discount rate	5.50%	6.00%	6.25%
Rate of increase in compensation levels	4.75%	4.75%	4.75%
Expected long-term rate of return on plan assets	7.50%	7.50%	6.75%

The components of net periodic benefit cost consisted of the following:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
		(in thousands)	
Service cost	\$ 290	\$ 217	\$ 157
Interest cost	175	155	158
Expected return on plan assets	(194)	(169)	(134)
Net amortization and deferral	<u>(13)</u>	<u>(12)</u>	<u>1</u>
Net periodic benefit cost	<u>\$ 258</u>	<u>\$ 191</u>	<u>\$ 182</u>

The accumulated benefit obligations for years ended December 31, 2005 and 2004 are \$2.6 million and \$2.1 million respectively.

The expected long-term rate of return on Pension Plan assets assumption was determined based on historical returns earned by equity and fixed income securities, adjusted to reflect future return expectations based on plan targeted asset allocation. Equity and fixed income securities were assumed to earn returns in the ranges of 5.0% to 15.0% and 3.25% to 6.5%, respectively, including a long-term inflation rate estimated at 3.0%. When these overall return expectations are applied to the Pension Plan's targeted allocation, the expected rate of return is determined to be 7.50%, which is

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approximately the mid-point of the range of expected return. The weighted average asset allocation of the Pension Plan at September 30, 2005 and 2004, the Pension Plan measurement date, was as follows:

	2005	2004
Asset category:		
Equity mutual funds	57.1%	62.4%
Fixed income security mutual funds	42.9%	37.6%
	<u>100.0%</u>	<u>100.0%</u>

The Company's targeted long-term asset allocation on average will approximate 60%-70% with equity managers and 30%-40% with fixed income managers. This allocation is consistent with the Company's goal of diversifying the Pension Plan assets in order to preserve capital while achieving investment results that will contribute to the proper funding of pension obligations and cash flow requirements. The Company's management regularly reviews the Pension Plan's actual asset allocation and periodically rebalances its investments to the targeted allocation when considered appropriate. The asset allocation to fixed income managers at September 30, 2005 of 42.9% temporarily exceeded the long-term range; however, by December 31, 2005, it was rebalanced to 37.0%. The Company's management believes that 7.50% is a reasonable long-term rate of return on the Pension Plan's Qualified Plan assets. The Company's management will continue to evaluate its actuarial assumptions, including the expected rate of return, at least annually, and will adjust as necessary. The Company's required minimum contribution to the Pension Plan for the 2006 plan year is approximately \$218 thousand.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	(in thousands)
2006	\$ 45
2007	84
2008	84
2009	99
2010	123
Years 2011-2015	1,093

**Supplemental Executive Retirement Plan** — The Bank also maintains a non-qualified supplemental executive retirement plan (the "SERP") covering certain members of the Company's senior management. The SERP was amended during 2003 to provide a benefit based on a percentage of final average earnings, as opposed to the fixed benefit that the superceded plan provided for. The obligations related to the SERP are indirectly funded by various life insurance contracts naming the Bank as beneficiary. The Bank has also indirectly funded the SERP, as well as other benefits provided to other employees through Bank-owned life insurance which was purchased in February 2003. The Bank uses an actuarial method of amortizing unrecognized net gains or losses which result from actual experience and assumptions being different than those that are projected. The amortization method the Bank is using recognizes the net gains or losses over the average remaining service period of active employees, which exceeds the required amortization.

The following are reconciliations of the benefit obligation and the fair value of plan assets, the funded status of the SERP, the amounts not recognized in the consolidated balance sheets, and the amounts recognized in the consolidated balance sheets.

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	<u>2005</u>	<u>2004</u>
	(in thousands)	
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 2,502	\$ 2,233
Service cost	104	94
Interest cost	148	141
Actuarial loss	169	127
Benefits paid	<u>(93)</u>	<u>(93)</u>
Benefit obligations at end of year	<u>2,830</u>	<u>2,502</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	—	—
Actual return on plan assets	—	—
Contributions to the plan	93	93
Benefits paid	<u>(93)</u>	<u>(93)</u>
Fair value of plan assets at end of year	<u>—</u>	<u>—</u>
Funded status	(2,830)	(2,502)
Unrecognized actuarial loss	638	488
Unrecognized prior service cost	<u>429</u>	<u>489</u>
Net amount recognized	<u>\$ (1,763)</u>	<u>\$ (1,525)</u>

Amounts recognized in the statements of financial position consist of:

Accrued benefit liability	(2,376)	(2,071)
Intangible asset	429	489
Accumulated other comprehensive income	184	57
Accrued benefit liability	<u>\$ (1,763)</u>	<u>\$ (1,525)</u>

Valuations of the SERP liability, as shown above, were conducted as of December 31, 2005 and 2004. The accumulated benefit obligations for years ended December 31, 2005 and 2004 were \$2.4 million and \$2.1 million respectively. Assumptions used by the Bank in both years in the determination of pension plan information consisted of the following:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Weighted-average discount rate	5.50%	6.00%	6.25%
Expected long-term rate of return on plan assets	N/A	N/A	N/A
Salary scale	5.00%	5.00%	5.00%

The components of net periodic benefit cost consisted of the following:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
		(in thousands)	
Service cost	\$ 104	\$ 94	\$ 73
Interest cost	148	141	132
Net amortization and deferral	<u>78</u>	<u>89</u>	<u>104</u>
Net periodic benefit cost	<u>\$ 330</u>	<u>\$ 324</u>	<u>\$ 309</u>

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The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	(in thousands)
2006	\$ 93
2007	174
2008	202
2009	202
2010	202
2011-2015	1,483

### Other Compensation Plans

The Company also maintains a non-qualified deferred compensation plan for certain directors. Expenses under this plan were approximately \$82 thousand in 2005 and \$71 thousand in both 2004 and 2003. The estimated present value of the benefit obligation included in other liabilities was \$0.9 million at December 31, 2005 and 2004. This obligation is indirectly funded by life insurance contracts naming the Bank as beneficiary. The increase in cash surrender value is included in other non-interest income on the Consolidated Statements of Income.

