

EVANS BANCORP INC  
Form 10-Q  
August 14, 2007

**Table of Contents**

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

(Mark One)

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

**For quarterly period ended June 30, 2007**

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

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

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

(Exact name of registrant as specified in its charter)

New York

16-1332767

(State of other jurisdiction of incorporation or organization)

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

14 -16 North Main Street, Angola, New York 14006

(Address of principal executive offices)

(Zip Code)

(716) 926-2000

(Registrant's telephone number, including area code)

Not applicable

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act: (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

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

Common Stock, \$.50 par value 2,747,675 shares as of August 1, 2007

INDEX  
EVANS BANCORP, INC. AND SUBSIDIARIES

	PAGE
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
<u>Unaudited Consolidated Balance Sheets June 30, 2007 and December 31, 2006</u>	1
<u>Unaudited Consolidated Statements of Operations Three months ended June 30, 2007 and 2006</u>	2
<u>Unaudited Consolidated Statements of Income-Six months ended June 30, 2007 and 2006</u>	3
<u>Unaudited Consolidated Statements of Stockholders Equity-Six months ended June 30, 2007 and 2006</u>	4
<u>Unaudited Consolidated Statements of Cash Flows Six months ended June 30, 2007 and 2006</u>	5
<u>Notes to Unaudited Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	14
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	25
<u>Item 4. Controls and Procedures</u>	26
<u>PART II. OTHER INFORMATION</u>	
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	27
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	28
<u>Item 6. Exhibits</u>	29
<u>SIGNATURES</u>	30
<u>EX-10.4</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	

---

**Table of Contents**

1

PART I FINANCIAL INFORMATION  
 ITEM I FINANCIAL STATEMENTS  
 EVANS BANCORP, INC. AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED BALANCE SHEETS  
 JUNE 30, 2007 AND DECEMBER 31, 2006  
 (in thousands, except share and per share amounts)

	June 30, 2007	December 31, 2006
<b>ASSETS</b>		
Cash and due from banks	\$ 13,907	\$ 11,710
Interest-bearing deposits at banks	568	882
Securities:		
Available for sale, at fair value	115,387	133,519
Held to maturity, at amortized cost	2,387	4,211
Loans and leases, net of allowance for loan and lease losses of \$3,866 in 2007 and \$3,739 in 2006	298,452	285,367
Properties and equipment, net	8,536	8,743
Goodwill	10,006	10,003
Intangible assets	2,012	2,298
Bank-owned life insurance	10,457	10,140
Other assets	7,780	7,021
<b>TOTAL ASSETS</b>	<b>\$ 469,492</b>	<b>\$ 473,894</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>LIABILITIES</b>		
Deposits:		
Demand	\$ 74,434	\$ 72,125
NOW	10,178	11,253
Regular savings	87,771	85,084
Muni-vest	45,162	31,240
Time	155,582	156,047
Total deposits	373,127	355,749
Securities sold under agreement to repurchase	6,622	8,954
Other short-term borrowings	5,800	24,753
Other liabilities	9,457	9,089
Junior subordinated debentures	11,330	11,330

Long-term borrowings	22,095	24,476
Total liabilities	428,431	434,351

## CONTINGENT LIABILITIES AND COMMITMENTS

## STOCKHOLDERS EQUITY:

Common stock, \$.50 par value; 10,000,000 shares authorized; 2,753,321 and 2,745,338 shares issued, respectively, and 2,747,675 and 2,733,056 shares outstanding, respectively	1,377	1,373
Capital surplus	26,283	26,160
Retained earnings	14,416	14,196
Accumulated other comprehensive loss, net of tax	(906)	(1,917)
Less: Treasury stock, at cost (5,646 and 12,282 shares, respectively)	(109)	(269)
Total stockholders equity	41,061	39,543
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 469,492</b>	<b>\$ 473,894</b>

*See Notes to Unaudited Consolidated Financial Statements*

---

**Table of Contents**

2

PART I FINANCIAL INFORMATION  
 ITEM I FINANCIAL STATEMENTS  
 EVANS BANCORP, INC. AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS  
 THREE MONTHS ENDED JUNE 30, 2007 AND 2006  
 (in thousands, except share and per share amounts)

	Three Months Ended June 30,	
	2007	2006
<b>INTEREST INCOME</b>		
Loans and leases	\$ 6,094	\$ 4,942
Interest bearing deposits at banks	10	19
Securities:		
Taxable	861	1,075
Non-taxable	435	483
Total interest income	7,400	6,519
<b>INTEREST EXPENSE</b>		
Deposits	2,670	2,126
Other borrowings	313	557
Junior subordinated debentures	223	206
Total interest expense	3,206	2,889
NET INTEREST INCOME	4,194	3,630
PROVISION FOR LOAN AND LEASE LOSSES	345	228
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	3,849	3,402
<b>NON-INTEREST INCOME:</b>		
Bank charges	548	477
Insurance service and fees	1,423	1,510
Net loss on sales of securities	(2,302)	
Premium on loans sold	4	1
Bank-owned life insurance	177	128
Other	439	373
Total non-interest income	289	2,489
<b>NON-INTEREST EXPENSE:</b>		
Salaries and employee benefits	2,621	2,440
Occupancy	525	501
Supplies	73	83
Repairs and maintenance	140	134
Advertising and public relations	133	190

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Professional services	273	251
Amortization of intangibles	142	135
Other insurance	90	90
Other	715	660
Total non-interest expense	4,712	4,484
(LOSS) INCOME BEFORE INCOME TAXES	(574)	1,407
INCOME TAX (BENEFIT) PROVISION	(435)	336
NET (LOSS) INCOME	\$ (139)	\$ 1,071
Net (loss) income per common share-basic	\$ (0.05)	\$ 0.39
Net (loss) income per common share-diluted	\$ (0.05)	\$ 0.39
Cash dividends per common share	\$ 0.00	\$ 0.00
Weighted average number of common shares	2,743,819	2,724,710
Weighted average number of diluted shares	2,743,819	2,727,803

*See Notes to Unaudited Consolidated Financial Statements*

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**Table of Contents**

3

PART I FINANCIAL INFORMATION  
 ITEM I FINANCIAL STATEMENTS  
 EVANS BANCORP, INC. AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED STATEMENTS OF INCOME  
 SIX MONTHS ENDED JUNE 30, 2007 AND 2006  
 (in thousands, except share and per share amounts)

	Six Months Ended June 30,	
	2007	2006
<b>INTEREST INCOME</b>		
Loans and leases	\$ 11,694	\$ 9,567
Interest bearing deposits at banks	97	30
Securities:		
Taxable	1,873	2,179
Non-taxable	878	957
Total interest income	14,542	12,733
<b>INTEREST EXPENSE</b>		
Deposits	5,373	4,021
Other borrowings	663	1,040
Junior subordinated debentures	441	398
Total interest expense	6,477	5,459
NET INTEREST INCOME	8,065	7,274
PROVISION FOR LOAN AND LEASE LOSSES	660	510
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	7,405	6,764
<b>NON-INTEREST INCOME:</b>		
Bank charges	1,019	975
Insurance service and fees	3,552	3,687
Net loss on sales of securities	(2,303)	
Premium on loans sold	5	4
Bank-owned life insurance	317	233
Other	843	736
Total non-interest income	3,433	5,635
<b>NON-INTEREST EXPENSE:</b>		
Salaries and employee benefits	5,289	4,941
Occupancy	1,128	1,033
Supplies	151	168
Repairs and maintenance	279	271
Advertising and public relations	220	261
Professional services	525	395



