

BRIDGE BANCORP INC
Form 10-K
March 15, 2006

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

FORM 10-K

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

For the fiscal year ended Commission File No.
December 31, 2005 000-18546

BRIDGE BANCORP, INC.

(Exact name of registrant as specified in its charter)

NEW YORK 11-2934195
(State or other jurisdiction of (IRS Employer Identification
incorporation or organization) Number)

2200 MONTAUK 11932
HIGHWAY,
BRIDGEHAMPTON, NEW
YORK
(Address of principal (Zip Code)
executive offices)

Registrant's telephone number, including area code: (631) 537-1000

Securities registered under Section 12 (b) of the Exchange Act:

| Title of each class | Name of each exchange on which registered |
|---------------------|--|
| None | None |

Securities registered under Section 12 (g) of the Exchange Act:

Common Stock, Par Value of \$0.01 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.
Yes [] No [X]

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

Act. 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 (§229.405) of this chapter 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 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 Act). Yes No

The approximate aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the closing price of the Common Stock on June 30, 2005, was \$151,032,625.

The number of shares of the Registrant's common stock outstanding on March 7, 2006 was 6,203,587.

Portions of the following documents are incorporated into the Parts of this Report on Form 10-K indicated below:

The Registrant's definitive Proxy Statement for the 2006 Annual Meeting to be filed pursuant to Regulation 14A filed on or before April 30, 2006 (Part III).

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PART I

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held April 28, 2006, dated March 24, 2006, are incorporated by reference into Part III.

Item 1. Business

Bridge Bancorp, Inc. (the “Registrant” or “Company”) is a registered bank holding company and is the holding company for The Bridgehampton National Bank (the “Bank”). The Bank was established in 1910 as a national banking association and is headquartered in Bridgehampton, New York. The Registrant was organized as a New York business corporation and incorporated under the laws of the State of New York in 1988, at the direction of the Board of Directors of the Bank for the purpose of becoming a bank holding company pursuant to a plan of reorganization; under which the former shareholders of the Bank became the shareholders of the Company. Since commencing business in March 1989, after the reorganization, the Registrant has functioned primarily as the holder of all of the Bank’s common stock. In May 1999, the Bank established a real estate investment trust subsidiary, Bridgehampton Community, Inc. (“BCI”). The assets transferred to BCI are viewed by the regulators as part of the Bank’s assets in consolidation. The operations of the Bank also include a financial subsidiary, a 100% ownership in an investment in Bridge Abstract LLC (“Bridge Abstract”). Prior to April 1, 2004, Bridgehampton Abstract Holding LLC, which was 100% owned by the Bank and was dissolved January 1, 2005, had a 51% ownership interest in Bridge Abstract. The mission of the Company is to achieve excellence in financial performance and build long-term shareholder value through a steadfast commitment to its employees, its customer relationships, and the community.

The Bank operates twelve branches on eastern Long Island. Federally chartered in 1910, the Bank was founded by local farmers and merchants. For nearly a century, the Bank has maintained its focus on building customer relationships on eastern Long Island. The Bank engages in full service commercial and consumer banking business, including accepting time and demand deposits from the consumers, businesses and local municipalities surrounding its branch offices. These deposits, together with funds generated from operations and borrowings, are invested primarily in (1) commercial real estate loans; (2) home equity loans; (3) construction loans; (4) residential mortgages; (5) secured and unsecured commercial and consumer loans; (6) FHLB, FNMA, and FHLMC mortgage-backed securities; (7) New York State and local municipal obligations; and (8) U.S. Treasury and government agency securities. In addition, the Bank offers merchant credit and debit card processing, automated teller machines, cash management services, online banking services, safe deposit boxes and individual retirement accounts. Through its title insurance abstract subsidiary, the Bank acts as a broker for title insurance services. The Bank’s customer base is comprised principally of small businesses as well as consumer relationships.

At present, the Registrant has no paid employees. The Bank employs 131 people on a full-time and part-time basis. The Bank provides a variety of employment benefits and considers its relationship with its employees to be positive.

All phases of the Bank’s business are highly competitive. The Bank faces direct competition from a significant number of financial institutions operating in its market area, many with a statewide or regional presence, and in some cases, a national presence. Most of these competitors are significantly larger than the Bank, and therefore have greater financial and marketing resources and lending limits than those of the Bank. The fixed cost of regulations remains high for community banks as compared to their larger competitors when spread over the much smaller customer base of a community bank. The Bank considers its major competition to be local commercial banks as well as other commercial banks with branches in the Bank’s market area. Other competitors include mortgage brokers and financial services firms other than financial institutions such as investment and insurance companies. Increased competition within the Bank’s market areas may limit growth and profitability. Additionally, as the Bank’s market area expands

westward, competitive pressure in new markets is expected to be strong. The title insurance abstract subsidiary also faces competition from other brokers of title insurance as well as directly from the companies that underwrite title insurance. In New York State, title insurance is obtained on most transfers of real estate and most mortgage transactions.

The Bank's market area is located on eastern Long Island. Although the Bank does maintain some customer relationships in Riverhead, Brookhaven and Shelter Island towns at this time, the majority of its customer base and all of its existing branches are located in the towns of Southampton, East Hampton, and Southold. In December 2005, the Company opened a branch facility in Westhampton Beach. Geographically this location moves the Bank westward and demonstrates the commitment to traditional growth through branch expansion. The Bank purchased property to construct new branch facilities in the Village of Southampton, the Village of East Hampton, and the Town of Southold. During the third quarter of 2005, the Company broke ground on a state-of-the-art branch facility in the Village of Southampton. Plans for a new East Hampton branch are in the municipal approval process. The Bank continues to add to its menu of products and services that meet the needs of consumers and businesses. During the third quarter of 2005, the Bank introduced payroll services for its commercial customers through a third-party provider. Management continues to

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make strategic decisions that position the Company for managed balance sheet growth going forward and that further support the return of long term value to shareholders.

Eastern Long Island is semi-rural. Surrounded by water and including the Hamptons and North Fork, the region is a recreational destination for the New York metropolitan area, and a highly regarded resort locale world-wide. Traditionally, the local economy has flourished in the summer months as a result of the influx of tourists and second homeowners. In recent years, the year-round population has grown considerably resulting in less seasonal fluctuations in the economy. Industries represented in the marketplace include retail establishments; construction and trades; restaurants and bars; lodging and recreation; professional entities; real estate; health services; passenger transportation and agricultural and related businesses. During the last decade, the Long Island wine industry has matured with an increasing number of new wineries and vineyards locating in the region each year. The vast majority of businesses are considered small businesses employing fewer than ten full-time employees. In recent years, more national chains have opened retail stores within the villages on the north and south forks of the island. Major employers in the region include the municipalities, school districts, hospitals, and financial institutions.

The Company, the Bank and its subsidiaries with the exception of the real estate investment trust, which files its own federal and state tax return, report their income on a consolidated basis using the accrual method of accounting and are subject to federal and state income taxation. In general, banks are subject to federal income tax in the same manner as other corporations. However, gains and losses realized by banks from the sale of available for sale securities are generally treated as ordinary income, rather than capital gains or losses. Additionally, the Company can exclude from its income 100% of dividends received from the Bank as a member of the same affiliated group. The Bank is subject to the New York State Franchise Tax on Banking Corporations based on certain criteria. The taxation of net income is similar to federal taxable income subject to certain modifications.

REGULATION AND SUPERVISION

The Bridgehampton National Bank is chartered by and is subject to extensive regulation, examination and supervision by the Office of the Comptroller of the Currency (the "OCC"). The Bank is a member of the Federal Home Loan Bank of New York and its deposit accounts are insured up to applicable limits by the Federal Deposit Insurance Corporation (the "FDIC"). The Bank also is a member of the Federal Reserve System. The Bank must file reports with the OCC concerning its activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with, or acquisitions of, other financial institutions. There are periodic examinations by the OCC to test the compliance with various regulatory requirements.

The Bank is subject to various statutory requirements and rules and regulations promulgated and enforced primarily by the OCC and to a lesser extent the FDIC. These statutes, rules and regulations relate to insurance of deposits, minimum capital requirements, allowable investments, lending authority, mergers, consolidations, issuance of securities, payment of dividends, establishment of branches and other aspects of our business.

This regulation and supervision establishes a comprehensive framework of activities in which the Bank may engage and is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves.

Bridge Bancorp, Inc., as a bank holding company controlling the Bank, is subject to the Bank Holding Company Act of 1956, as amended ("BHCA"), and the rules and regulations of the Federal Reserve Board under the BHCA applicable to bank holding companies. The Company is required to file reports with, and otherwise comply with the rules and regulations of the Federal Reserve Board. 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 insurance fund and depositors. 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 laws and regulations, whether by the OCC, the FDIC, the Federal Reserve Board or through legislation, could have a material adverse impact on the Bank and the Company and their operations and stockholders. Additional information on regulatory requirements is set forth in Note 11 to the Consolidated Financial Statements.