Effective April 1, 2003, the Company implemented a non-qualified deferred compensation plan whereby certain directors and certain officers may defer a portion of their base pre-tax compensation. Additionally, effective April 1, 2003, the Company implemented a non-qualified executive incentive retirement plan, whereby the Company will defer on behalf of certain officers a portion of their base compensation, as well as an incentive award based upon Company performance, until retirement or termination of service, subject to certain vesting arrangements. Expenses under these plans were approximately \$69 thousand in 2005 and \$38 thousand in both 2004 and 2003. The benefit obligation, included in other liabilities in the Company's Consolidated Balance Sheets, was \$563 thousand and \$321 thousand at December 31, 2005 and 2004, respectively.

Many of the benefit plans are indirectly funded by Bank-owned life insurance contracts with a total aggregate cash surrender value of approximately \$9.6 million and \$7.9 million at December 31, 2005 and 2004, respectively. An additional \$1.7 million of Bank-owned life insurance was purchased during 2005. Increases in cash surrender value are included in the "Other Non-Interest Income" financial statement line on the Company's Consolidated Statements of Income. Endorsement split-dollar life insurance benefits have also been provided to directors and certain officers of the Bank and its subsidiaries.

The Bank also has a defined contribution retirement and thrift 401(k) Plan (the "401(k) Plan") for its employees who meet certain length of service and age requirements. The provisions of the 401(k) Plan allow eligible employees to contribute a portion of their annual salary, up to the IRS statutory limit, with a matching contribution by the Bank equal to 1% of the employees' base compensation plus 25% of the employees' contribution up to 4% of their annual salary. The Bank can also make discretionary contributions to the 401(k) Plan. The Company's expense under this plan was approximately \$76 thousand, \$71 thousand and \$100 thousand for the years ended December 31, 2005, 2004 and 2003, respectively.

The Company has a Dividend Reinvestment Plan (the "DRIP") which provides each holder of record of the Company's common stock the opportunity to reinvest automatically the cash dividends they receive on shares of the Company's common stock. Stockholders who do not wish to participate in the DRIP continue to receive cash dividends, as declared, in the usual manner. Computershare Investor Services LLC (the "Agent") is the administrator of the DRIP. Shares purchased under the DRIP are held in safekeeping by the Agent until the stockholder terminates his/her participation in the DRIP. The Agent also acts as transfer agent and registrar for the Company's common stock.

### 12. STOCK-BASED COMPENSATION

At December 31, 2005, the Company had two stock-based compensation plans, which are described below. The Company accounts for the fair value of its grants under those plans in accordance with SFAS No. 123. The Company granted stock options for the first time in 2003. The compensation cost charged against income for those plans was \$112 thousand, \$87 thousand and \$35 thousand for 2005, 2004 and 2003, respectively, included in "Salaries and Employee Benefits" in the Company's Consolidated Statements of Income. In addition, expense for director options was recognized to reflect \$71 thousand, \$78 thousand and \$68 thousand in 2005, 2004 and 2003, respectively, as a part of "Other" expense in the Company's Consolidated Statements of Income.

## Fixed Stock Option Plan

Under the Company's 1999 Employee Stock Option and Long-Term Incentive Plan, as amended (the "Option Plan"), the Company may grant options to 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 grant and an option's maximum term is ten years. The options have vesting schedules from 1 1/2 years through 9 years. At December 31, 2005, there were a total of 196,970 shares available for grant under the Option Plan. All fiscal 2003 granted eligible stock options outstanding on December 7, 2005 were adjusted to reflect the Company's three stock dividends issued in December 2003, 2004 and 2005, in accordance with the terms of the Option Plan. All fiscal 2004 granted eligible stock options outstanding on December 7, 2005 were adjusted to reflect the Company's two stock dividends issued in December 2004 and 2005, in accordance with the terms of the Option Plan. Options issued in 2005 are not yet eligible for adjustment until stock dividends and splits accumulate to more than 10%. 2003 and 2004 share and per share amounts within this note have been adjusted retroactively to reflect the effect of stock dividends, including the number and exercise price of shares subject to option under the terms of the Option Plan.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2005, 2004 and 2003, respectively; dividend yield of 2.89%, 2.76% and 2.73%; expected volatility of 20.06%, 21.84% and 28.83%; risk-free interest rate of 4.24%, 3.66% and 2.77%; and expected life of 6.53, 6.55 and 7.49 years. The weighted average fair value of options granted during the year were \$4.63 per share in 2005; \$5.13 per share in 2004 and \$5.47 per share in 2003, with the fair values in 2004 and 2003 being adjusted for the effect of stock dividends.