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Amortization of intangibles	286	265
Other insurance	180	177
Other	1,586	1,459
Total non-interest expense	9,644	8,970
INCOME BEFORE INCOME TAXES	1,194	3,429
INCOME TAXES	46	952
NET INCOME	\$ 1,148	\$ 2,477
Net income per common share-basic	\$ 0.42	\$ 0.91
Net income per common share-diluted	\$ 0.42	\$ 0.91
Cash dividends per common share	\$ 0.34	\$ 0.34
Weighted average number of common shares	2,737,232	2,723,835
Weighted average number of diluted shares	2,737,914	2,725,870

*See Notes to Unaudited Consolidated Financial Statements*

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**Table of Contents**

4

## PART 1 FINANCIAL INFORMATION

## ITEM 1 FINANCIAL STATEMENTS

## EVANS BANCORP, INC. AND SUBSIDIARIES

## UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

SIX MONTHS ENDED JUNE 30, 2007 AND 2006

(in thousands, except share and per share amounts)

	<b>Common Stock</b>	<b>Capital Surplus</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive (Loss)</b>	<b>Treasury Stock</b>	<b>Total</b>
<b>Balance, January 1, 2006</b>	\$ 1,373	\$ 26,155	\$ 11,087	\$ (1,387)	\$ (352)	\$ 36,876
Impact of adopting SAB 108, net of tax \$12			43			43
Comprehensive income: Net Income			2,477			2,477
Net unrealized loss on available-for-sale securities, net of tax effect of \$737				(1,156)		(1,156)
Total comprehensive income						1,364
Cash dividends (\$0.34 per common share)			(928)			(928)
Stock options expense		60				60
Reissued 9,642 shares treasury stock under dividend reinvestment plan		(33)			219	186
Reissued 5,773 shares treasury stock under employee stock purchase plan		(29)			129	100
Purchased 18,050 shares for treasury					(386)	(386)
<b>Balance, June 30, 2006</b>	\$ 1,373	\$ 26,153	\$ 12,679	\$ (2,543)	\$ (390)	\$ 37,272

<b>Balance, January 1, 2007</b>	\$ 1,373	\$ 26,160	\$ 14,196	\$ (1,917)	\$ (269)	\$ 39,543
Comprehensive income:						
Net Income			1,148			1,148
Net unrealized gain on available-for sale securities, net of reclassification of loss of \$1,413 (after tax) and tax effect of (\$629)				985		985
Amortization of prior service cost and net loss, net of tax effect (\$17)				26		26
Total comprehensive income						2,159
Cash dividends (\$0.34 per common share)			(928)			(928)
Stock options expense		56				56
Reissued 8,747 shares treasury stock under dividend reinvestment plan		(21)			195	174
Reissued 2,500 shares of restricted stock		(53)			53	
Issued 7,983 shares treasury stock	4	161				165
Reissued 4,689 shares treasury stock under employment stock purchase plan		(20)			101	81
Purchased 9,300 shares for treasury					(189)	(189)
<b>Balance, June 30, 2007</b>	\$ 1,377	\$ 26,283	\$ 14,416	\$ (906)	\$ (109)	\$ 41,061

*See Notes to Unaudited Consolidated Financial Statements*

**Table of Contents**

5

PART I FINANCIAL INFORMATION  
ITEM I FINANCIAL STATEMENTS  
EVANS BANCORP, INC. AND SUBSIDIARIES  
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS  
SIX MONTHS ENDED JUNE 30, 2007 AND 2006  
(in thousands)

	Six Months Ended June 30,	
	2007	2006
<b>OPERATING ACTIVITIES:</b>		
Interest received	\$ 13,748	\$ 13,025
Fees received	5,367	5,413
Interest paid	(6,416)	(5,523)
Cash paid to employees and suppliers	(8,525)	(7,806)
Income taxes paid	(1,069)	(897)
Proceeds from sale of loans held for resale	1,117	684
Originations of loans held for resale	(1,385)	(887)
Net cash provided by operating activities	2,837	4,009
<b>INVESTING ACTIVITIES:</b>		
Available for sales securities:		
Purchases	(66,937)	(333)
Proceeds from sales	45,653	
Proceeds from maturities	39,733	10,328
Held to maturity securities:		
Purchases	(93)	(2,052)
Proceeds from maturities	1,917	1,861
Additions to properties and equipment	(193)	(409)
Increase in loans, net of repayments	(13,676)	(12,943)
Sale of other real estate	(6)	
Acquisitions		(184)
Cash paid on earn-out agreements	(202)	(57)
Net cash provided by used in investing activities	6,196	(3,789)
<b>FINANCING ACTIVITIES:</b>		
Repayments of short-term borrowings	(21,285)	(5,458)
Repayments of long-term borrowings	(2,381)	(2,459)
Increase in deposits	17,378	6,200
Dividends paid	(928)	(928)
Purchase of treasury stock	(189)	(386)
Re-issuance of treasury stock	255	286

Net cash used in financing activities	(7,150)	(2,745)
Net increase (decrease) in cash and equivalents	1,883	(2,525)
<b>CASH AND CASH EQUIVALENTS:</b>		
Beginning of period	12,592	15,635
End of period	\$ 14,475	\$ 13,110

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**Table of Contents**

6

PART I FINANCIAL INFORMATION  
 ITEM I FINANCIAL STATEMENTS  
 EVANS BANCORP, INC. AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 SIX MONTHS ENDED JUNE 30, 2007 AND 2006  
 (in thousands)

	Six Months Ended June 30,	
	2007	2006
<b>RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:</b>		
Net income	\$ 1,148	\$ 2,477
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	856	861
Deferred tax expense (benefit)	91	(303)
Provision for loan and lease losses	660	510
Net loss on sales of assets	2,309	
Premiums on loans sold	(5)	(4)
Stock options expense	56	60
Proceeds from sale of loans held for resale	1,117	684
Originations of loans held for resale	(1,385)	(887)
Changes in assets and liabilities affecting cash flow:		
Other assets	(2,968)	(122)
Other liabilities	958	733
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>\$ 2,837</b>	<b>\$ 4,009</b>
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES</b>		
Issuance of shares for earn out agreement	\$ 165	\$
<i>See Notes to Unaudited Consolidated Financial Statements</i>		

**Table of Contents**

7

**PART 1 FINANCIAL INFORMATION****ITEM 1 FINANCIAL STATEMENTS****EVANS BANCORP, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****SIX MONTHS ENDED JUNE 30, 2007 AND 2006****1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

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

The results of operations for the three and six month period ended June 30, 2007 are not necessarily indicative of the results to be expected for the full year. The accompanying unaudited consolidated financial statements should be read in conjunction with the Audited Consolidated Financial Statements and the Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006.