Bridge Bancorp, Inc. had nominal results of operations for 2005, 2004 and 2003 on a parent-only basis. Equity incentive plan grants of stock options and stock awards are recorded directly to the holding company. In the event the Company subsequently expands its current operations, its sources of funds will be dependent on dividends from the Bank, its own earnings, additional capital raised and borrowings. The information in this report reflects principally the financial condition and results of operations of the Bank. The Bank's results of operations are primarily dependent on its net interest income. The Bank also generates other income, such as fee income on deposit accounts and merchant credit and debit card processing programs, income from its title insurance abstract subsidiary, and net gains on sales of securities and loans. The level of its other expenses, such as salaries and benefits, occupancy and equipment

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costs, other general and administrative expenses, expenses from its title insurance abstract subsidiary, and income tax expense, further affects the Bank's net income.

The Company files certain reports with the Securities and Exchange Commission under the federal securities laws. The Company's operations are also subject to extensive regulation by other federal, state and local governmental authorities and it is subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of its operations. Management believes that the Company is in substantial compliance, in all material respects, with applicable federal, state and local laws, rules and regulations. Because the Company's business is highly regulated, the laws, rules and regulations applicable to it are subject to regular modification and change. There can be no assurance that these proposed laws, rules and regulations, or any other laws, rules or regulations, will not be adopted in the future, which could make compliance more difficult or expensive or otherwise adversely affect the Company's business, financial condition or prospects.

EXECUTIVE OFFICERS

| Name | Positions held with the Company |
|---------------------|---|
| Thomas J. Tobin | President and Chief Executive Officer |
| Janet T. Verneuille | Senior Vice President and Chief Financial Officer and Treasurer |

Biographical information of executive officers of the Company who are not directors is as follows:

Janet T. Verneuille, age 45, has served as the Company's Senior Vice President since January 2000 and Chief Financial Officer since January 2001 and as Treasurer of the Company since March 2003. Ms. Verneuille served as Vice President and Controller of the Company from October 1995 to 2001.

OTHER INFORMATION

Through a link on the Investor Relations section of the Bank's website of www.bridgenb.com, copies of the Company's Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) for 15(d) of the Exchange Act, are made available, free of charge, as soon as reasonably practicable after electronically filing such material with, or furnishing it to, the Securities and Exchange Commission. Copies of such reports and other information also are available at no charge to any person who requests them or at www.sec.gov. Such requests may be directed to Bridge Bancorp, Inc., Investor Relations, 2200 Montauk Highway, PO Box 3005, Bridgehampton, NY 11932, (631) 537-1000.

CORPORATE GOVERNANCE

The Company has a Code of Ethics, which applies to all directors, officers, and employees. The Code of Ethics is posted on the Bank's website at www.bridgenb.com.

Item 1A. Risk Factors

Concentration of Loan Portfolio

The Bank generally invests a greater proportion of our assets in loans secured by commercial and residential real estate properties located in eastern Long Island. A downturn in real estate values and economic conditions on eastern Long Island could have a significant impact on the value of collateral securing the loans as well as the ability for the repayment of loans. See a further discussion in “Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations - Financial Condition - Loans.”

Changes in Interest Rates Could Affect Profitability

The ability to earn a profit, like most financial institutions, depends on the net interest income, which is the difference between the interest income that the Bank earns on its interest-bearing assets, such as loans and investments, and the interest expense which we pay on our interest-bearing liabilities, such as deposits. Our profitability depends on our ability to manage our assets and liabilities during periods of changing market interest rates.

A sustained decrease in market interest rates could adversely affect our earnings. When interest rates decline, borrowers tend to refinance higher-rate, fixed-rate loans at lower rates. Under those circumstances, we would not be able to reinvest those prepayments in assets earning interest rates as high as the rates on those prepaid loans or in investment securities. In addition, the majority of our loans are at variable interest rates, which would adjust to lower rates.

In a period of rising interest rates, the interest income earned on our assets may not increase as rapidly as the interest paid on our

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liabilities. We are vulnerable to volatility in our earnings as a result of an increase in interest rates as the Bank has an asset-sensitive balance sheet. In an increasing interest rate environment, our cost of funds is expected to increase more rapidly than interest earned on our loan and investment portfolio as the primary source of funds is deposits with generally shorter maturities than those on our loans and investments.

Geographic Location

The Bank's market area is in the eastern end of Long Island and its customer base is mainly located in the towns of East Hampton, Southampton and Southold. Competition in the banking and financial services industry is intense. The profitability of the Bank depends on the continued ability to successfully compete. The Bank competes with commercial banks, savings banks, insurance companies, and brokerage and investment banking firms. Many of our competitors have substantially greater resources and lending limits than the Bank and may offer certain services that the Bank does not provide. In addition competitors recently have been offering loans with lower fixed rates and loans with more attractive terms and a loose credit structure than the Bank has been willing to offer. Additionally, the high cost of living on the twin forks of eastern Long Island creates staff recruitment and retention challenges.

The Loss of Key Personnel Could Impair our Future Success

Our future success depends in part on the continued service of our executive officers, other key management, as well as our staff, and on our ability to continue to attract, motivate, and retain additional highly qualified employees. The loss of services of one or more of our key personnel or our inability to timely recruit replacements for such personnel, or to otherwise attract, motivate, or retain qualified personnel could have an adverse effect on our business, operating results, and financial condition.

Highly Regulated Environment

We are subject to extensive regulation, supervision and examination by the OCC, FDIC, the Federal Reserve Board and the Securities and Exchange Commission. Such regulation and supervision govern the activities in which a financial institution and its holding company may engage and are intended primarily for the protection of the consumer. Recently regulators have intensified their focus on the USA PATRIOT Act's anti-money laundering and Bank Secrecy Act compliance requirements. In order to comply with regulations, guidelines and examination procedures in this area as well as other areas of the Bank, we have been required to adopt new policies and procedures and to install new systems. We cannot be certain that the policies, procedures, and systems we have in place are flawless and there is no assurance that in every instance we are in full compliance with these requirements. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of an institution. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, may have a material impact on our operations.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

At present, the Registrant does not own or lease any property. The Registrant uses the Bank's space and employees without separate payment. Headquarters are located at 2200 Montauk Highway, Bridgehampton, New York 11932. The Bank's internet address is www.bridgenb.com

The Bank's Main Office is owned. The Bank also owns buildings that house its Montauk Branch located at 1 The Plaza, Montauk, New York; its Southold Branch located at 54790 Main Road, Southold, New York; and its Westhampton Beach Office at 194 Mill Road, Westhampton Beach, New York. The Bank currently leases out a portion of the Montauk building. The Bank leases seven additional properties as branch locations at 26 Park Place,

East Hampton, New York; 218 Front Street, Greenport, New York; 48 East Montauk Highway, Hampton Bays, New York; Mattituck Plaza, Main Road, Mattituck, New York; 2 Bay Street, Sag Harbor, New York; 425 County Road 39A, Southampton, New York; and 94 Main Street, Southampton, New York. Additionally, the Bank utilizes space for a branch in Peconic Landing, 1500 Brecknock Road, Greenport, New York.

In 2002, the Bank purchased property in the Village of Southampton and construction began in December 2005 on a new facility. In 2003, the Bank purchased property in the Village of East Hampton. The Bank entered into a contract for the purchase of real estate in the Town of Southold. The Bank plans to construct new branches at these locations.

Item 3. Legal Proceedings

The Registrant and its subsidiary are subject to certain pending and threatened legal actions that arise out of the normal course of business. In the opinion of management at the present time, the resolution of any pending or threatened litigation will not have a material adverse effect on its financial condition or results of operations.

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

No matters were submitted to a vote of the shareholders during the fourth quarter of the fiscal year covered by this report.

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The Company's common stock is traded on the NASDAQ® over the counter bulletin board market under the symbol, "BDGE." The following table details the quarterly high and low bid prices of the Company's common stock and the dividends declared for such periods.

At December 31, 2005 the Company had approximately 663 shareholders of record, not including the number of persons or entities holding stock in nominee or the street name through various banks and brokers.

COMMON STOCK INFORMATION

| | Stock Prices | | Dividends |
|------------|--------------|---------|-----------|
| | High | Low | Declared |
| By Quarter | | | |
| 2005 | | | |
| First | \$32.60 | \$30.20 | \$0.22 |
| Second | \$31.75 | \$26.20 | \$0.23 |
| Third | \$29.50 | \$26.10 | \$0.23 |
| Fourth | \$26.50 | \$24.25 | \$0.23 |

| | Stock Prices | | Dividends |
|------------|--------------|---------|-----------|
| | High | Low | Declared |
| By Quarter | | | |
| 2004 | | | |
| First | \$27.23 | \$22.50 | \$0.16 |
| Second | \$30.83 | \$25.47 | \$0.17 |
| Third | \$30.25 | \$27.00 | \$0.18 |
| Fourth | \$30.75 | \$28.75 | \$0.21 |

Amounts have been restated for a three-for-two stock split, in the form of a stock dividend, effective July 9, 2004.