The following is a summary of the status of the Company's stock option activity for 2005, 2004 and 2003:

	Number of Shares	Weighted-Average Exercise Price
Balance at January 1, 2003	—	—
Granted	31,256	\$ 19.47
Exercised	—	—
Forfeited	—	—
Balance at December 31, 2003	31,256	\$ 19.47
Granted	30,870	\$ 21.75
Exercised	—	—
Forfeited	1,130	\$ 20.48
Balance at December 31, 2004	60,996	\$ 20.60
Granted	29,000	\$ 22.73
Exercised	840	\$ 19.80
Forfeited	—	—
Expired	579	\$ 19.25
Balance at December 31, 2005	88,577	\$ 21.32
Options exercisable at December 31, 2005	38,502	\$ 21.77



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The following table summarizes information about fixed stock options outstanding at December 31, 2005, 2004 and 2003:

Exercise Price	Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Life (Years)	Options Exercisable	Weighted Average Exercise Price
December 31, 2005:					
\$19.25 - \$19.80	29,258	\$19.47	7.53	11,894	\$19.80
\$21.71 - \$21.77	30,319	\$21.74	8.57	14,608	\$21.72
\$22.00 - \$23.77	29,000	\$22.73	9.58	12,000	\$23.77
Total	88,577	\$21.32	8.56	38,502	\$21.77
December 31, 2004:					
\$19.25 - \$19.80	30,677	\$19.48	8.37	13,313	\$19.78
\$21.71 - \$21.77	30,319	\$21.74	9.57	13,230	\$21.71
Total	60,996	\$20.60	8.96	26,543	\$20.74
December 31, 2003:					
\$19.25 - \$19.80	31,256	\$19.47	9.53	12,734	\$19.80

### Employee Stock Purchase Plan

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 December 31, 2005, there were 89,863 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. During fiscal 2005, approximately 76% of eligible employees participated in the Purchase Plan. Under the Purchase Plan, the Company issued 11,312 and 8,602 shares to employees in 2005 and 2004, respectively. Compensation cost is recognized for the fair value of the employees' purchase rights, which was estimated using the Black-Scholes model with the following assumptions for 2005, 2004 and 2003, respectively: dividend yield of 2.79%, 2.70% and 2.73%; expected life of six months; expected volatility of 22.84%, 25.90% and 28.83%; risk-free interest rates of 3.04%, 1.36% and 0.90%. The weighed average fair value of those purchase rights granted in 2005, 2004 and 2003 was \$6.82, \$6.84 and \$6.49 per share, respectively. The compensation cost that has been charged against income for the Purchase Plan was \$70 thousand, \$63 thousand and \$30 thousand for 2005, 2004 and 2003, respectively.

## 13. INCOME TAXES

The components of the provision for income taxes were as follows:

	2005	2004	2003
		(in thousands)	
Income taxes currently payable	\$ 1,863	\$ 1,450	\$ 1,053
Deferred tax (benefit) expense	(102)	(54)	171
Net provision	<u>\$ 1,761</u>	<u>\$ 1,396</u>	<u>\$ 1,224</u>

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The Company's provision for income taxes differs from the amounts computed by applying the Federal income tax statutory rates to income before income taxes. A reconciliation of the differences is as follows:

	2005		2004		2003	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
Tax provision at statutory rate	\$ 2,237	34%	\$ 2,008	34%	\$ 1,796	34%
Decrease in taxes resulting from:						
Tax-exempt income	(722)	(11)	(735)	(12)	(729)	(14)
Tax-exempt insurance proceeds	(32)	(1)	—	—	—	—
State taxes, net of federal benefit	184	3	157	3	110	2
Other items, net	94	2	(34)	(1)	47	1
Provision for income taxes	<u>\$ 1,761</u>	<u>27%</u>	<u>\$ 1,396</u>	<u>24%</u>	<u>\$ 1,224</u>	<u>23%</u>

At December 31, 2005 and 2004 the components of the net deferred tax asset were as follows:

	2005	2004
	(in thousands)	
Deferred tax assets:		
Allowance for loan losses	\$ 1,132	\$ 1,048
Net unrealized losses on securities	814	—
Pension premiums	812	726
Deferred compensation	524	457
Stock options granted	85	57
Gross deferred tax assets	<u>\$ 3,367</u>	<u>\$ 2,288</u>
Deferred tax liabilities:		
Depreciation and amortization	\$ 446	\$ 359
Prepaid expenses	412	387
Net unrealized gains on securities	—	381
Gross deferred tax liabilities	<u>\$ 858</u>	<u>\$ 1,127</u>
Net deferred tax asset	<u>\$ 2,509</u>	<u>\$ 1,161</u>

The net deferred tax asset at December 31, 2005 and 2004 is included in "other assets" in the accompanying Consolidated Balance Sheets.

In assessing the realizability of the deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, availability of operating loss carry-backs, projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical taxable income, the opportunity for net operating loss carry-backs, and projections for future taxable income over the periods which deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these deductible differences at December 31, 2005.

## 14. RELATED PARTY TRANSACTIONS

The Bank has entered into loan transactions with certain directors, significant shareholders and their affiliates (related parties) in the ordinary course of its business. The aggregate amount of loans to such related parties on December 31, 2005 was \$4.9 million and \$6.2 million at 2004. During 2005, there were \$9.7 million of advances and new loans to such related parties, and repayments amounted to \$11.0 million. Terms of these loans have prevailing market pricing that would be offered to a similar customer base.

## 15. CONTINGENT LIABILITIES AND COMMITMENTS

The 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 are commitments to extend credit and standby letters of credit. A summary of the Bank's commitments and contingent liabilities at December 31, 2005 and 2004 is as follows:

	<u>2005</u>	<u>2004</u>
	(in thousands)	
Commitments to extend credit	\$ 66,479	\$ 58,799
Standby letters of credit	<u>2,000</u>	<u>2,069</u>
Total	\$ 68,479	\$ 60,868

Commitments to extend credit and standby letters of credit all include exposure to some credit loss in the event of non-performance 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 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 to the Bank. The Bank has not incurred any losses on its commitments during the past three years.