**2. SECURITIES**

Securities which the Company has the positive ability and intent to hold to maturity are stated at amortized cost. Securities which the Company has identified as available-for-sale are stated at fair value with unrealized gains and losses excluded from earnings and reported net of deferred income taxes, in accumulated other comprehensive loss, a component of stockholders' equity. Available-for-sale securities are net of unrealized losses of \$0.3 million, \$1.5 million and \$1.9 million as of June 30, 2007, March 31, 2007, and December 31, 2006, respectively. As of June 30, 2007 the securities portfolio did not contain any other than temporary declines in fair value.

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

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

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

agencies.

The analysis of the allowance for loan and lease losses is composed of three components: specific credit allocation, general portfolio allocation and a subjective allocation. The specific credit allocation includes a

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**Table of Contents**

detailed review of the credit in accordance with the Statement of Financial Accounting Standards ( SFAS ) No. 114, Accounting by Creditors for Impairment of a Loan and No. 118, Accounting by Creditors for Impairment of a Loan Income Recognition and Disclosures, and allocation is made based on this analysis. The general portfolio allocation consists of an assigned reserve percentage based on the historical loss experience of the loan or lease category.

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

The following table sets forth information regarding the allowance for loan and lease losses for the six month periods ended June 30, 2007 and 2006.

**Allowance for loan and lease losses**

	Six months ended June 30,	
	2007	2006
	(in thousands)	
Beginning balance, January 1	\$ 3,739	\$ 3,211
Charge-offs:		
Commercial	(153)	(105)
Real estate	(5)	
Installment loans	(4)	(28)
Overdrafts	(16)	(14)
Direct financing leases	(400)	(105)
Total charge-offs	(578)	(252)
Recoveries:		
Commercial	9	41
Real estate		
Installment loans	1	56
Overdrafts	8	9
Direct financing leases	27	29
Total recoveries	45	135
Net charge-offs	(533)	(117)
Provision for loan and lease losses	660	510
Ending balance, June 30	\$ 3,866	\$ 3,604

Ratio of net charge-offs to average net loans and leases outstanding (annualized)	0.37%	0.09%
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Table of Contents

9

4. PER SHARE DATA

The common stock per share information is based upon the weighted average number of shares outstanding during each period, retroactively adjusted for stock dividends and stock splits. The Company's potential dilutive securities included 682 dilutive shares for the six month periods ended June 30, 2007. There were no dilutive securities for the three months ended June 30, 2007. There were 3,093 and 2,035 dilutive shares for the three and six month periods ended June 30, 2006. On February 23, 2007, the Company declared a cash dividend of \$0.34 per share payable on April 2, 2007 to shareholders of record as of March 12, 2007.

Potential common shares that would have the effect of increasing diluted earnings per share are considered to be anti-dilutive. In accordance with SFAS No. 128, Earnings Per Share, these shares were not included in calculating diluted earnings per share. As of the three and six month periods ended June 30, 2007, there were approximately 74 thousand and 61 thousand shares, respectively, that are not included in calculating diluted earnings per share because their effect was anti-dilutive. As of the three and six month periods ended June 30, 2006, there were approximately 46 thousand and 59 thousand shares that are not included in calculating diluted earnings per share because their effect was anti-dilutive.

5. TREASURY STOCK

During the quarter ended June 30, 2007 the Company repurchased 5,800 shares of common stock at an average cost of \$20.14 per share, pursuant to the Company's publicly announced common stock repurchase program.

6. SEGMENT INFORMATION

The Company is comprised of two primary business segments, banking and insurance agency activities. The following tables set forth information regarding these segments for the three and six month periods ended June 30, 2007 and 2006.

Three Months Ended  
June 30, 2007  
(in thousands)

	<b>Banking Activities</b>	<b>Insurance Agency Activities</b>	<b>Total</b>
Net interest income (expense)	\$ 4,297	\$ (103)	\$ 4,194
Provision for loan and lease losses	345		345
Net interest income (expense) after provision for loan and lease losses	3,952	(103)	3,849
Non-interest income	(1,134)		(1,134)
Insurance service and fees		1,423	1,423
Non-interest expense	3,577	1,135	4,712
(Loss) income before income taxes	(759)	185	(574)
Income tax (benefit) provision	(509)	74	(435)

Net (loss) income	\$	(250)	\$	111	\$	(139)
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**Table of Contents**

10

Six Months Ended  
June 30, 2007  
(in thousands)

	<b>Banking Activities</b>	<b>Insurance Agency Activities</b>	<b>Total</b>
Net interest income (expense)	\$ 8,288	\$ (223)	\$ 8,065
Provision for loan and lease losses	660		660
Net interest income (expense) after provision for loan and lease losses	7,628	(223)	7,405
Non-interest income	(119)		(119)
Insurance service and fees		3,552	3,552
Non-interest expense	7,360	2,284	9,644
Income before income taxes	149	1,045	1,194
Income tax (benefit) provision	(372)	418	46
Net income	\$ 521	\$ 627	\$ 1,148

Three Months Ended  
June 30, 2006  
(in thousands)

	<b>Banking Activities</b>	<b>Insurance Agency Activities</b>	<b>Total</b>
Net interest income (expense)	\$ 3,744	\$ (114)	\$ 3,630
Provision for loan and lease losses	228		228
Net interest income (expense) after provision for loan and lease losses	3,516	(114)	3,402
Non-interest income	979		979
Insurance service and fees		1,510	1,510
Non-interest expense	3,369	1,115	4,484
Income before income taxes	1,126	281	1,407
Income taxes	224	112	336
Net income	\$ 902	\$ 169	\$ 1,071

**Table of Contents**

11

Six Months Ended  
June 30, 2006  
(in thousands)

	<b>Banking Activities</b>	<b>Insurance Agency Activities</b>	<b>Total</b>
Net interest income (expense)	\$ 7,506	\$ (232)	\$ 7,274
Provision for loan and lease losses	510		510
Net interest income (expense) after provision for loan and lease losses	6,996	(232)	6,764
Non-interest income	1,948		1,948
Insurance service and fees		3,687	3,687
Non-interest expense	6,651	2,319	8,970
Income before income taxes	2,293	1,136	3,429
Income taxes	498	454	952
Net income	\$ 1,795	\$ 682	\$ 2,477

**7. CONTINGENT LIABILITIES AND COMMITMENTS**

The unaudited consolidated financial statements do not reflect various commitments and contingent liabilities, which arise in the normal course of business, and which involve elements of credit risk, interest rate risk and liquidity risk. These commitments and contingent liabilities consist of commitments to extend credit and standby letters of credit. A summary of the Bank's commitments and contingent liabilities at June 30, 2007 and 2006 is as follows:

	<b>2007 (in thousands)</b>	<b>2006</b>
Commitments to extend credit	\$ 57,662	\$ 54,966
Standby letters of credit	2,089	2,080
Total	\$ 59,751	\$ 57,046

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

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

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**Table of Contents**

12

The Company is subject to possible litigation proceedings in the normal course of business. As of June 30, 2007, there were no claims pending against the Company that management considered to be material.

**8. RECLASSIFICATIONS AND ERROR CORRECTION**

Certain reclassifications have been made to the 2006 unaudited consolidated financial statements to conform with the presentation used in 2007.

In the second quarter of 2007, the Company identified an error in its amortization of deferred loan fees in accordance with SFAS 91. The amortization of these fees was understated by \$173 thousand (\$106 thousand after tax) due to a systems error in 2005, 2006 and the first quarter of 2007. The correction of this error was recorded in the three months ended June 30, 2007 as a \$173 thousand increase to loan interest income. Income tax expense was increased by \$67 thousand, resulting in an increase in net income of \$106 thousand. Neither the origination nor the correction of the error was material to our financial statements.