ISSUER PURCHASES OF EQUITY SECURITIES

| Period | Total Number of Shares Purchased in Month | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced | Maximum Number (or Approximate Dollar Value) of Shares that |
|--------|---|------------------------------|--|---|
| | | | | |

| | | | Plans or Programs-2004 (1) | May Yet Be Purchased Under the Plans or Programs |
|------------------|-------|---------|----------------------------------|--|
| October 2005 | | | 83,106 | 97,704 |
| November 2005 | 9,820 | \$24.61 | 92,926 | 87,884 |
| December 2005 | 4,500 | \$26.05 | 97,426 | 83,384 |

(1) The Board of Directors reaffirmed the stock repurchase program on May 17, 2004.

- The Board of Directors approved repurchase of shares up to 180,810 shares.
- There is no expiration date for the stock repurchase plan.
- There is no stock repurchase plan that has expired nor been terminated during the period ended December 31, 2005.

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Item 6. Selected Financial Data

Five-Year Summary of Operations

(In thousands, except per share data and financial ratios)

Set forth below are selected consolidated financial and other data of the Company. The Company's business is primarily the business of the Bank. This financial data is derived in part from, and should be read in conjunction with, the Consolidated Financial Statements of the Company.

| December 31, | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|------------------|-----------|-----------|-----------|-----------|
| Selected Financial Data: | | | | | |
| Securities available for sale | \$184,178 | \$204,021 | \$195,341 | \$182,416 | \$127,102 |
| Securities held to maturity | 10,012 | 21,213 | 14,396 | 11,023 | 16,159 |
| Total loans | 302,264 | 296,134 | 273,188 | 248,388 | 215,362 |
| Total assets | 533,444 | 547,200 | 511,613 | 463,986 | 393,523 |
| Total deposits | 468,025 | 469,311 | 457,159 | 406,409 | 357,155 |
| Total stockholders' equity | 46,651 | 47,213 | 42,794 | 39,971 | 32,861 |
| Year Ended December 31, | | | | | |
| Selected Operating Data: | | | | | |
| Total interest income | \$ 28,713 | \$ 26,923 | \$ 25,968 | \$ 26,486 | \$ 27,009 |
| Total interest expense | 4,319 | 2,351 | 2,601 | 4,490 | 7,868 |
| Net interest income | 24,394 | 24,572 | 23,367 | 21,996 | 19,141 |
| Provision for loan losses | 300 | 300 | - | 220 | 323 |
| Net interest income after provision for loan losses | 24,094 | 24,272 | 23,367 | 21,776 | 18,818 |
| Total other income | 5,105 | 5,440 | 4,716 | 3,405 | 2,419 |
| Total other expenses | 14,647 | 13,564 | 12,997 | 11,942 | 11,198 |
| Income before income taxes | 14,552 | 16,148 | 15,086 | 13,239 | 10,039 |
| Provision for income taxes | 4,929 | 5,771 | 5,488 | 4,722 | 3,292 |
| Net income | \$ 9,623 | \$ 10,377 | \$ 9,598 | \$ 8,517 | \$ 6,747 |
| December 31, | | | | | |
| Selected Financial Ratios and Other Data: | | | | | |
| Return on average equity | 20.15% | 22.82% | 22.58% | 23.93% | 21.41% |
| Return on average assets | 1.76% | 1.89% | 1.91% | 1.90% | 1.73% |
| Average equity to average assets | 8.71% | 8.30% | 8.46% | 7.96% | 8.06% |
| Dividend payout ratio ⁽¹⁾ | 58.88% | 43.39% | 50.98% | 29.57% | 34.27% |
| Diluted earnings per share | \$1.53 | \$1.64 | \$1.53 | \$1.37 | \$1.07 |
| Basic earnings per share | \$1.54 | \$1.66 | \$1.55 | \$1.38 | \$1.07 |
| Cash dividends declared per common share ⁽¹⁾ | \$0.91 | \$0.72 | \$0.78 | \$0.41 | \$0.37 |

(1) On December 15, 2003, the Company declared a special dividend of approximately \$1,660,000, or \$0.27 per share.

Amounts have been restated for a three-for-two stock split, in the form of a stock dividend, effective July 9, 2004.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

PRIVATE SECURITIES LITIGATION REFORM ACT SAFE HARBOR STATEMENT

This report may contain statements relating to the future results of the Company (including certain projections and business trends) that are considered "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995 (the "PSLRA"). Such forward-looking statements, in addition to historical information, which involve risk and uncertainties, are based on the beliefs, assumptions and expectations of management of the Company. Words such as "expects," "believes," "should," "plans," "anticipates," "will," "potential," "could," "intend," "may," "outlook," "predict," "estimates," "assumes," "likely," and variations of such similar expressions are intended to identify such forward-looking statements. Examples of forward-looking statements include, but are not limited to, possible or assumed estimates with respect to the financial condition, expected or anticipated revenue, and results of operations and business of the Company, including earnings growth; revenue growth in retail banking, lending and other areas; origination volume in the Company's consumer, commercial and other lending businesses; current and future capital management programs; non-interest income levels, including fees from the abstract subsidiary and banking services as well as product sales; tangible capital generation; market share; expense levels; and other business operations and strategies. For this presentation, the Company claims the protection of the safe harbor for forward-looking statements contained in the PSLRA.

Factors that could cause future results to vary from current management expectations include, but are not limited to, changing economic conditions; legislative and regulatory changes; monetary and fiscal policies of the federal government; changes in tax policies; rates and regulations of federal, state and local tax authorities; changes in interest rates; deposit flows; the cost of funds; demand for loan products; demand for financial services; competition; changes in the quality and composition of the Bank's loan and investment portfolios; changes in management's business strategies; changes in accounting principles, policies or guidelines; changes in real estate values and other factors discussed elsewhere in this report, and in other reports filed by the Company with the Securities and Exchange Commission. The forward-looking statements are made as of the date of this report, and the Company assumes no obligation to update the forward-looking statements or to update the reasons why actual results could differ from those projected in the forward-looking statements.

OVERVIEW

Net income for 2005 was \$9,623,000 or diluted earnings per share of \$1.53 as compared to \$10,377,000 or \$1.64 per share for 2004. Net earnings declined from the prior year-end by 7.3% or \$754,000. Return on average equity and return on average assets were 20.15% and 1.76% for 2005 respectively as compared to 22.82% and 1.89% for 2004.

2005 proved most challenging of recent years for the Company. The flat yield curve caused pressure on the net interest margin and, consequently, the Company continued its strategy to limit balance sheet growth and let the more volatile and increasingly expensive deposits run off the balance sheet. As anticipated, total assets at year-end 2005 decreased slightly from the prior year-end to \$533,444,000. Average assets were relatively flat year over year.

Significant accomplishments during 2005 include:

- Continued high performance with return on average equity of 20.15% and return on average assets of 1.76%
- Balance sheet management to avoid further declines of the net interest margin
 - Demand deposit increase of 20.2%
 - Maintenance of superior credit quality
 - Efficiency ratio of 48.03%
- Gross revenue growth in the title insurance abstract subsidiary of 49.3%
- Opening of the Westhampton Beach branch

· Effective capital management

The flattening of the yield curve caused by rising short-term rates combined with falling long-term rates during 2005 resulted in net interest margin compression and a decrease in earnings. As expected, the net interest margin declined to 4.9% for the year ended December 31, 2005 from 5.0% for the year ended December 31, 2004. The flattening yield curve caused an increase in the cost of funds without a commensurate increase in the yield on assets. Because the Company's interest bearing liabilities repriced or matured more quickly than its interest earning assets, an increase in interest rates generally resulted in a decrease in net interest income. As additional competitors vied for deposit growth during 2005, interest rates on deposits in the market place increased. The high cost of deposits as a funding source, coupled with flat yields at the long-end of the curve resulted in less attractive investment opportunities.

Net interest income was \$24,394,000 in 2005 compared to \$24,572,000 in 2004 and \$23,367,000 in 2003. The decrease of only 0.7% over 2004 reflects the stabilization of the net interest margin despite the continued flat yield curve.

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Competition in our market areas continued to intensify throughout 2005. Merger and acquisition activity and expansion of financial institutions in our region brought new financial institutions into our market area in recent years. The majority of our competitors are larger than the Bank, and many execute different business strategies. Although Bank products and services are competitively priced, the Bank continues to focus on a relationship-based business model that underscores the value of individualized service.

Building long term relationships with our customers remains essential to the Bank's brand. Key to the Bank's ability to attract and retain customer relationships is the accessibility and responsiveness of our officers and staff. Expanding our branch network and developing lines of business that complement the Bank's core products are fundamental objectives of the Bank's overall business development strategy. Commitment to community involvement further differentiates the Bank in existing and new markets and continues to be integral to the Company's corporate culture.