The Company has entered into contracts with third parties, which contracts include indemnification clauses. Examples of such contracts include contracts with third party service providers, brokers and dealers, correspondent banks, purchasers of residential mortgages. Additionally, the Company has bylaws, policies and agreements under which it indemnifies its officers and directors from liability for certain events or occurrences while the directors or officers are, or were, serving at the Company's request in such capacities. The Company indemnifies its officers and directors to the fullest extent allowed by law. The maximum potential amount of future payments that the Company could be required to make under these indemnification provisions is unlimited, but would be affected by all relevant defenses to such claims, as well as directors' and officers' liability insurance maintained by the Company. Due to the nature of these indemnification provisions, it is not possible to quantify the aggregate exposure to the Company resulting from them.

The Company leases certain offices, land and equipment under long-term operating leases. The aggregate minimum annual rental commitments under these leases total approximately \$384 thousand in 2006; \$328 thousand in 2007; \$322 thousand in 2008; \$303 thousand in 2009; \$284 thousand in 2010; and \$3.4 million thereafter. The rental expense under operating leases contained in the Company's Consolidated Statements of Income included \$499 thousand, \$422 thousand and \$317 thousand in 2005, 2004 and 2003, respectively.

## 16. CONCENTRATIONS OF CREDIT

All of the Bank's loans, commitments and standby letters of credit have been granted to customers in the Bank's market area. Investments in state and municipal securities also involve governmental entities within the Bank's market area, which is Western New York. The concentrations of credit by type of loan are set forth in Note 3, "Loans, Net." The distribution of commitments to extend credit approximates the distribution of loans outstanding. Standby letters of credit were granted primarily to commercial borrowers. The Bank, as a matter of policy, does not extend credit to any single borrower or group in excess of 15% of capital.

## 17. SEGMENT INFORMATION

The Company is comprised of two primary business segments: banking and insurance agency activities. The reportable segments are separately managed and their performance is evaluated based on net income. All sources of segment specific revenues and expenses attributed to management's definition of net income. Revenues from transactions between the two segments are not significant. The accounting policies of the segments are the same as those described in Note 1.

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The following table sets forth information regarding these segments for the years ended December 31, 2005, 2004 and 2003.

	2005		
	Banking Activities	Insurance Agency Activities (in thousands)	Total
Net interest income (expense)	\$14,713	\$ (399)	14,314
Provision for loan losses	769	—	769
Net interest income (expense) after provision for loan losses	13,944	(399)	13,545
Non-interest income	3,955	—	3,955
Insurance commissions and fees	—	6,377	6,377
Net gain on sales of assets	107	—	107
Non-interest expense	12,784	4,620	17,404
Income before income taxes	5,222	1,358	6,580
Income taxes	1,218	543	1,761
Net income	<u>\$ 4,004</u>	<u>\$ 815</u>	<u>\$ 4,819</u>
	2004		
	Banking Activities	Insurance Agency Activities (in thousands)	Total
Net interest income (expense)	\$12,692	\$ (95)	12,597
Provision for loan losses	485	—	485
Net interest income (expense) after provision for loan losses	12,207	(95)	12,112
Non-interest income	3,280	—	3,280
Insurance commissions and fees	—	5,053	5,053
Net gain on sales of assets	239	—	239
Non-interest expense	10,827	3,952	14,779
Income before income taxes	4,899	1,006	5,905
Income taxes	1,000	396	1,396
Net income	<u>\$ 3,899</u>	<u>\$ 610</u>	<u>\$ 4,509</u>

	2003		
	<u>Banking Activities</u>	<u>Insurance Agency Activities</u>	<u>Total</u>
		(in thousands)	
Net interest income (expense)	\$10,870	\$ (24)	10,846
Provision for loan losses	480	—	480
Net interest income (expense) after provision for credit losses	10,390	(24)	10,366
Non-interest income	3,655	—	3,655
Insurance commissions and fees	—	3,767	3,767
Net gain on sales of assets	244	—	244
Non-interest expense	9,727	3,012	12,739
Income before income taxes	4,562	731	5,293
Income taxes	992	232	1,224
Net income	<u>\$ 3,570</u>	<u>\$ 499</u>	<u>\$ 4,069</u>

	<u>December 31, 2005</u>	<u>December 31, 2004</u>
	(in thousands)	
<b>Identifiable Assets, Net</b>		
Banking activities	\$ 456,036	\$ 416,424
Insurance agency activities	12,510	12,618
Consolidated Total Assets	<u>\$ 468,546</u>	<u>\$ 429,042</u>

## 18. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value.

*Cash and Cash Equivalents* – For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

*Interest Bearing Deposits at Other Banks* - The carrying amount of Interest Bearing Deposits at Other Banks approximates fair value due to their short-term nature.

*Securities* – For securities, fair value equals quoted market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

*Loans Receivable* – The fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, net of the appropriate portion of the allowance for loan losses. For variable rate loans, the carrying amount is a reasonable estimate of fair value.

*Deposits* – The fair value of demand deposits, NOW accounts, Muni-vest and regular savings accounts is the amount payable on demand at the reporting date. The fair value of time deposits is estimated using the rates currently offered for deposits of similar remaining maturities.

*Other Borrowed Funds* – The fair value of the short-term portion of other borrowed funds approximates its carrying value. The fair value of the long-term portion of other borrowed funds is estimated using a discounted cash flow analysis based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

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*Junior Subordinated Debentures* – The carrying amount of Junior Subordinated Debentures is a reasonable estimate of fair value due to the fact that they bear a floating interest rate that adjusts on a quarterly basis.