**9. NET PERIODIC BENEFIT COSTS**

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

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

The following table represents net periodic benefit costs recognized:

	Three months ended June 30, (in thousands)			
	Pension Benefits		Supplemental Executive Retirement Plan	
	2007	2006	2007	2006
Service cost	\$ 91	\$ 79	\$ 15	\$ 29
Interest cost	61	49	40	38
Expected return on plan assets	(62)	(58)		
Amortization of prior service cost	(4)	(4)	14	14
Amortization of the net loss	7	6	4	4
Net periodic benefit cost	\$ 93	\$ 72	\$ 73	\$ 85



**Table of Contents**

13

	Six months ended June 30, (in thousands)			
	Pension Benefits		Supplemental Executive Retirement Plan	
	2007	2006	2007	2006
Service cost	\$ 183	\$ 158	\$ 29	\$ 58
Interest cost	121	98	80	76
Expected return on plan assets	(123)	(116)		
Amortization of prior service cost	(8)	(8)	28	28
Amortization of the net loss	15	12	9	8
Net periodic benefit cost	\$ 188	\$ 144	\$ 146	\$ 170

**10. INCOME TAXES**

Income tax expense totaled \$46 thousand for the six month period ended June 30, 2007 for an effective tax rate of 3.9%. There was an income tax benefit of \$(435) thousand for the second quarter. The low effective tax rate for the year-to-date and the income tax benefit for the quarter were due to the loss on sale of securities of \$2.3 million incurred in the second quarter. Excluding the loss on sale of securities, the effective tax rate on all other income for the three-month and six-month periods ended June 30, 2007 was 26.3% and 26.7%, respectively, compared to 23.9% and 27.8% in the prior year. Excluding the loss on sale of securities, the Company records an effective tax rate for the period that will be reflective of the projected annual tax rate based on expected supportable tax positions.

**11. RECENT ACCOUNTING PRONOUNCEMENTS**

**Accounting for Uncertainty in Income Taxes** In July 2006, the FASB issued FIN 48, Accounting for Uncertainty in Income Taxes, to set out a consistent framework for tax preparers to use to determine the appropriate level of tax reserves to maintain for uncertain tax positions. This interpretation of FASB Statement No. 109 uses a two-step approach wherein a tax benefit is recognized if a position is more likely than not to be sustained. The amount of the benefit is then measured to be the highest tax benefit that is greater than 50 percent likely to be realized. FIN 48 also sets out disclosure requirements to enhance transparency of an entity's tax reserves. The Company adopted FIN 48 as of January 1, 2007. There were no unrecognized tax benefits or penalties at the date of adoption.

The Internal Revenue Service (IRS) commenced examinations of the Company's U.S. Federal income tax returns for 2003, 2004, and 2005 in the first quarter of 2007. It is anticipated that the examination related to these returns will be completed within the next twelve months. To date, there are no proposed adjustments that will have a material impact on the Company's financial position or results of operations. All penalties or interest on adjustments, if any, will be expensed as income tax expense.

**Fair Value Measurements (SFAS 157)** In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). This standard defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. In addition, SFAS 157 precludes the use of block discounts and supersedes the guidance in EITF 02-3, which prohibited the recognition of day-1 gains on certain derivative trades when determining the fair value of instruments not traded in an active market. With the adoption of this standard, these changes will be reflected as a cumulative effect adjustment to the opening balance of retained earnings. The standard also requires the Company to reflect its own credit standing when measuring the fair value of debt it has issued that is carried at fair value, including derivatives, prospectively from the date of adoption.

**Table of Contents**

14

SFAS 157 is effective for the Company's fiscal year beginning January 1, 2008, with earlier adoption permitted for the Company's fiscal year beginning January 1, 2007. The Company did not early adopt FAS 157. The Company is currently evaluating the potential impact of adopting this standard.

**Fair Value Option (SFAS 159)** On February 15, 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159). Under this Standard, the Company may elect to report financial instruments and certain other items at fair value on a contract-by-contract basis with changes in value reported in earnings. This election is irrevocable. SFAS 159 provides an opportunity to mitigate volatility in reported earnings that is caused by measuring hedged assets and liabilities that were previously required to use a different accounting method than the related hedging contracts when the complex provisions of SFAS 133 hedge accounting are not met. SFAS 159 is effective for years beginning after November 15, 2007. Early adoption within 120 days of the beginning of a company's 2007 fiscal year is permissible, provided the company has not yet issued interim financial statements for 2007 and has adopted SFAS 157. The Company did not early adopt FAS 159. The Company is currently evaluating the potential impact of adopting this standard.

**Split-Dollar Life Insurance** - At its September 2006 meeting, the Emerging Issues Task Force (EITF) reached a final consensus on Issue 06-04, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." The consensus stipulates that an agreement by an employer to share a portion of the proceeds of a life insurance policy with an employee during the postretirement period is a postretirement benefit arrangement required to be accounted for under SFAS No. 106 or Accounting Principles Board Opinion (APB) No. 12, "Omnibus Opinion" 1967. The consensus concludes that the purchase of a split-dollar life insurance policy does not constitute a settlement under SFAS No. 106 and, therefore, a liability for the postretirement obligation must be recognized under SFAS No. 106 if the benefit is offered under an arrangement that constitutes a plan or under APB No. 12 if it is not part of a plan. Issue 06-04 is effective for annual or interim reporting periods beginning after December 15, 2007. The provisions of Issue 06-06 should be applied through either a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or retrospective application. The Company has endorsement split-dollar life insurance policies covering certain directors and employees.

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

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

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

Securities and Exchange Commission (the SEC). Many of these factors are beyond the Company's control and are difficult to predict.

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**Table of Contents**

15

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

**APPLICATION OF CRITICAL ACCOUNTING ESTIMATES**

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

The most significant accounting policies followed by the Company are presented in Note 1 to the Audited Consolidated Financial Statements included in Item 8 in its Annual Report on Form 10-K. These policies, along with the disclosures presented in the other Notes to the Company's Audited Consolidated Financial Statements contained in its Annual Report on Form 10-K and in this financial review, provide information on how significant assets and liabilities are valued in the Company's Unaudited Consolidated Financial Statements and how those values are determined.

Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for loan and lease losses and valuation of goodwill to be the accounting areas that require the most subjective or complex judgments, and as such, could be most subject to revision as new information becomes available.

**Allowance for Loan and Lease Losses**

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

**Goodwill**

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

model.