Although total deposits decreased 0.3% at year-end 2005 from the same date the prior year, demand deposits increased \$32,060,000 year over year, bringing demand deposits as a percentage of total deposits to 40.7%. Average total deposits decreased slightly by 1.0% in 2005 versus the prior year. Average cost of interest bearing liabilities increased to 1.4% for 2005, from 0.7% for the year ended December 31, 2004.

The rate of loan growth for 2005 was slower than the prior two years reflecting increased competition for quality credits within our market area. However, the Bank experienced growth in its core business, with increases in average net loans of 5.2% in 2005 compared to 2004. The Company recently redeployed and expanded its team of lenders to foster loan growth going forward. Notwithstanding intense competition for commercial and consumer credits in the market place, the Company grew total loans 2.1% or \$6,130,000 for the year ended December 31, 2005 over December 31, 2004.

The Bank added \$300,000 to the allowance for loan losses during 2005. The loan loss reserve remains healthy relative to existing nonperforming assets as compared to our peers, and the provision for loan loss for 2005 was consistent with the provision in 2004. The Bank's loan portfolio is heavily weighted toward real estate and real estate collateralized loans. As such, management carefully monitors the loan portfolio as well as real estate trends on eastern Long Island. By maintaining conservative underwriting criteria, the Company believes it will be better positioned against declining credit quality should there be a weakening of the local real estate market.

While the Bank continues to expand its market presence and product offerings, efficiency of operations remains a priority. The efficiency ratio was 48.03% for 2005. Through branch expansion and growth in existing markets, the Company expects increasing low cost stable deposits to fuel asset growth resulting in improvements to net interest income. The fourth quarter 2005 opening of the Bank's Westhampton Beach facility introduced the Bank's first branch to incorporate an on-premises café. In addition, the Bank has four new market opportunities currently in various stages of development with projected completion dates over the next two years. The Bank's branch expansion plans include entry into high growth markets that meet its competitive niche. Other investments include improvement of facilities in the Bank's existing markets to facilitate growth objectives. During the fourth quarter of 2005, the Company started construction on a state-of-the-art branch facility in Southampton Village. Plans for a new East Hampton branch are in the municipal approval process.

The Bank continues to add to its menu of products and services that meet the needs of consumers and businesses. During the third quarter of 2005, payroll services for commercial customers were introduced via a third party provider.

Other financial results include a 6.2% decrease in other income for 2005. For the year ended December 31, 2005, net gains from sales of securities available for sale totaled \$116,000 as compared to \$734,000 in 2004. Bridge Abstract continues to represent strong potential for non interest income, and the Bank continues to broaden its client base to

protect its revenue stream in the event of a softening of the local real estate market. Total other expenses increased by \$1,083,000 or 8.0% over last year. These increases resulted primarily from increased salaries and benefit expenses in 2005, as well as increased professional fees primarily from the costs associated with the review of executive compensation. Salaries and benefits increases reflected unusually low costs in 2004 from unfilled management positions that were subsequently filled in 2005, coupled with additional staff to support the expansion of the branch network and growth in business lines such as the title insurance abstract subsidiary in 2005. In addition, with the unanticipated departure of the Chief Operating Officer in the fourth quarter of 2005, an accrual for related severance was recorded at that time. The Board of Directors intends to fill the unanticipated vacancy of the Chief Operating Officer position.

Stockholders' equity totaled \$46,651,000 at December 31, 2005 as compared to \$47,213,000 at December 31, 2004. With a Tier 1 Capital to Average Assets ratio of 9.1%, the Company's strong capital level allowed it to benefit from opportunities to buy back shares of Company stock under its Board approved stock repurchase program. Although the average equity to average assets is high as compared to the prior four years, capital management strategies consider the support of expected asset growth in the near and long term as well as the sustainability of dividends.

The Company continued its trend of uninterrupted dividends through 2005. Dividends declared in 2005 of \$0.91 per share increased

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26.4% over the prior year. The dividend was raised in the first quarter and remained constant for the second, third and fourth quarters resulting in a payout ratio of 58.9%. Increasing the payout ratio returns shareholders' capital investment at a more rapid rate while maintaining the safety and soundness of the Company. The dividend provided an annual yield of 3.68% at December 31, 2005. During 2004, the Company re-approved its stock repurchase plan, which permits the repurchase of up to 5.0% of its outstanding shares or 180,810 shares. During 2005, 75,926 shares were repurchased. Cash dividends of \$5,666,000 were declared during 2005.

The Company's shareholder base consists mainly of retail shareholders and the Company is unaware of any stockholder owning more than 5% of the outstanding shares. Many shareholders have held shares of Bridge Bancorp, Inc. over the long term. Throughout economic cycles, we encourage shareholders to evaluate total return over incremental periods of time. Total return on the Company's stock for the one year ended December 31, 2005 was a negative 16.5%. Total return over the three year period ended December 31, 2005 was 82.0%, and for the five year period ended December 31, 2005 the total return on shares of Bridge Bancorp, Inc. was 165.7%. The total return earned over these periods assumes all realized dividends are reinvested into the security. As with many small cap public bank holding companies, the Company's average daily trading volume remains lower when compared to larger more actively traded public companies.

During 2006, we are realistic yet positive as we anticipate continued pressure on the net interest margin and therefore on earnings. Management's focus remains on disciplined balance sheet growth primarily from the increases in consumer and commercial deposits; net interest margin management; maintenance of a strong credit culture; and operational efficiency while optimizing opportunities for near term and future growth.

The discussion and analysis in this report should be read in conjunction with the Consolidated Financial Statements, the notes thereto and the other financial information included elsewhere in this filing. Certain reclassifications have been made to prior year amounts, and the related discussion and analysis, to conform to the current year presentation. The Company's results of operations are significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government policies, changes in accounting standards, and actions of regulatory agencies.

CRITICAL ACCOUNTING POLICIES

Note 1 to our Consolidated Financial Statements for the year ended December 31, 2005 contains a summary of our significant accounting policies. Various elements of our accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. Our policy with respect to the methodologies used to determine the allowance for loan losses is our most critical accounting policy. This policy is important to the presentation of our financial condition and results of operations, and it involves a higher degree of complexity and requires management to make difficult and subjective judgments, which often require assumptions or estimates about highly uncertain matters. The use of different judgments, assumptions and estimates could result in material differences in our results of operations or financial condition.

The following is a description of our critical accounting policy and an explanation of the methods and assumptions underlying its application.

ALLOWANCE FOR LOAN LOSSES

Management considers the accounting policy on loans and the related allowance for loan losses to be the most critical and requires complex management judgment as discussed below. The judgments made regarding the allowance for loan losses can have a material effect on the results of operations of the Company.

The allowance for loan losses is established and maintained through a provision for loan losses based on probable incurred losses inherent in the Bank's loan portfolio. Management evaluates the adequacy of the allowance on a quarterly basis. The allowance is comprised of both individual valuation allowances and loan pool valuation allowances. If the allowance for loan losses is not sufficient to cover actual loan losses, the Company's earnings could decrease.

The Bank monitors its entire loan portfolio on a regular basis, with consideration given to detailed analysis of classified loans, repayment patterns, probable incurred losses, past loss experience, current economic conditions, and various types of concentrations of credit. Additions to the allowance are charged to expense and realized losses, net of recoveries, are charged to the allowance.

Individual valuation allowances are established in connection with specific loan reviews and the asset classification process including the procedures for impairment testing under Statement of Accounting Standard ("SFAS") No. 114, "Accounting by Creditors for Impairment of a Loan, an Amendment of FASB Statements No. 5 and 15," and SFAS No. 118, "Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures, an Amendment of SFAS No. 114." Such valuation, which includes a review of loans for which full collectibility in accordance with contractual terms is not reasonably assured, considers the estimated fair value of the underlying collateral less the costs to sell, if any, or the present value of expected future cash flows, or the loan's

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observable market value. Any shortfall that exists from this analysis results in a specific allowance for the loan. Pursuant to our policy, loan losses must be charged-off in the period the loans, or portions thereof, are deemed uncollectible. Assumptions and judgments by management, in conjunction with outside sources, are used to determine whether full collectibility of a loan is not reasonably assured. These assumptions and judgments also are used to determine the estimates of the fair value of the underlying collateral or the present value of expected future cash flows or the loan's observable market value. Individual valuation allowances could differ materially as a result of changes in these assumptions and judgments. Individual loan analyses are periodically performed on specific loans considered impaired. The results of the individual valuation allowances are aggregated and included in the overall allowance for loan losses.