*Commitments to extend credit and standby letters of credit* – As described in Note 15 “Contingent Liabilities and Commitments,” the Company was a party to financial instruments with off-balance sheet risk at December 31, 2005 and 2004. Such financial instruments consist of commitments to extend permanent financing and letters of credit. If the options are exercised by the prospective borrowers, these financial instruments will become interest-earning assets of the Company. If the options expire, the Company retains any fees paid by the counterparty in order to obtain the commitment or guarantee. The fair value of commitments is estimated based upon fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate commitments, the fair value estimation takes into consideration an interest rate risk factor. The fair value of guarantees and letters of credit is based on fees currently charged for similar agreements. The fair value of these off-balance sheet items at December 31, 2005 and 2004 approximates the recorded amounts of the related fees, which are not considered material.

At December 31, 2005 and 2004, the estimated fair values of the company’s financial instruments were as follows:

	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)		(in thousands)	
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 15,635	\$ 15,635	\$ 8,124	\$ 8,124
Interest bearing deposits at other banks	\$ —	\$ —	\$ 984	\$ 984
Securities	\$159,952	\$159,952	\$169,879	\$169,879
Loans, net	\$256,810	\$252,280	\$217,599	\$219,823
<b>Financial liabilities:</b>				
Deposits	\$336,808	\$337,250	\$301,928	\$301,503
Other borrowed funds and securities sold under agreements to repurchase	\$ 76,903	\$ 75,317	\$ 75,340	\$ 73,992
Junior Subordinated Debentures	\$ 11,330	\$ 11,330	\$ 11,330	\$ 11,330

## 19. REGULATORY MATTERS

The Company is subject to the dividend restrictions set forth by the FRB and the OCC. Under such restrictions, the Company may not, without the prior approval of the FRB and the OCC, declare dividends in excess of the sum of the current year’s earnings (as defined in FRB regulations) plus the retained earnings (as defined in FRB regulations) from the prior two years.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table that follows) of total and Tier I capital (as defined in FRB regulations) to risk-weighted assets (as defined in FRB regulations), and of Tier I capital (as defined in FRB regulations) to average assets (as defined in FRB regulations). Management believes as of December 31, 2005 and 2004, that the Company and the Bank met all capital adequacy requirements to which it is subject.

The most recent notification from its regulators categorized the Company and the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Company and the Bank must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Company’s or Bank’s category rating.

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The Company's and the Bank's actual capital amounts and ratios were as follows:

2005								
(dollars in thousands)								
	Company		Bank		Minimum for Capital Adequacy Purposes		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Risk-Based Capital (to Risk Weighted Assets)	\$ 40,437	13.7%	\$ 39,055	13.3%	\$ 23,661	8.0%	\$ 29,576	10.0%
Tier I Capital (to Risk Weighted Assets)	\$ 37,226	12.6%	\$ 35,855	12.2%	\$ 11,830	4.0%	\$ 17,746	6.0%
Tier I Capital (to Average Assets)	\$ 37,226	8.3%	\$ 35,855	8.0%	\$ 17,967	4.0%	\$ 22,459	5.0%
2004								
(dollars in thousands)								
	Company		Bank		Minimum for Capital Adequacy Purposes		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Risk-Based Capital (to Risk Weighted Assets)	\$ 36,840	14.3%	\$ 36,431	14.2%	\$ 20,632	8.0%	\$ 25,791	10.0%
Tier I Capital (to Risk Weighted Assets)	\$ 33,852	13.1%	\$ 33,443	13.0%	\$ 10,316	4.0%	\$ 15,474	6.0%
Tier I Capital (to Average Assets)	\$ 33,852	8.1%	\$ 33,443	8.0%	\$ 16,815	4.0%	\$ 21,018	5.0%

## 20. PARENT COMPANY ONLY FINANCIAL INFORMATION

Parent company (Evans Bancorp, Inc.) only condensed financial information is as follows:

### CONDENSED BALANCE SHEETS

	December 31,	
	2005	2004
(in thousands)		
<b>ASSETS</b>		
Cash	\$ 48	\$ 168
Other equity securities	330	330
Investment in subsidiaries	47,828	46,306
Total assets	<u>\$ 48,206</u>	<u>\$ 46,804</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Junior subordinated debentures	\$ 11,330	\$ 11,330
<b>STOCKHOLDERS' EQUITY</b>		
Total Stockholders' Equity	\$ 36,876	\$ 35,474
Total liabilities and stockholders' equity	<u>\$ 48,206</u>	<u>\$ 46,804</u>

## CONDENSED STATEMENTS OF INCOME

	<u>2005</u>	<u>December 31,</u> <u>2004</u> (in thousands)	<u>2003</u>
Dividends from subsidiaries	\$ 2,940	\$ 2,898	\$ 2,467
Expenses	<u>(823)</u>	<u>(436)</u>	<u>(258)</u>
Income before equity in undistributed earnings of subsidiaries	2,117	2,462	2,209
Equity in undistributed earnings of subsidiaries	<u>2,702</u>	<u>2,047</u>	<u>1,860</u>
Net income	<u>\$ 4,819</u>	<u>\$ 4,509</u>	<u>\$ 4,069</u>