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**Table of Contents**

16

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

Total gross loans and leases grew to \$302.3 million at June 30, 2007, reflecting a \$7.9 million or 2.7% increase from March 31, 2007 and a \$13.2 million or 4.6% increase from December 31, 2006. Gross loans and leases are net of \$8.5 million, \$8.2 million of unearned income and \$7.8 million unearned income on direct financing leases as of June 30, 2007, March 31, 2007 and December 31, 2006, respectively. Commercial loans and leases totaled \$213.5 million at June 30, 2007, reflecting a \$6.5 million or 3.1% increase from March 31, 2007, and an \$11.8 million or 5.9% increase from December 31, 2006. Growth in direct financing leases of \$2.9 million or 8.6%, commercial installment loans of \$1.9 million or 10.6%, and commercial lines of credit of \$1.1 million or 8.6%, were largely responsible for the increase from March 31, 2007 to June 30, 2007. Growth in direct financing leases of \$5.4 million or 17.0%, commercial installment loans of \$3.1 million or 18.2%, and commercial lines of credit of \$2.0 million or 16.8% were largely responsible for the increase from December 31, 2006 to June 30, 2007. Consumer loans totaled \$88.0 million at June 30, 2007, reflecting a \$1.2 million or 1.4% increase from March 31, 2007 and a \$1.2 million or 1.4% increase from December 31, 2006. Real estate loans accounted for most of the increase as those loans increased \$0.8 million or 1.6% from March 31, 2007 to June 30, 2007 and \$1.5 million or 3.0% from December 31, 2006 to June 30, 2007. The Bank continues to sell certain fixed rate residential mortgages originated below a designated interest level to the Federal National Mortgage Association ( FNMA ), while maintaining the servicing rights for those mortgages. During the three month period ended June 30, 2007, the Bank sold mortgages to FNMA totaling \$0.8 million, as compared to \$0.2 million during the three month period ended June 30, 2006. During the six month period ended June 30, 2007, the Bank sold mortgages to FNMA totaling \$1.1 million, as compared to \$0.7 million during the six month period ended June 30, 2006. At June 30, 2007, the Bank had a loan servicing portfolio principal balance of \$28.4 million upon which it earns servicing fees, as compared to \$28.9 million at March 31, 2007, and \$28.7 million at December 31, 2006.

**Loan and Lease Portfolio Composition**

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

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**Table of Contents**

17

	June 30, 2007 (in thousands)	Percentage	December 31, 2006 (in thousands)	Percentage
<b>Commercial Loans and Leases</b>				
Real Estate	\$ 141,600	46.8%	\$ 140,376	48.6%
Installment	20,410	6.8%	17,263	6.0%
Direct Financing Leases	37,145	12.3%	31,742	11.0%
Lines of Credit	14,339	4.7%	12,279	4.2%
Cash Reserve	50	0.0%	39	0.0%
<b>Total Commercial Loans and Leases</b>	<b>213,544</b>	<b>70.6%</b>	<b>201,699</b>	<b>69.8%</b>
<b>Consumer Loans</b>				
Real Estate	50,343	16.7%	48,877	16.9%
Home Equity	34,619	11.4%	34,453	11.9%
Installment	2,350	0.8%	2,621	0.9%
Overdrafts	270	0.1%	163	0.1%
Credit Card		0.0%	298	0.1%
Other	382	0.1%	341	0.1%
<b>Total Consumer Loans</b>	<b>87,964</b>	<b>29.1%</b>	<b>86,753</b>	<b>30.0%</b>
Net Deferred Costs & Unearned Discounts	810	0.3%	654	0.2%
<b>Total Loans and Leases</b>	<b>302,318</b>	<b>100.0%</b>	<b>289,106</b>	<b>100.0%</b>
Allowance for Loan and Lease Losses	(3,866)		(3,739)	
<b>Loans and Leases, net</b>	<b>\$ 298,452</b>		<b>\$ 285,367</b>	

Net loan and lease charge-offs were \$365 thousand in the three month period ended June 30, 2007 as compared to net recoveries of \$12 thousand in the same period of 2006. Net charge-offs were \$533 thousand for the six month period ended June 30, 2007 as compared to \$117 thousand in the same period of 2006. Non-performing loans and leases, defined as accruing loans and leases greater than 90 days past due and non-accrual loans and leases, totaled 0.26% of total loans and leases outstanding at June 30, 2007 as compared to 0.22% at March 31, 2007 and 0.23% at December 31, 2006. The allowance for loan and lease losses totaled \$3.9 million or 1.28% of total loans and leases outstanding at June 30, 2007 as compared to \$3.9 million or 1.32% of total loans and leases at March 31, 2007 and \$3.7 million or 1.29% of total loans and leases outstanding at December 31, 2006.

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

**Table of Contents**

18

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

	<b>June 30, 2007</b> (in thousands)	<b>December 31, 2006</b>
Non-accruing loans and leases:		
Mortgage loans on real estate		
Residential 1-4 family	\$	\$
Commercial and multi-family	128	145
Construction		
Second mortgages		
Home equity lines of credit		
Total mortgage loans on real estate	128	145
Direct financing leases	290	
Commercial loans	256	443
Consumer installment loans		
Personal		
Credit cards		
Other		
Total consumer installment loans		
Total non-accruing loans and leases	\$ 674	\$ 588
Accruing loans and leases 90+ days past due	98	74
Total non-performing loans and leases	772	662
Total non-performing loans and leases as a percentage of total assets	0.16%	0.15%
Total non-performing loans and leases as a percentage of total loans and leases	0.26%	0.23%

For the three and six month periods ended June 30, 2007, gross interest income that would have been reported on non-accruing loans and leases had they been current, was \$28 thousand and \$46 thousand, respectively. For the three and six month periods ended June 30, 2006, gross interest income that would have been reported on non-accruing loans and leases had they been current, was \$20 thousand and \$54 thousand, respectively. There was \$12 thousand and \$18 thousand of interest income included in net income for the three and six month periods ended June 30, 2007, and no interest income for the same periods in 2006 on non-accruing loans and leases.

**Investing Activities**

Total securities declined to \$117.8 million at June 30, 2007, reflecting a \$36.3 million or 23.6% decrease from March 31, 2007, and a \$19.9 million or 14.5% decrease from December 31, 2006. The decline in the securities



portfolio is a result of the Company's sale of \$45 million in securities in June 2007 as it initiates its strategy to de-lever a portion of its balance sheet. The decline was less than the amount sold because the Company needed to purchase short-term discount notes to pledge as collateral against its remaining municipal deposits. As some of those municipal deposits continue to roll off, the Company will allow some of its short-term discount notes to mature without being replaced. The Company monitors extension and prepayment risk in the portfolio to limit potential exposures. Management believes the average expected life of the portfolio is 2.4 years as of June 30, 2007, as compared to 2.7 years as of March 31, 2007. Available-for-sale securities with a total fair value of \$112.2 million at June 30, 2007 were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

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**Table of Contents**

19

**Funding Activities**

Total deposits at June 30, 2007 were \$373.1 million, reflecting a \$6.8 million or 1.8% decrease from March 31, 2007. Time deposits \$100,000 and over decreased \$12.0 million, or 14.3%, to \$72.0 million mainly due to municipal deposits and run off of time deposits accumulated in promotions in prior periods. Additionally, muni-vest balances decreased \$1.6 million or 3.4% from March 31, 2007. The Company has allowed these sources of funds to roll off as part of its de-leverage strategy. As the investment securities balance has declined, these funds were no longer needed. These decreases were partially offset by an increase of \$3.6 million, or 5.1%, in demand deposits. Core deposits (all deposits excluding time deposits greater than \$100,000) increased \$5.2 million, or 1.8%, to \$301.2 million from March 31, 2007.