Loan pool valuation allowances represent loss allowances that have been established to recognize the inherent risks associated with our lending activities, but which, unlike individual allowances, have not been allocated to particular problem assets. Pool evaluations are broken down as follows: first, loans with homogenous characteristics are pooled by loan type and include home equity loans, residential mortgages, land loans and consumer loans. Then all remaining loans are segregated into pools based upon the risk rating of each credit. Key factors in determining a credit's risk rating include management's evaluation of: cash flow, collateral, guarantor support, financial disclosures, industry trends and management. The determination of the adequacy of the valuation allowance is a process that takes into consideration a variety of factors. The Bank has developed a range of valuation allowances necessary to adequately provide for probable incurred losses inherent in each pool of loans. We consider our own charge-off history along with the growth in the portfolio as well as the Bank's credit administration and asset management philosophies and procedures when determining the allowances for each pool. In addition, we evaluate and consider the impact that existing and projected economic and market conditions may have on the portfolio as well as known and inherent risks in the portfolio. Finally, we evaluate and consider the allowance ratios and coverage percentages of both peer group and regulatory agency data. These evaluations are inherently subjective because, even though they are based on objective data, it is management's interpretation of that data that determines the amount of the appropriate allowance. If the evaluations prove to be incorrect, the allowance for loan losses may not be sufficient to cover losses inherent in the loan portfolio, resulting in additions to the allowance for loan losses.

The Classification Committee is comprised of both members of management and the Board of Directors. The adequacy of the reserves is analyzed quarterly, with any adjustment to a level deemed appropriate by the Classification Committee, based on its risk assessment of the entire portfolio. Based on the Classification Committee's review of the classified loans and the overall reserve levels as they relate to the entire loan portfolio at December 31, 2005, management believes the allowance for loan losses has been established at levels sufficient to cover the probable incurred losses in the Bank's loan portfolio. Future additions or reductions to the allowance may be necessary based on changes in economic, market or other conditions. Changes in estimates could result in a material change in the allowance. In addition, various regulatory agencies, as an integral part of the examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize adjustments to the allowance based on their judgments of the information available to them at the time of their examination.

For additional information regarding our allowance for loan losses, see Note 3 to the Consolidated Financial Statements.

NET INCOME

Net income for 2005 totaled \$9,623,000 or \$1.53 per diluted share while net income for 2004 totaled \$10,377,000, or \$1.64 per diluted share, as compared to net income of \$9,598,000 or \$1.53 per diluted share for the year ended December 31, 2003. Net income decreased \$754,000 or 7.3% as compared to 2004 and net income for 2004 increased \$779,000 or 8.1% over 2003. Significant trends for 2005 include: (i) a \$178,000 or 0.7% decrease in net interest income; (ii) a \$335,000 or 6.2% decrease in total other income and (iii) a \$1,083,000 or 8.0% increase in total other

expenses. The provision for income taxes decreased \$842,000 or 14.6%.

NET INTEREST INCOME

Net interest income, the primary contributor to earnings, represents the difference between income on interest earning assets and expenses on interest bearing liabilities. Net interest income depends upon the volume of interest earning assets and interest bearing liabilities and the interest rates earned or paid on them.

The following table sets forth certain information relating to the Company's average consolidated statements of financial condition and its consolidated statements of income for the years indicated and reflect the average yield on assets and average cost of liabilities for the years indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the years shown. Average balances are derived from daily average balances and include non-performing accrual loans. The yields and costs include fees, which are considered adjustments to yields. Interest on nonaccrual loans has been included only to the extent reflected in the consolidated statements of income. For purposes of this table, the average balances for investments in debt and equity securities exclude unrealized appreciation/depreciation due to the application of SFAS No. 115, "*Accounting for Certain Investments in Debt and Equity Securities.*"

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| Year Ended December 31, (Dollars in thousands) | 2005 | | | 2004 | | | 2003 | | |
|---|--------------------|-------------------------------|------|--------------------|-------------------------------|------|--------------------|-------------------------------|------|
| | Average Balance | Average Yield/ Interest | Cost | Average Balance | Average Yield/ Interest | Cost | Average Balance | Average Yield/ Interest | Cost |
| Interest earning assets: | | | | | | | | | |
| Loans, net (including loan fee income) | \$ 299,950 | \$ 20,724 | 6.9% | \$ 285,058 | \$ 18,850 | 6.6% | \$ 257,301 | \$ 17,971 | 7.0% |
| Mortgage-backed securities | 102,460 | 4,160 | 4.0 | 107,146 | 4,137 | 3.8 | 98,278 | 4,012 | 4.1 |
| Taxable securities | 41,485 | 1,520 | 3.6 | 57,170 | 2,187 | 3.8 | 59,942 | 2,285 | 3.8 |
| Tax exempt securities ⁽¹⁾ | 60,005 | 2,944 | 4.8 | 53,552 | 2,514 | 4.6 | 43,357 | 2,449 | 5.7 |
| Federal funds sold | 7,971 | 265 | 3.3 | 7,776 | 98 | 1.2 | 6,581 | 74 | 1.1 |
| Securities, restricted | 2,034 | 95 | 4.7 | 1,895 | 34 | 1.8 | 1,635 | 66 | 4.0 |
| Deposits with banks | 93 | 2 | 2.2 | 176 | 2 | 1.1 | 118 | 1 | 0.9 |
| Total interest earning assets | 513,998 | 29,710 | 5.8 | 512,773 | 27,822 | 5.4 | 467,212 | 26,858 | 5.7 |
| Non interest earning assets: | | | | | | | | | |
| Cash and due from banks | 15,871 | | | 16,591 | | | 16,279 | | |
| Other assets | 18,186 | | | 18,671 | | | 18,972 | | |
| Total assets | \$ 548,055 | | | \$ 548,035 | | | \$ 502,463 | | |
| Interest bearing liabilities: | | | | | | | | | |
| Savings, N.O.W. and money market deposits | \$ 249,382 | 3,022 | 1.2% | \$ 258,100 | \$ 1,331 | 0.5% | \$ 248,520 | \$ 1,478 | 0.6% |
| Certificates of deposit of \$100,000 or more | 28,777 | 550 | 1.9 | 36,249 | 475 | 1.3 | 29,284 | 477 | 1.6 |
| Other time deposits | 27,805 | 470 | 1.7 | 31,907 | 457 | 1.4 | 33,010 | 597 | 1.8 |
| Federal funds purchased | 1,999 | 72 | 3.6 | 2,136 | 33 | 1.5 | 2,931 | 44 | 1.5 |
| Other borrowings | 6,688 | 205 | 3.1 | 3,131 | 55 | 1.8 | 332 | 5 | 1.5 |
| Total interest bearing liabilities | 314,651 | 4,319 | 1.4 | 331,523 | 2,351 | 0.7 | 314,077 | 2,601 | 0.8 |
| Non interest bearing liabilities: | | | | | | | | | |
| Demand deposits | 183,260 | | | 167,765 | | | 142,269 | | |

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| | | | | | | |
|--|-------------------|-------------|------------|------|------------|------|
| Other liabilities | 2,386 | | 3,277 | | 3,608 | |
| Total liabilities | 500,297 | | 502,565 | | 459,954 | |
| Stockholders' equity | 47,758 | | 45,470 | | 42,509 | |
| Total liabilities and stockholders' equity | \$ 548,055 | | \$ 548,035 | | \$ 502,463 | |
| Net interest income/interest rate spread ⁽²⁾ | | | | | | |
| | 25,391 | 4.4% | 25,471 | 4.7% | 24,257 | 4.9% |
| Net interest earning assets/net interest margin ⁽³⁾ | | | | | | |
| | \$ 199,347 | 4.9% | \$ 181,250 | 5.0% | \$ 153,135 | 5.2% |
| Ratio of interest earning assets to interest bearing liabilities | | | | | | |
| | 163.4% | | 154.7% | | 148.8% | |
| Less: Tax equivalent adjustment | | | | | | |
| | (997) | | (899) | | (890) | |
| Net interest income | \$ 24,394 | | \$ 24,572 | | \$ 23,367 | |

(1) The above table is presented on a tax equivalent basis.

(2) Net interest rate spread represents the difference between the yield on interest earning assets and the cost of interest bearing liabilities.

(3) Net interest margin represents net interest income divided by average interest earning assets.