## CONDENSED STATEMENTS OF CASH FLOWS

	<u>2005</u>	<u>Year Ended</u> <u>2004</u> (in thousands)	<u>2003</u>
Operating Activities:			
Net income	\$ 4,819	\$ 4,509	\$ 4,069
Adjustments to reconcile net income to net cash provided by operating activities:			
Change in other equity securities	—	(330)	—
Undistributed earnings of subsidiaries	<u>(2,702)</u>	<u>(2,047)</u>	<u>(1,860)</u>
Net cash provided by operating activities	2,117	2,132	2,209
Investing Activities:			
Investment in subsidiaries	—	(11,000)	—
Net cash used by investing activities	—	(11,000)	—
Financing Activities:			
Proceeds from borrowings	—	11,330	—
Cash dividends paid, net	(1,777)	(1,675)	(1,562)
Purchase of Treasury stock	<u>(460)</u>	<u>(744)</u>	<u>(570)</u>
Net cash (used) provided by financial activities	(2,237)	8,911	(2,132)
Net (decrease) increase in cash	(120)	43	77
Cash beginning of year	<u>168</u>	<u>125</u>	<u>48</u>
Cash ending of year	<u>\$ 48</u>	<u>\$ 168</u>	<u>\$ 125</u>



## 21. QUARTERLY FINANCIAL DATA — UNAUDITED

(in thousands, except per share data)

	4 <sup>th</sup> Quarter	3 <sup>rd</sup> Quarter	2 <sup>nd</sup> Quarter	1 <sup>st</sup> Quarter
<b>2005</b>				
Interest income	\$ 6,038	\$ 5,952	\$ 5,694	\$ 5,199
Interest expense	2,439	2,194	2,099	1,837
Net interest income	3,599	3,758	3,595	3,362
Net income	1,126	1,256	1,175	1,262
Earnings per share basic*	0.41	0.46	0.44	0.46
Earnings per share diluted*	0.41	0.46	0.44	0.46
<b>2004</b>				
Interest income	\$ 4,848	\$ 4,479	\$ 4,358	\$ 4,023
Interest expense	1,658	1,232	1,195	1,026
Net interest income	3,190	3,247	3,163	2,997
Net income	1,188	1,074	1,079	1,168
Earnings per share basic*	0.44	0.39	0.40	0.42
Earnings per share diluted*	0.44	0.39	0.40	0.42

\* All share and per share information is stated after giving effect to the 5 percent stock dividends paid in December 2005 and 2004.

### Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

Not applicable.

### Item 9A. 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 December 31, 2005 (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 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 December 31, 2005 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### Item 9B. OTHER INFORMATION

Not Applicable.

### **PART III**

#### **Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

The information required by this item (Items 401, 405 and 406 of Regulation S-K) relating to the Company's directors and director nominees, executive officers; Audit Committee of the Board of Directors (including identification of its "audit committee financial expert"); Chief Executive Officer/Treasurer Code of Ethics; and compliance with Section 16(a) of the Exchange Act by the Company's officers, directors and 10% beneficial owners is included under the captions "Information Regarding Directors, Director Nominees and Executive Officers," "Board of Director Committees" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's Proxy Statement related to the 2006 Annual Meeting of Shareholders and is incorporated herein by reference.

#### **Item 11. EXECUTIVE COMPENSATION**

The information required by this item (Item 402 of Regulation S-K) relating to executive and director compensation is included under the captions "Executive Compensation," "Compensation of Directors," "Compensation Committee Interlocks and Insider Participation," "Human Resource Committee Report on Executive Compensation" and "Performance Graph" in the Company's Proxy Statement related to the 2006 Annual Meeting of Shareholders and is incorporated herein by reference. The information under the captions "Human Resource Committee Report on Executive Compensation" and "Performance Graph" is furnished in response to this Item 11.

#### **Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this item (Items 201(d) and 403 of Regulation S-K) relating to the Company's security ownership of certain beneficial owners and management, and securities authorized for issuance under equity compensation plans, is included under the captions "Security Ownership of Management and Certain Beneficial Owners" and "Equity Compensation Plan Information" in the Company's Proxy Statement related to the 2006 Annual Meeting of Shareholders and is incorporated herein by reference.

#### **Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information required by this item (Item 404 of Regulation S-K) is included under the caption "Certain Relationships and Related Transactions" in the Company's Proxy Statement related to the 2006 Annual Meeting of Shareholders and is incorporated herein by reference.

#### **Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this item is included under the caption "Independent Auditors" in the Company's Proxy Statement related to the 2006 Annual Meeting of Shareholders and is incorporated herein by reference.

### **PART IV**

#### **Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

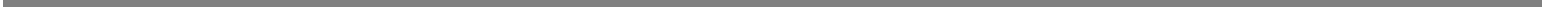
The following documents are filed as a part of this Report on Form 10-K:

1. Financial statements: See "Consolidated Financial Statements and Supplementary Data" in Part II, Item 8 of this Report on Form 10-K.
2. All other financial statement schedules are omitted because they are not applicable or the required information is included in the Company's Consolidated Financial Statements or Notes thereto included in Part II, Item 8. of this Report on Form 10-K.