Total deposits increased \$17.4 million or 4.9% increase from December 31, 2006. The increase in deposits from December 31, 2006 was primarily attributable to an increase in muni-vest deposits of \$13.9 million or 44.6%, which was the mainly due to a large deposit made by a single municipal customer in the first quarter. Additionally, demand deposits increased \$2.3 million or 3.2% from December 31, 2006, while NOW accounts decreased \$1.1 million or 9.6% from December 31, 2006.

As the securities portfolio has declined, the Company has had less need to rely on wholesale sources of funds. Short-term borrowings from other correspondent banks and the Federal Home Loan Bank of New York was \$5.8 million at June 30, 2007 as compared to \$26.4 million at March 31, 2007 and \$24.8 million at December 31, 2006.

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**Table of Contents****ANALYSIS OF RESULTS OF OPERATIONS****Average Balance Sheet**

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

	<b>Three Months Ended June 30, 2007</b>			<b>Three Months Ended June 30, 2006</b>		
	<b>Average Outstanding Balance</b> (dollars in thousands)	<b>Interest Earned/ Paid</b>	<b>Yield/ Rate</b>	<b>Average Outstanding Balance</b> (dollars in thousands)	<b>Interest Earned/ Paid</b>	<b>Yield/ Rate</b>
<b>ASSETS</b>						
Interest-earning assets:						
Loans and leases, net	\$ 294,365	\$ 6,094	8.28%	\$ 264,064	\$ 4,942	7.49%
Taxable securities	85,975	861	4.01%	106,830	1,075	4.03%
Tax-exempt securities	39,425	435	4.41%	45,151	483	4.28%
Interest bearing deposits at banks	2,333	10	1.71%	1,458	19	5.21%
<b>Total interest-earning assets</b>	<b>422,098</b>	<b>7,400</b>	<b>7.01%</b>	<b>417,503</b>	<b>6,519</b>	<b>6.25%</b>
Non interest-earning assets:						
Cash and due from banks	10,789			12,507		
Premises and equipment, net	8,653			8,194		
Other assets	29,681			28,865		
<b>Total Assets</b>	<b>\$ 471,221</b>			<b>\$ 467,069</b>		
<b>LIABILITIES &amp; STOCKHOLDERS EQUITY</b>						
Interest-bearing liabilities:						
NOW	\$ 11,015	\$ 6	0.22%	\$ 11,659	\$ 6	0.21%
Regular savings	85,638	256	1.20%	87,352	220	1.01%
Muni-Vest savings	46,989	514	4.38%	43,123	458	4.25%
Time deposits	156,521	1,894	4.84%	142,847	1,442	4.04%
Other borrowed funds	30,495	298	3.91%	53,715	546	4.07%
Junior subordinated debentures	11,330	223	7.87%	11,330	206	7.27%

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Securities sold U/A to repurchase	7,453	15	0.81%	6,373	11	0.69%
Total interest-bearing liabilities	349,441	\$ 3,206	3.67%	356,399	\$ 2,889	3.24%
Noninterest-bearing liabilities:						
Demand deposits	71,340			66,149		
Other	9,913			7,598		
Total liabilities	\$ 430,694			\$ 430,146		
Stockholders' equity	40,527			36,923		
Total Liabilities and Equity	\$ 471,221			\$ 467,069		
Net interest earnings		\$ 4,194			\$ 3,630	
Net yield on interest earning assets			3.97%			3.48%
Interest rate spread			3.34%			3.01%

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**Table of Contents**

21

	Six Months Ended June 30, 2007			Six Months Ended June 30, 2006		
	Average Outstanding Balance (dollars in thousands)	Interest Earned/ Paid	Yield/ Rate	Average Outstanding Balance (dollars in thousands)	Interest Earned/ Paid	Yield/ Rate
<b>ASSETS</b>						
Interest-earning assets:						
Loans and leases, net	\$ 290,696	\$ 11,694	8.05%	\$ 260,986	\$ 9,567	7.33%
Taxable securities	90,159	1,873	4.15%	109,928	2,179	3.96%
Tax-exempt securities	40,327	878	4.35%	45,314	957	4.22%
Interest bearing deposits at banks	4,676	97	4.15%	1,320	30	4.55%
Total interest-earning assets	425,858	14,542	6.83%	417,548	12,733	6.10%
Non interest-earning assets:						
Cash and due from banks	10,889			12,213		
Premises and equipment, net	8,681			8,175		
Other assets	29,619			28,507		
Total Assets	\$ 475,047			\$ 466,443		
<b>LIABILITIES &amp; STOCKHOLDERS EQUITY</b>						
Interest-bearing liabilities:						
NOW	\$ 11,532	\$ 12	0.21%	\$ 11,611	\$ 11	0.19%
Regular savings	86,933	508	1.17%	88,484	408	0.92%
Muni-Vest savings	47,458	1,032	4.35%	38,648	788	4.08%
Time deposits	156,988	3,821	4.87%	146,104	2,814	3.85%
Other borrowed funds	32,248	634	3.93%	52,611	1,012	3.85%
Junior subordinated debentures	11,330	441	7.78%	11,330	398	7.03%
Securities sold U/A to repurchase	7,447	29	0.78%	7,216	28	0.78%
Total interest-bearing liabilities	353,936	\$ 6,477	3.66%	356,004	\$ 5,459	3.07%

Noninterest-bearing liabilities:			
Demand deposits	71,132	65,978	
Other	9,685	7,304	
Total liabilities	\$ 434,753	\$ 429,286	
Stockholders' equity	40,294	37,157	
Total Liabilities and Equity	\$ 475,047	\$ 466,443	
Net interest earnings	\$ 8,065	\$ 7,274	
Net yield on interest earning assets		3.79%	3.48%
Interest rate spread		3.17%	3.03%

Net (Loss) Income

The net loss was \$(0.1) million or \$(0.05) per basic and diluted share for the three months ended June 30, 2007, as compared to net income of \$1.1 million or \$0.39 per basic and diluted share for the same period in 2006. The net loss was largely a result of the loss on sale of securities in the quarter. The return on average assets was -0.12% and 0.92% for the three month periods ended June 30, 2007 and 2006, respectively. The return on average equity was -1.37% and 11.60% for the three month periods ended June 30, 2007 and 2006, respectively.

Net operating income (as defined in the subsequent Supplemental Reporting of Non-GAAP Results of Operations ) for the second quarter of 2007 was \$1.17 million, up 7.3% from \$1.09 million during last year's

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**Table of Contents**

22

second quarter, and diluted operating earnings per share increased \$0.02, or 5.0%, to \$0.42 per share. The increase in net operating income was driven by growth in net interest income and non-interest income, offset by an increase in non-interest expenses.

Net income was \$1.1 million or \$0.42 per basic and diluted share for the six months ended June 30, 2007, as compared to \$2.5 million or \$0.91 per basic and diluted share for the same period in 2006. The decrease is largely explained by the loss on sale of securities in the second quarter. Net income represented a return on average assets of 0.48% and 1.06% for the six month periods ended June 30, 2007 and 2006, respectively. The return on average equity was 5.70% and 13.33% for the six month periods ended June 30, 2007 and 2006, respectively.

For the six months ended June 30, 2007, net operating income was \$2.48 million, down slightly from \$2.51 million for the same period in 2006, and diluted net operating earnings per share was \$0.91 compared with \$0.92 last year.