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RATE/VOLUME

Net interest income can be analyzed in terms of the impact of changes in rates and volumes. The following table illustrates the extent to which changes in interest rates and in the volume of average interest earning assets and interest bearing liabilities have affected the Bank's interest income and interest expense during the periods indicated. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior rate); (ii) changes attributable to changes in rates (changes in rates multiplied by prior volume); and (iii) the net changes. For purposes of this table, changes, which are not due solely to volume or rate changes, have been allocated to these categories based on the respective percentage changes in average volume and rate. Due to the numerous simultaneous volume and rate changes during the periods analyzed, it is not possible to precisely allocate changes between volume and rates. In addition, average earning assets include nonaccrual loans.

| Year Ended December 31, (In thousands) | 2005 Over 2004 Changes Due To | | | 2004 Over 2003 Changes Due To | | |
|---|----------------------------------|----------|---------------|----------------------------------|------------|---------------|
| | Volume | Rate | Net Change | Volume | Rate | Net Change |
| Interest income on interest earning assets: | | | | | | |
| Loans (including loan fee income) | \$ 1,004 | \$ 870 | \$ 1,874 | \$ 1,676 | \$ (797) | \$ 879 |
| Mortgage-backed securities | (186) | 209 | 23 | 353 | (228) | 125 |
| Taxable securities | (584) | (83) | (667) | (100) | 2 | (98) |
| Tax exempt securities (1) | 309 | 121 | 430 | 516 | (451) | 65 |
| Federal funds sold | 3 | 164 | 167 | 15 | 9 | 24 |
| Securities, restricted | 3 | 58 | 61 | 9 | (41) | (32) |
| Deposits with banks | (2) | 2 | - | 1 | - | 1 |
| Total interest earning assets | 547 | 1,341 | 1,888 | 2,470 | (1,506) | 964 |
| Interest expense on interest bearing liabilities: | | | | | | |
| Savings, N.O.W. and money market deposits | (47) | 1,738 | 1,691 | 55 | (202) | (147) |
| Certificates of deposit of \$100,000 or more | (112) | 187 | 75 | 101 | (103) | (2) |
| Other time deposits | (63) | 76 | 13 | (19) | (121) | (140) |
| Federal funds purchased | (2) | 41 | 39 | (12) | 1 | (11) |
| Other borrowings | 91 | 59 | 150 | 49 | 1 | 50 |
| Total interest bearing liabilities | (133) | 2,101 | 1,968 | 174 | (424) | (250) |
| Net interest income | \$ 680 | \$ (760) | \$ (80) | \$ 2,296 | \$ (1,082) | \$ 1,214 |

(1) The above table is presented on a tax equivalent basis.

The net interest margin compression continued in 2005. The decrease in the net interest margin resulted from the continued historically low interest rate environment, as well as a narrowing between short and long-term rates. Net interest income was \$24,394,000 in 2005 compared to \$24,572,000 in 2004 and \$23,367,000 in 2003. The decrease of 0.7% as compared to 2004 reflects the stabilization of the net interest margin despite the continued flat yield curve. Yields on interest bearing liabilities increased 66 basis points during 2005 compared to the prior year, which were partly offset by increased yields of 36 basis points on interest earning assets. Average interest bearing liabilities were \$314,651,000 in 2005 representing a 5.1% decrease versus 2004. Average interest bearing assets grew slightly by \$1,225,000 in 2005, an increase of 0.2% compared to 2004. The 5.2% increase in net interest income of 2004 over 2003 represents the increase in average interest earning assets. Average interest earning assets grew to \$512,773,000 in 2004 from \$467,212,000 in 2003, representing a 9.8% increase. Average interest bearing liabilities totaled \$331,523,000 in 2004 and \$314,077,000 in 2003. The percentage increase year over year was 5.6%. The tax adjusted net interest margin was 4.9% in 2005, 5.0% in 2004, and 5.2% in 2003.

Total interest income increased to \$28,713,000 in 2005 from \$26,923,000 in 2004 and from \$25,968,000 in 2003, an increase of 6.6% between 2005 and 2004 and 3.7% increase to 2004 from 2003. The average yield on total interest earning assets for 2005 increased to 5.8% from 5.4% in 2004 and the average yield for 2004 decreased to 5.4% from 5.7% for 2003. The ratio of interest earning assets to interest bearing liabilities increased to 163.4% in 2005 as compared to 154.7% in 2004 and 148.8% in 2003. Growth of interest earning assets is partially attributed to funding from non-interest bearing deposits which positively impacted the net interest margin. Interest income on loans increased \$1,874,000 in 2005 over 2004 and \$879,000 in 2004 over 2003 while average loans increased 5.2% to \$299,950,000 in 2005 versus 2004 and 10.8% to \$285,058,000 in 2004 from 2003. The yield on average loans for 2005 increased to 6.9% from 6.6% in 2004 and the average yield for 2004 decreased to 6.6% from 7.0% for 2003.

Interest income on investment in debt and equity securities decreased \$251,000 or 3.2% in 2005 from 2004 and 2004 increased \$51,000 or 0.6% from 2003. Amortization of premiums on mortgage-backed securities totaled approximately \$786,000, \$1,261,000, and \$2,244,000 in 2005, 2004, and 2003, respectively. Average total securities decreased 6.3% to \$205,984,000 in 2005 from 2004 and increased 8.1% to \$219,763,000 in 2004 from 2003. The tax adjusted average yield on total securities increased to 4.2% in 2005 from

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2004 and decreased to 4.0% in 2004 from 4.3% in 2003. Average federal funds sold increased \$195,000 or 2.5% in 2005 from 2004 and increased \$1,195,000 or 18.2% in 2004 from 2003.

Interest expense increased \$1,968,000 to \$4,319,000 in 2005 from 2004 and decreased \$250,000 to \$2,351,000 in 2004 from \$2,601,000 in 2003. The increase of 83.7% in 2005 and the decrease of 9.6% in 2004 in interest expense were caused by the upward trend in the cost of average interest bearing liabilities. The cost of average interest bearing liabilities was 1.4% in 2005, 0.7% in 2004 and 0.8% during 2003. Average federal funds purchased and overnight borrowings totaled \$8,687,000 and \$5,267,000 in 2005 and 2004, respectively. While average federal funds purchased decreased, the average balance for overnight borrowings increased.

Provision for Loan Losses

Total loans grew \$6,130,000 or 2.1% during 2005 and \$22,946,000 or 8.4% during 2004. Average net loans grew \$14,892,000 or 5.2% during 2005 over 2004 and \$27,757,000 or 10.8% during 2004 when compared to the prior year. Real estate mortgage loans were the largest contributor of the growth for both 2005 and 2004 and increased \$6,116,000 or 2.6% and \$23,556,000 or 11.1%, respectively. Growth in real estate loans is primarily attributed to an increase in commercial mortgages and increases in the home equity loan portfolio. Increases in installment/consumer loans were the next largest contributor and grew \$3,142,000 or 47% during 2005 and \$580,000 or 9.5% during 2004. Commercial, financial and agricultural loans decreased \$2,698,000 or 7.9% in 2005 from 2004 and increased \$532,000 or 1.6% in 2004 from 2003. Fixed rate loans represented 13.8%, 14.9%, and 16.5% of total loans at December 31, 2005, 2004, and 2003, respectively.

The performance of the loan portfolio continued to be strong for the years ended December 31, 2005 and 2004. Nonaccrual loans decreased \$1,037,000 to \$658,000 in 2005 from 2004. In 2004, nonaccrual loans increased \$1,543,000 to \$1,695,000. This represents 0.2% and 0.6% of net loans at December 31, 2005 and 2004, respectively. Subsequent to December 31, 2004, three loans having a total principal amount of \$1,288,000 were removed from the nonaccrual list. Of these loans, two loans returned to accrual status and one loan was repaid. The Company had no foreclosed real estate at December 31, 2005 and 2004.

Net charge-offs were \$105,000, \$256,000 and \$150,000 for the years ended December 31, 2005, 2004 and 2003, respectively. The ratio of allowance for loan losses to nonaccrual loans was 362.2%, 129.1%, and 1410.5% at December 31, 2005, 2004, and 2003, respectively.

Loans of approximately \$5,085,000, \$7,679,000 and \$8,706,000 at December 31, 2005, 2004, and 2003, respectively were classified as potential problem loans. This represents 1.7%, 2.6%, and 3.2% of total loans at December 31, 2005, 2004, and 2003, respectively. Subsequent to December 31, 2005, two potential problem loans in the amount of \$1,266,000 have been repaid. These are loans for which management has information that indicates the borrower may not be able to comply with the present repayment terms. These loans are subject to increased management attention and their classification is reviewed on at least a quarterly basis. Due to the structure and nature of the credits, management currently believes that the likelihood of sustaining a material loss on these relationships is remote.

Based on our continuing review of the overall loan portfolio, of the current asset quality of the portfolio, and the net charge-offs, a provision for loan losses of \$300,000 was recorded in 2005 and in 2004. No provision was recorded in 2003. The allowance for loan losses increased to \$2,383,000 at December 31, 2005, and \$2,188,000 at December 31, 2004, as compared to \$2,144,000 at December 31, 2003. As a percentage of total loans, the allowance was 0.79% and 0.74% at December 31, 2005 and 2004, respectively.