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### 3. Exhibits

Exhibit No.	Exhibit Description
3.1	Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3a of the Company's Registration Statement on Form S-4 (Registration No. 33-25321) as filed on November 7, 1988).
3.1.1	Certificate of Amendment to the Company's Certificate of Incorporation (incorporated by reference to Exhibit 3.3 of the Company's Form 10-Q for the fiscal quarter ended March 31, 1997 as filed on May 14, 1997).
3.2	Bylaws of the Company (incorporated by reference to Exhibit 3b of the Company's Registration Statement on Form S-4 (Registration No. 33-25321) as filed on November 7, 1988).
3.2.1	Amendment to the Bylaws of the Company (incorporated by reference to Exhibit 3.3 of the Company's Form 10-Q for the fiscal quarter ended June 30, 1996 as filed on August 5, 1996).
3.2.2	Amendment to the Bylaws of the Company (incorporated by reference to Exhibit 3.5 of the Company's Form 10-K for the fiscal year ended December 31, 1997 as filed on March 30, 1998).
4.1	Evans Bancorp Employee Stock Purchase Plan (incorporated by reference to Exhibit 4.7 of the Company's Registration Statement on Form S-8 (Registration No. 333-106655 as filed on June 30, 2003).
4.2	Evans Bancorp, Inc. 1999 Stock Option and Long-Term Incentive Plan (incorporated by reference to Exhibit 99.1 of the Company's Registration Statement on Form S-8 (Registration No. 333-123679 as filed on March 30, 2005).
4.3	Evans Bancorp, Inc. Dividend Reinvestment Plan, as amended (incorporated by reference to the Company's Registration Statement on Form S-3D (Registration No. 333-123678 as filed on March 30, 2005).
4.4	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 of the Company's Form 10-Q for the fiscal quarter ended March 31, 1997 as filed on May 14, 1997).
4.5	Indenture between the Company, as Issuer, and Wilmington Trust Company, as Trustee, dated as of October 1, 2004 (incorporated by reference to Exhibit 10.2 of the Company's Form 10-Q for the fiscal quarter ended September 30, 2004 as filed on November 4, 2004).
10.1*	Employment Agreement between Evans National Bank and Richard M. Craig (incorporated by reference to Exhibit 10.1 of the Company's Form 10-K for the fiscal year ended December 31, 1997 as filed on March 30, 1998).
10.2*	Employment Agreement between Evans National Bank and James Tilley (incorporated by reference to Exhibit 10.2 of the Company's Form 10-K for the fiscal year ended December 31, 1997 as filed on March 30, 1998).
10.3*	Employment Agreement between Evans National Bank and William R. Glass (incorporated by reference to Exhibit 10.3 of the Company's Form 10-K for the fiscal year ended December 31, 1997 as filed on March 30, 1998).
10.4*	Specimen 1984 Director Deferred Compensation Agreement (incorporated by reference to Exhibit 10.5 of the Company's Form 10 (Registration No. 0-18539) as filed on April 30, 1990).
10.5*	Specimen 1989 Director Deferred Compensation Agreement (incorporated by reference to Exhibit 10.6 of the Company's Form 10 (Registration No. 0-18539) as filed on April 30, 1990).
10.6*	Summary of Provisions of Director Deferred Compensation Agreements (incorporated by reference to Exhibit 10.7 of the Company's Form 10 (Registration No. 0-18539) as filed on April 30, 1990).
10.7	Investment Service Agreement between O'Keefe Shaw & Co., Inc. and ENB Associates Inc. (incorporated by reference to Exhibit 10.1 of the Company's Form 10-Q for the fiscal quarter ended March 31, 2000 as filed on May 8, 2000).
10.8*	Employment Agreement between Evans National Bank and Robert Miller (incorporated by reference to Exhibit 10.11 of the Company's Form 10-K for the fiscal year ended December 31, 2000 as filed on March 29, 2001).
10.9*	Employment Agreement between Evans National Bank and Mark DeBacker (incorporated by reference to Exhibit 10.15 of the Company's Form 10-Q for the fiscal quarter ended June 30, 2001 as filed on August 1, 2001).
10.10*	Evans National Bank Executive Life Insurance Plan (incorporated by reference to Exhibit 10.10 to the Company's Form 10-K for the fiscal year ended December 31, 2003 as filed on March 18, 2004).
10.11*	Evans National Bank Supplemental Executive Retirement Plan (incorporated by reference to Exhibit 10.11 to the Company's Form 10-K for the fiscal year ended December 31, 2003 as filed on March 18, 2004).



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10.13	Agreement of Sale and Purchase of Assets among ENB Insurance Agency, Inc., Ulrich & Company, Inc., Ulrich Development Company, LLC and David L. Ulrich dated as of October 1, 2004 (incorporated by reference to Exhibit 10.1 of the Company's Form 10-Q for the fiscal quarter ended September 30, 2004 as filed on November 4, 2004).
10.14*	Form of Supplemental Executive Retirement Participatory Agreement incorporated by reference to Exhibit 10.15 of the Company's Form 10-K for the fiscal year ended December 31, 2004, as filed on March 28, 2005).
10.15*	Form of Deferred Compensation Participatory Agreement incorporated by reference to Exhibit 10.16 of the Company's Form 10-K for the fiscal year ended December 31, 2004, as filed on March 28, 2005).
10.16*	Form of Executive Life Insurance Split-Dollar Endorsement Participatory Agreement incorporated by reference to Exhibit 10.17 of the Company's Form 10-K for the fiscal year ended December 31, 2004, as filed on March 28, 2005).
10.17	Form of Floating Rate Junior Subordinated Debt Security due 2034 (incorporated by reference to Exhibit 10.3 of the Company's Form 10-Q for the fiscal quarter ended September 30, 2004 as filed on November 4, 2004).
10.18	Amended and Restated Declaration of Trust of Evans Capital Trust I, dated as of October 1, 2004 (incorporated by reference to Exhibit 10.4 of the Company's Form 10-Q for the fiscal quarter ended September 30, 2004 as filed on November 4, 2004).
10.19	Guarantee Agreement of the Company, dated as of October 1, 2004 (incorporated by reference to Exhibit 10.5 of the Company's Form 10-Q for the fiscal quarter ended September 30, 2004 as filed on November 4, 2004).
10.20	Purchase Agreement among the Company, Evans Capital Trust I, and NBC Capital Markets Group, Inc., dated as of October 1, 2004 (incorporated by reference to Exhibit 10.6 of the Company's Form 10-Q for the fiscal quarter ended September 30, 2004 as filed on November 4, 2004).
10.21	Asset Purchase Agreement by and among Evans National Leasing, Inc., Evans Bancorp, Inc., M&C Leasing Co., Inc., APCOT NY Corp., John Gallo, and for certain limited purposes, Brian Gallo, dated as of December 31, 2004 (incorporated by reference to Exhibit 10.22 of the Company's Form 10-K for the fiscal year ended December 31, 2004, as filed March 28, 2005).
10.22	Summary of compensation arrangements for Named Executive Officers and Directors (incorporated by reference to Exhibit 10.1 of the Company's Form 10Q for the fiscal quarter ended March 31, 2005, as filed on May 13, 2005).
21.1	Subsidiaries of the Company (incorporated by reference to Exhibit 10.21 of the Company's Form 10-K for the fiscal year ended December 31, 2004, as filed March 28, 2005).
23.1	Independent Registered Public Accounting Firm's Consent from KPMG LLP (filed herewith).
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
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 (filed herewith).
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 (filed herewith).