**Supplemental Reporting of Non-GAAP Results of Operations**

In accordance with U.S. generally accepted accounting principles ( GAAP ), included in the computation of net income for the 2007 second quarter period were a \$1.41 million, or \$0.51 per diluted share, after-tax loss on the sale of securities and a \$0.11 million, or \$0.04 per diluted share, after-tax gain related to an adjustment in SFAS 91 loan fee income. Management considers these two items to be non-operating in nature and is therefore presenting supplemental reporting of its results on a net operating basis. This non-GAAP information is being disclosed because management believes that providing these non-GAAP financial measures provides investors with information useful in understanding the Company s financial performance, its performance trends, and financial position. Specifically, the Company provides measures based on net operating earnings, which excludes transactions and other revenues and expenses that management does not believe are reflective of ongoing operations or are not expected to recur. While the Company s management uses these non-GAAP measures in its analysis of the Company s performance, this information should not be viewed as a substitute for financial results determined in accordance with GAAP or considered to be more important than financial results determined in accordance with GAAP, nor is it necessarily comparable to non-GAAP measures which may be presented by other companies. A reconciliation of net (loss) income and diluted (loss) earnings per share with net operating income and diluted net operating earnings per share is provided in the following table.

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Table of Contents

23

**Reconciliation of GAAP Net (Loss) Income to Net Operating Income**

	<b>Three months ended June 30,</b>		<b>Increase (Decrease)</b>  (in thousands except per share data)	<b>Six months ended June 30,</b>		<b>Increase (Decrease)</b>
	<b>2007</b>	<b>2006</b>		<b>2007</b>	<b>2006</b>	
<b>GAAP Net (Loss) Income</b>	<b>(139)</b>	<b>1,071</b>		<b>1,148</b>	<b>2,477</b>	
Loss on sale of securities*	1,413			1,414		
Gain related to SFAS 91 loan fee income accounting error correction*	(106)	18		(79)	29	
<b>Net operating income</b>	<b>1,168</b>	<b>1,089</b>	<b>7.3%</b>	<b>2,483</b>	<b>2,506</b>	<b>-0.9%</b>
<b>GAAP diluted (loss) earnings per share</b>	<b>(0.05)</b>	<b>0.39</b>		<b>0.42</b>	<b>0.91</b>	
Loss on sale of securities*	0.51			0.52		
Gain related to SFAS 91 loan fee income accounting error correction*	(0.04)	0.01		(0.03)	0.01	
<b>Diluted net operating earnings per share</b>	<b>0.42</b>	<b>0.40</b>	<b>5.0%</b>	<b>0.91</b>	<b>0.92</b>	<b>-1.1%</b>

\* after any tax-related effect

As was announced on June 27, 2007, Evans sold \$45 million of investment securities at a loss in order to restructure its balance sheet to de-lever its investment in lower-margin assets, with the intention of reducing higher-cost wholesale borrowings. This transaction has provided excess capital compared with historical levels. Management may consider various alternatives for deploying this capital, including share buybacks, increased or special dividends, acquisitions, and other investment and capital management initiatives.

In the second quarter of 2007, the Company identified an error in its amortization of deferred loan fees in accordance with SFAS 91. The amortization of these fees was understated by \$173 thousand (\$106 thousand after tax) due to a systems error in 2005, 2006 and the first quarter of 2007. The correction of this error was recorded in the three months ended June 30, 2007 as a \$173 thousand increase to loan interest income. Income tax expense was increased by \$67 thousand, resulting in an increase in net income of \$106 thousand. Neither the origination nor the correction of the error was material to the financial statements.

Other Operating Results



Net interest income for the three and six month periods ended June 30, 2007 was \$4.2 million and \$8.1 million, respectively, an increase of \$0.6 million and \$0.8 million over the same periods in 2006. This is primarily a result of growth in the Bank's commercial loan portfolio, particularly its leasing portfolio, offset by increased interest expense on time deposits. \$0.1 million of the increase in both periods is attributable to an increase in SFAS 91 loan fee income from the error correction described above.

The net interest margin for the three and six month periods ended June 30, 2007 was 3.97% and 3.79%, respectively, as compared to 3.48% for the same periods in 2006. The return on interest earning assets increased 76 and 73 basis points in the three and six month periods ended June 30, 2007 due to the adjustment made to SFAS 91 loan fee income and a greater concentration of the loan portfolio being in higher-yielding leases. Interest free funds

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**Table of Contents**

24

contributed 65 basis points and 62 basis points in the three and six month periods ended June 30, 2007, respectively, due to an increase in average demand deposits and average shareholders' equity, compared to a 47 basis point and 45 basis point contribution in the same periods of 2006. The strong growth of loans and leases and demand deposits was offset by an increase in the Bank's cost of interest-bearing liabilities, which increased to 3.67% and 3.66% in the three and six month periods ended June 30, 2007, respectively, from 3.24% and 3.07% in the same periods of 2006. The rise in interest rates on time deposits was the primary driver of the increase in the cost of funds.

The provision for loan and lease losses for the three and six month periods ended June 30, 2007 increased to \$345 thousand and \$660 thousand, respectively, from \$228 thousand and \$510 thousand for the same periods in 2006. The increase was a result of continued commercial loan growth, particularly the Bank's expanding direct financing lease portfolio, through Evans National Leasing, which tends to have a higher credit risk than consumer loans and commercial loans collateralized by real estate.

Non-interest income was \$0.3 million for the three month period ended June 30, 2007, which is down \$2.2 million from \$2.5 million in the same period of 2006. Non-interest income was \$3.4 million for the six month period ended June 30, 2007, a decrease of \$2.2 million from the same period of 2006. The decline in the respective periods in 2007 is due to the loss of \$2.3 million realized on the sale of securities in June 2007. In addition, insurance fee revenue declined \$0.1 million for the three and six-month periods ended June 30, 2007 compared to the same periods in 2006. These were somewhat offset by increases in deposit service charges of \$71 thousand for the quarter and \$44 thousand for the year-to-date period, bank-owned life insurance income of \$49 thousand for the quarter and \$84 thousand for the year-to-date period, and other income of \$66 thousand for the quarter and \$107 thousand for the year-to-date period. The increase in other income was largely due to fee income on the expanding lease portfolio along with increased ATM and interchange fee revenue.

Non interest expense was \$4.7 million for three month period ended June 30, 2007, an increase of \$0.2 million or 5.1% from the same period in 2006. Non interest expense was \$9.6 million for the six month period ended June 30, 2007, an increase of \$0.7 million or 7.5% from the same period in 2006. Salary and employee benefit expense for the three and six month periods ended June 30, 2007 increased \$0.2 million and \$0.3 million, respectively, from the same periods in 2006, due to a new branch office opened in December 2006, management transition costs, and merit pay increases awarded in early 2007. Occupancy expenses also increased as a result of the new branch. Higher professional services expenses were the result of a market analysis for the Company's distribution network by a consultant, executive search, and investor relations consulting. Other expenses were up for the six month period ended June 30, 2007 largely as a result of the loss related to a branch operational error in processing checks incurred in the first quarter.