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The following table sets forth changes in the allowance for loan losses.

| December 31, (Dollars in thousands) | 2005 | 2004 | 2003 | 2002 | 2001 |
|--|----------|----------|----------|----------|----------|
| Allowance for loan losses | | | | | |
| balance at beginning of period | \$ 2,188 | \$ 2,144 | \$ 2,294 | \$ 2,249 | \$ 2,100 |
| Charge-offs: | | | | | |
| Real estate mortgage loans | 7 | 3 | 38 | 4 | - |
| Real estate construction loans | - | - | - | - | - |
| Commercial, financial and agricultural loans | 153 | 302 | 163 | 212 | 108 |
| Installment/consumer loans | 129 | 65 | 148 | 22 | 59 |
| Total | 289 | 370 | 349 | 238 | 167 |
| Recoveries: | | | | | |
| Real estate mortgage loans | 17 | 23 | 13 | 8 | 29 |
| Real estate construction loans | 100 | - | - | - | - |
| Commercial, financial and agricultural loans | 37 | 61 | 90 | 44 | 12 |
| Installment/consumer loans | 30 | 30 | 96 | 31 | 51 |
| Total | 184 | 114 | 199 | 83 | 92 |
| Net charge-offs (recoveries) | 105 | 256 | 150 | 155 | 75 |
| Provision for loan losses charged to operations | 300 | 300 | - | 220 | 323 |
| Balance before reclass to other liabilities | 2,383 | 2,188 | 2,144 | 2,314 | 2,348 |
| Net change in other liabilities portion allocated to off balance sheet items | - | - | - | (20) | (99) |
| Balance at end of period | \$ 2,383 | \$ 2,188 | \$ 2,144 | \$ 2,294 | \$ 2,249 |
| Ratio of net charge-offs during period to average loans outstanding | 0.04% | 0.09% | 0.06% | 0.07% | 0.04% |

Allocation of Allowance for Loan Losses

The following table sets forth the allocation of the total allowance for loan losses by loan type.

| Year Ended December 31, (In thousands) | 2005 Percentage of Loans to Total | 2004 Percentage of Loans to Total | 2003 Percentage of Loans to Total | 2002 Percentage of Loans To Total | 2001 Percentage of Loans to Total |
|--|--|--|--|--|--|
| | | | | | |

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| | Amount | Loans | Amount | Loans | Amount | Loans | Amount | Loans | Amount | Loans |
|--|-----------------|---------------|-----------------|---------------|-----------------|---------------|-----------------|---------------|-----------------|---------------|
| Commercial, financial and agricultural loans | \$ 273 | 10.5% | \$ 315 | 11.6% | \$ 272 | 12.4% | \$ 591 | 15.6% | \$ 505 | 13.1% |
| Real estate construction loans | 183 | 5.9 | 148 | 6.2 | 148 | 7.3 | 227 | 5.0 | 337 | 4.1 |
| Real estate mortgage loans | 1,817 | 80.4 | 1,659 | 80.0 | 1,663 | 78.1 | 1,160 | 76.2 | 1,160 | 79.9 |
| Installment/consumer loans | 110 | 3.2 | 66 | 2.2 | 61 | 2.2 | 316 | 3.2 | 247 | 2.9 |
| Total | \$ 2,383 | 100.0% | \$ 2,188 | 100.0% | \$ 2,144 | 100.0% | \$ 2,294 | 100.0% | \$ 2,249 | 100.0% |

Non Interest Income

Total other income decreased by \$335,000 or 6.2% in 2005 to \$5,105,000 as compared to an increase of \$724,000 or 15.4% to \$5,440,000 in 2004 compared to \$4,716,000 in 2003. The decline in total other income during 2005 compared to 2004 was due to decreases in net gains on sales of securities of \$618,000 and lower service charges on deposit accounts of \$224,000 partly offset by increased title fee income of \$427,000 from Bridge Abstract. Higher total other income during 2004 versus 2003 was primarily attributable to the increase in title fee income of \$524,000 from Bridge Abstract and the increase in fees for other customer services of \$156,000.

Net gains on securities of \$116,000, \$734,000 and \$826,000 were recognized in 2005, 2004 and 2003, respectively. Service charges on deposit accounts for the year ended December 31, 2005 totaled \$2,104,000, a decrease of \$224,000 as compared to 2004. For the year

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ended December 31, 2004, service charges were \$2,328,000, an increase of \$50,000 or 2.2% from 2003. The Company believes that the decline is attributable to the change in customer behavior to avoid paying fees for overdrafts and uncollected account balances, which partially stems from changes in our fee policies. Published research indicates that this is an industry pattern. Fees for other customer services totaled \$1,484,000 in 2005, \$1,341,000 in 2004, and \$1,185,000 in 2003, reflecting steady increases. The higher income predominately related to increased merchant processing revenue.

Bridge Abstract, the Bank's title insurance abstract subsidiary, generated title fee income of \$1,293,000, \$866,000, and \$342,000 in 2005, 2004, and 2003, respectively. Increases were due primarily to increased volume of transactions as a result of business development efforts that supported the continuing growth.

Other operating income for the year ended December 31, 2005 totaled \$108,000, a decrease of \$63,000 or 36.8% from the prior year. Other operating income for 2004 totaled \$171,000, an increase of \$86,000 or 101.2% over 2003.

Non Interest Expense

Other expenses increased by \$1,083,000 or 8.0% in 2005 to \$14,647,000 from \$13,564,000 in 2004 and 2004 increased \$567,000 or 4.4% from \$12,997,000 in 2003. Increases occurred in most of the components of other expenses due to higher costs as well as overall growth due to increased volume of transactions for processing. The primary component of this change was an increase in salaries and employee benefits of \$891,000 or 12.0% in 2005 and \$556,000 or 8.1% in 2004. Salaries and benefits increases reflect unfilled management positions from 2004 that were subsequently filled in the current year, coupled with additional staff to support the expansion of the branch network and growth in business lines such as the title insurance abstract subsidiary in 2005. In addition, the unanticipated departure of the Chief Operating Officer in the fourth quarter of 2005 and an accrual for related severance was recorded at that time. The change between 2004 and 2003 was a result of increases in staff for the expansion of branch operations, as well as to comply with the increased regulatory burden as the Company met thresholds in both asset size and market capitalization.

Other operating expenses for the year ended December 31, 2005 totaled \$3,411,000, an increase of \$296,000 or 9.5% compared to 2004, and 2004 totaled \$3,115,000, a decrease of \$43,000 or 1.4% over 2003. The increase in 2005 resulted from increased professional fees primarily from costs associated with the review of the executive compensation policies which are reviewed every three years.

Provision for Income Taxes

The provision for income taxes for December 31, 2005, 2004, and 2003 was \$4,929,000, \$5,771,000, and \$5,488,000, respectively. The decrease in 2005 was due to income before income taxes declining to \$14,552,000 from \$16,148,000 in 2004. This reduction also is partially attributed to a reduction in the New York State tax. The increase in provision for income taxes during 2004 was due to income before income taxes increasing to \$16,148,000 in 2004 from \$15,086,000 in 2003. The effective tax rate was 33.9%, 35.7% and 36.4% for the years ended December 31, 2005, 2004, and 2003, respectively.

FINANCIAL CONDITION

The assets of the Company totaled \$533,444,000 at December 31, 2005, a decrease of \$13,756,000 or 2.5% from the previous year-end. This decline mainly resulted from a decrease in total securities of \$31,044,000 or 13.8% partly offset by an increase in total loans of \$6,130,000 or 2.1% and an increase in total cash and cash equivalents of \$6,813,000 or 76.9%.

Total stockholders' equity was \$46,651,000 at December 31, 2005, a decrease of \$562,000 or 1.2% from December 31, 2004 due to repurchases of treasury stock of \$2,134,000 and to a net unrealized loss on securities of \$2,376,000 at

December 31, 2005 as compared to a net unrealized gain on securities of \$403,000 at December 31, 2004.

Loans

The concentration of loans in our primary market areas may increase risk. Unlike larger banks that are more geographically diversified, the Bank's loan portfolio consists primarily of real estate loans secured by commercial and residential real estate properties located in the Bank's principal lending area on eastern Long Island. The local economic conditions on eastern Long Island have a significant impact on the volume of loan originations and the quality of our loans, the ability of borrowers to repay these loans, and the value of collateral securing these loans. A significant decline in the general economic conditions caused by inflation, recession, unemployment or other factors beyond the Company's control would impact these local economic conditions and could negatively affect the financial results of the Company's operations. Additionally, while the Company has a significant amount of commercial real estate loans, the majority which are owner-occupied, decreases in tenant occupancy may also have a negative effect on the ability of borrowers to make timely repayments of their loans, which would have an adverse impact on the Company's earnings.

The interest rates charged by the Bank on loans are affected primarily by the demand for such loans, the supply of money available for lending purposes, the rates offered by its competitors, the Bank's relationship with the customer, and the related credit risks of the

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transaction. These factors are affected by general and economic conditions including, but not limited to, monetary policies of the federal government, including the Federal Reserve Board, legislative policies and governmental budgetary matters.

The Bank targets its business lending and marketing strategy towards loans that primarily meet the needs of small to medium-sized businesses. These small- to medium-sized businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities. If general economic conditions negatively impact these businesses, the results of operations and financial condition may be adversely affected.