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\* Indicates a management contract or compensatory plan or arrangement.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized:

**EVANS BANCORP, INC.**

By: /s/ James Tilley  
James Tilley, President and  
Chief Executive Officer  
Date: March 21, 2006

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

Signature	Title	Date
<u>/s/ James Tilley</u> James Tilley	President and Chief Executive Officer/Director (Principal Executive Officer)	March 21, 2006
<u>/s/ Mark DeBacker</u> Mark DeBacker	Treasurer (Principal Financial Officer)	March 21, 2006
<u>/s/ Phillip Brothman</u> Phillip Brothman	Chairman of the Board/Director	March 21, 2006
<u>/s/ Thomas H. Waring, Jr.</u> Thomas H. Waring, Jr.	Vice Chairman of the Board/Director	March 21, 2006
<u>/s/ James E. Biddle, Jr.</u> James E. Biddle, Jr.	Secretary/Director	March 21, 2006
<u>/s/ William F. Barrett</u> William F. Barrett	Director	March 21, 2006
<u>/s/ LaVerne G. Hall</u> LaVerne G. Hall	Director	March 21, 2006
<u>/s/ Kenneth C. Kirst</u> Kenneth C. Kirst	Director	March 21, 2006
<u>/s/ Mary Catherine Militello</u> Mary Catherine Militello	Director	March 21, 2006
<u>/s/ Robert G. Miller, Jr.</u> Robert G. Miller, Jr.	Director	March 21, 2006
<u>/s/ John R. O'Brien</u> John R. O'Brien	Director	March 21, 2006
<u>/s/ David M. Taylor</u> David M. Taylor	Director	March 21, 2006
<u>/s/ Nancy W. Ware</u> Nancy W. Ware	Director	March 21, 2006

**EXHIBIT INDEX**

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31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
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 (filed herewith).
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 (filed herewith).

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\* Indicates a management contract or compensatory plan or arrangement.



***Exhibit 23.1***

**Consent of Independent Registered Public Accounting Firm**

The Board of Directors  
Evans Bancorp, Inc.:

We consent to the incorporation by reference in the Registration Statements (No. 333-106655 and No. 333-123679) on Form S-8 and (No. 333-123678 and No. 333-34347) on Form S-3D of Evans Bancorp, Inc. of our report dated March 8, 2006, with respect to the consolidated balance sheets of Evans Bancorp, Inc. and subsidiaries as of December 31, 2005 and 2004, 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, 2005, and all related financial statement schedules, which report appears in the December 31, 2005 Annual Report on Form 10-K of Evans Bancorp, Inc.

/s/ KPMG LLP  
Buffalo, New York  
March 20, 2006



***Exhibit 31.1***

**Certification**

I, James Tilley, certify that:

1. I have reviewed this annual report on Form 10-K of Evans Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 23, 2006

/s/ James Tilley

James Tilley  
President and Chief Executive Officer  
(Principal Executive Officer)



***Exhibit 31.2***  
**Certification**

I, Mark DeBacker, certify that:

1. I have reviewed this annual report on Form 10-K of Evans Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 23, 2006

/s/ Mark DeBacker  
Mark DeBacker  
Treasurer  
(Principal Financial Officer)





*Exhibit 32.1*

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, James Tilley, the President and Chief Executive Officer of Evans Bancorp, Inc., certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge: (1) that the Annual Report of Evans Bancorp, Inc. on Form 10-K for the fiscal year ended December 31, 2005 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (2) that information contained in such Annual Report on Form 10-K fairly presents in all material respects the financial condition and results of operations of Evans Bancorp, Inc. This certification is made to comply with the provisions of Section 906 of the Sarbanes-Oxley Act and is not intended to be used for any other purpose.

Date: March 23, 2006

By /s/ James Tilley

Name: James Tilley

Title: President and Chief Executive Officer  
(Principal Executive Officer)



*Exhibit 32.2*

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Mark DeBacker, the Treasurer of Evans Bancorp, Inc., certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge: (1) that the Annual Report of Evans Bancorp, Inc. on Form 10-K for the fiscal year ended December 31, 2005 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (2) that information contained in such Annual Report on Form 10-K fairly presents in all material respects the financial condition and results of operations of Evans Bancorp, Inc. This certification is made to comply with the provisions of Section 906 of the Sarbanes-Oxley Act and is not intended to be used for any other purpose.

Date: March 23, 2006

By: /s/ Mark DeBacker

Name: Mark DeBacker

Title: Treasurer  
(Principal Financial Officer)