Income tax expense totaled \$46 thousand for the six month period ended June 30, 2007 for an effective tax rate of 3.9%. There was an income tax benefit of \$(435) thousand for the second quarter. The low effective tax rate for the year-to-date and the income tax benefit for the quarter were due to the loss on sale of securities of \$2.3 million incurred in the second quarter. Excluding the loss on sale of securities, the effective tax rate on all other income for the three-month and six-month periods ended June 30, 2007 was 26.3% and 26.7%, respectively, compared to 23.9% and 27.8% in the prior year. Excluding the loss on sale of securities, the Company records an effective tax rate for the period that will be reflective of the projected annual tax rate based on expected supportable tax positions.

**CAPITAL**

The Bank has consistently maintained regulatory capital ratios at, or above, federal well capitalized standards. Equity as a percentage of assets was 8.8% at June 30, 2007, up from 8.1% at March 31, 2007 and 8.3% at December 31, 2006. Book value per outstanding common share was \$14.94 at June 30, 2007, compared to \$14.71 at March 31, 2007, and \$14.46 at December 31, 2006. Total stockholders' equity was \$41.1 million at June 30, 2007, up from \$40.1 million at March 31, 2007 and \$39.5 million at December 31, 2006. The increase is primarily attributable to total comprehensive income of \$2.2 million in the six month period ended June 30, 2007, offset by \$0.9 million in dividends in the six month period ended June 30, 2006. The \$2.3 million realized loss (\$1.4 million after taxes) on the sale of securities in June 2007 did not change shareholders' equity in total as the loss was reclassified from

accumulated other comprehensive loss to retained earnings.

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**Table of Contents**

25

**LIQUIDITY**

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

Cash flows from the Bank's investment portfolio are laddered, so that securities mature at regular intervals, to provide funds from principal and interest payments at various times as liquidity needs may arise. Contractual maturities are also laddered, with consideration as to the volatility of market prices. At June 30, 2007, approximately 44.6% of the Bank's securities had contractual maturity dates of one year or less and approximately 66.7% had maturity dates of five years or less. The increased concentration in short-term securities is intended to be temporary as part of the Bank's de-leverage strategy. In June 2007, the Bank sold \$45 million in investment securities with an average maturity of 3.0 years. The Bank intends to allow a corresponding amount of municipal deposits to mature and not be replaced to complete the de-leverage. Until the municipal deposits roll off, the Bank is required to hold collateral to pledge against those municipal deposits. The Bank purchased short-term securities to pledge against those deposits resulting in the increased concentration in short-maturity securities. The Company believes that the Bank maintains a sufficient level of U.S. government and government agency securities and New York State municipal bonds that can be pledged as collateral for municipal deposits. Available assets of \$119.7 million, less public and purchased funds of \$169.5 million, resulted in a long-term liquidity ratio of 71% at June 30, 2007, versus 75% at March 31, 2007 and 80% at December 31, 2006.

The Company's liquidity needs can be met by more aggressively pursuing time deposits, or accessing the brokered time deposit market.

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

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

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

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



**Table of Contents**

26

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

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

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

	Calculated (decrease) increase in projected annual net interest income (in thousands)	
	June 30, 2007	December 31, 2006
Changes in interest rates		
+200 basis points	(668)	(853)
+100 basis points	(333)	(424)
-100 basis points	321	379
-200 basis points	470	551

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

**ITEM 4 CONTROLS AND PROCEDURES**

**DISCLOSURE CONTROLS AND PROCEDURES**

The Company's management, with the participation of the Company's principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on that evaluation, the Company's principal executive and principal financial officers concluded that the Company's disclosure controls and procedures as of June 30, 2007 (the end of the period covered by this Report) have been designed and are functioning effectively to provide reasonable assurance that the information required to be disclosed by the Company in its reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

**CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

No changes in the Company's internal control over financial reporting were identified in the fiscal quarter ended June 30, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents**

27

**PART II OTHER INFORMATION****ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****Sales of Unregistered Securities**

On April 13, 2007, the Company issued 7,983 shares of its common stock to Apcot NY, Inc. in connection with the earn-out components of Evans National Leasing's acquisition of M&C Leasing Co, Inc., pursuant to the terms of the asset purchase agreement made as of December 31, 2004, filed as Exhibit 10.22 to the Company's Form 10-K for the fiscal year ended December 31, 2004. The shares had an aggregate value of \$164,670 at the time of issuance, and were issued in reliance upon exemption from registration under Regulation D of the Securities Act of 1933, as amended.

**Issuer Purchases of Equity Securities**

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

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
April 2007 (April 1, 2007 through April 30, 2007)	400	\$ 20.09	400	41,215
May 2007 (May 1, 2007 through May 31, 2007)	5,400	\$ 20.14	5,400	35,815
June 2007 (June 1, 2007 through June 30, 2007)				35,815
Total	5,800	\$ 20.14	5,800	

All of the foregoing shares were purchased in open market transactions. On August 18, 2005, the Company announced that its Board of Directors authorized a common stock repurchase program, pursuant to which the Company may repurchase of up to 75,000 shares of the Company's common stock over the next two years, unless the program is terminated earlier. The Company did not make any repurchases during the quarter ended June 30, 2007 other than pursuant to this publicly announced program, and there were no other publicly announced plans or programs outstanding during the quarter ended June 30, 2007.

**Table of Contents**

28

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

The 2007 annual shareholders meeting of the registrant was held on April 26, 2007. At the meeting Phillip Brothman, Mary Catherine Militello, David M. Taylor, and Thomas H. Waring, Jr. were re-elected as directors for a term of three years, and David J. Nasca was elected a director for a term of three years. The following table reflects the tabulation of votes with respect to each director who was elected at the 2007 annual meeting.

Number of Votes

Director Nominees:	For:	Withheld:
Phillip Brothman	1,746,236	101,367
Mary Catherine Militello	1,739,219	108,384
David J. Nasca	1,740,097	107,506
David M. Taylor	1,776,243	71,360
Thomas H. Waring, Jr.	1,732,191	115,412

The following directors also continued their terms as directors of the Company following the 2007 annual shareholders meeting:

William F. Barrett  
 James E. Biddle, Jr.  
 LaVerne G. Hall  
 Kenneth C. Kirst  
 Robert G. Miller, Jr.  
 John R. O'Brien  
 James Tilley  
 Nancy W. Ware

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**Table of Contents**

29

**ITEM 6 EXHIBITS**

Exhibit No.	Name	Page No.
10.1	Employment Agreement between Evans National Bank and Gary A. Kajtoch (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on April 23, 2007)	
10.2	Restricted Stock Agreement between Evans Bancorp, Inc. and David J. Nasca (Incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed on April 23, 2007)	
10.3	First amendment to the Evans National Bank Executive Life Insurance Plan (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on May 2, 2007)	
10.4	Letter Agreement regarding Insurance Coverage for James Tilley filed herewith	32
31.1	Certification of Principal Executive Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.	33
31.2	Certification of the Principal Financial Officer pursuant to section 302 of The Sarbanes-Oxley Act of 2002.	34
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.	35
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.	36

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**Table of Contents**

30

**SIGNATURES**

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

Evans Bancorp, Inc.

DATE

August 14, 2007

/s/David J. Nasca

David J. Nasca  
President and CEO  
(On Behalf of the Registrant  
and  
as Principal Executive Officer)

DATE

August 14, 2007

/s/Gary A. Kajtoch

Gary A. Kajtoch  
Treasurer  
(Principal Financial Officer)

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**Table of Contents**

31

**Exhibit Index**

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