With respect to the underwriting of loans, there are certain risks, including the risk of non-payment that is associated with each type of loan that the Bank markets. Approximately 46.2% of the Bank's loan portfolio at December 31, 2005 is comprised of commercial real estate loans. Home equity lines of credit comprise approximately 19.5%, construction mortgage loans comprise approximately 10.8%, residential mortgages comprise approximately 9.8%, and land loans comprise approximately 1.1%. Risks associated with concentration in real estate loans include potential losses from fluctuating values of land and improved properties. Largest loan concentrations by industry are loans granted to lessors of commercial property both nonowner occupied and owner occupied. The Bank uses conservative underwriting criteria to better insulate itself from a downturn in real estate values and economic conditions on eastern Long Island that could have a significant impact on the value of collateral securing the loans as well as the ability of customers to repay loans.

The remainder of the loan portfolio is comprised of commercial and consumer loans, which comprises approximately 12.8% of the Bank's loan portfolio. The primary risks associated with commercial loans are the cash flow of the business, the experience and quality of the borrowers' management, the business climate, and the impact of economic factors. The primary risks associated with consumer loans relate to the borrower, such as the risk of a borrower's unemployment as a result of deteriorating economic conditions or the amount and nature of a borrower's other existing indebtedness, and the value of the collateral securing the loans if the Bank must take possession of the collateral. Consumer loans also have risks associated with concentrations of loans in a single type of loan.

The Company's policy for charging off loans is a multi-step process. A loan is considered a potential charge-off when it is in default of either principal or interest for a period of 90, 120 or 180 days, depending upon the loan type, as of the end of the prior month. In addition to date criteria, other triggering events may include, but are not limited to, notice of bankruptcy by the borrower or guarantor, death of the borrower, and deficiency balance from the sale of collateral. These loans identified are presented for evaluation at the regular meeting of the Classification Committee. The recovery of charged-off balances is actively pursued until the potential for recovery has been exhausted, or until the expense of collection does not justify the recovery efforts.

Total loans grew \$6,130,000 or 2.1% since year end 2004. Average net loans grew by \$14,892,000 or 5.2% when compared to the prior year. Certain components of the loan portfolio contributed to the growth: real estate mortgage loans increased \$6,116,000 or 2.6%, installment/consumer loans increased \$3,142,000, while commercial, financial and agricultural loans decreased \$2,698,000 or 7.9% and real estate construction loans decreased \$492,000 since December 31, 2004. The rate of loan growth for 2005 was slower than in prior years reflecting increased competition for quality credits within our market area.

The following table sets forth the major classifications of loans:

| December 31, (In thousands) | 2005 | 2004 | 2003 | 2002 | 2001 |
|--------------------------------|------------------|-----------|-----------|-----------|-----------|
| | \$242,928 | \$236,812 | \$213,256 | \$189,226 | \$172,214 |

| | | | | | |
|---|------------------|-----------|-----------|-----------|-----------|
| Real estate mortgage loans | | | | | |
| Commercial, financial, and agricultural loans | 31,644 | 34,342 | 33,810 | 38,692 | 28,281 |
| Installment/consumer loans | 9,827 | 6,685 | 6,105 | 8,011 | 6,149 |
| Real estate construction loans | 17,960 | 18,452 | 20,037 | 12,520 | 8,784 |
| Total loans | 302,359 | 296,291 | 273,208 | 248,449 | 215,428 |
| Unearned income | (95) | (157) | (20) | (61) | (66) |
| | 302,264 | 296,134 | 273,188 | 248,388 | 215,362 |
| Allowance for loan losses | (2,383) | (2,188) | (2,144) | (2,294) | (2,249) |
| Net loans | \$299,881 | \$293,946 | \$271,044 | \$246,094 | \$213,113 |

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The following table sets forth the approximate maturities and sensitivity to changes in interest rates of certain loans, exclusive of real estate mortgages and consumer loans to individuals as of December 31, 2005:

| | Within One Year | After One But Within Five Years | After Five Years | Total |
|--------------------------------------|--------------------|---------------------------------------|---------------------|------------------|
| (In thousands) | | | | |
| Commercial loans | \$ 11,966 | \$ 14,315 | \$ 5,363 | \$ 31,644 |
| Construction loans ⁽¹⁾ | 7,132 | 1,000 | 9,828 | 17,960 |
| Total | \$ 19,098 | \$ 15,315 | \$ 15,191 | \$ 49,604 |
| Rate provisions: | | | | |
| Amounts with fixed interest rates | \$ 1,854 | \$ 7,617 | \$ 1,493 | \$ 10,964 |
| Amounts with variable interest rates | 17,244 | 7,698 | 13,698 | 38,640 |
| Total | \$ 19,098 | \$ 15,315 | \$ 15,191 | \$ 49,604 |

(1) Included in the "After Five Years" column, are one-step construction loans that contain a preliminary construction period (interest only) that automatically convert to amortization at the end of the construction phase.

Past Due, Nonaccrual and Restructured Loans

The following table sets forth selected information about past due, nonaccrual and restructured loans.

| December 31, (In thousands) | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---------------|-----------------|---------------|---------------|---------------|
| Loans 90 days or more past due and still accruing | \$ - | \$ - | \$ - | \$ - | \$ - |
| Nonaccrual loans | 658 | 1,695 | 152 | 200 | 532 |
| Restructured loans | - | - | - | - | - |
| Other real estate owned, net | - | - | - | - | - |
| Total | \$ 658 | \$ 1,695 | \$ 152 | \$ 200 | \$ 532 |
| Year Ended December 31, (In thousands) | 2005 | 2004 | 2003 | 2002 | 2001 |
| Gross interest income that would have been recorded during the year under original terms: | | | | | |
| Nonaccrual loans | \$ 38 | \$ 16 | \$ 9 | \$ 13 | \$ 66 |
| Restructured loans | - | - | - | - | - |

Gross interest income recorded
during the year:

| | | | | | | | | | | |
|----------------------------------|----|----|----|----|----|---|----|---|----|----|
| Nonaccrual loans | \$ | 17 | \$ | 12 | \$ | 6 | \$ | 4 | \$ | 17 |
| Restructured loans | | - | | - | | - | | - | | - |
| Commitments for additional funds | | - | | - | | - | | - | | - |

Securities

Total securities decreased to \$194,190,000 at December 31, 2005 from \$225,234,000 at December 31, 2004. The reduction in the investment securities portfolio is primarily attributed to reduced cash flows from deposits, and the deployment of existing cash flows into different assets. The high costs of deposits as a funding source, coupled with flat yields at the long end of the curve, resulted in less attractive investment opportunities. The available for sale portfolio decreased 9.5% to \$182,801,000 and the securities held to maturity declined 52.8% to \$10,012,000. Securities held as available for sale may be sold in response to, or in anticipation of, changes in interest rates and resulting prepayment risk, or other factors. U.S. Treasury and government agency securities decreased to \$37,662,000 at December 31, 2005 from \$54,039,000 at December 31, 2004 and mortgage-backed securities decreased by \$13,040,000, while state and municipal obligations increased by \$10,176,000. Fixed rate securities represent 92.5% of total securities at December 31, 2005. The Bank continued to maintain its levels of mortgage-backed securities, which represented approximately 51.4% of the available for sale balance at December 31, 2005 as compared to 52.9% at the prior year-end. A change in market rates was the primary reason for the net decrease in unrealized depreciation in securities available for sale, which decreased other comprehensive income.

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A summary of the amortized cost, gross unrealized gains, gross unrealized losses and estimated fair value of securities is as follows:

| December 31, (In thousands) | 2005 | | | | | | 2004 | | | | | |
|--|-------------------|------------------------------|-------------------------------|----------------------------|-------------------|------------------------------|-------------------------------|----------------------------|-------------------|------------------------------|-------------------------------|----------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Available for sale: | | | | | | | | | | | | |
| U.S. Treasury and government agency securities | \$ 38,443 | \$ 7 | \$ (788) | \$ 37,662 | \$ 53,736 | \$ 519 | \$ (216) | \$ 54,039 | \$ 52,855 | \$ 1,479 | \$ (165) | \$ 54,169 |
| State and municipal obligations | 51,392 | 387 | (559) | 51,220 | 40,027 | 1,098 | (81) | 41,044 | 35,495 | 1,619 | (70) | 37,024 |
| Mortgage-backed securities | 96,938 | 27 | (3,046) | 93,919 | 107,609 | 483 | (1,133) | 106,959 | 102,463 | 1,124 | (1,101) | 102,486 |
| Total available for sale | 186,773 | 421 | (4,393) | 182,801 | 201,372 | 2,100 | (1,430) | 202,042 | 190,813 | 4,222 | (1,336) | 193,699 |
| Securities, restricted: | | | | | | | | | | | | |
| Federal Reserve Bank Stock | 36 | - | - | 36 | 36 | - | - | 36 | 36 | - | - | 36 |
| Federal Home Loan Bank Stock | 1,341 | - | - | 1,341 | 1,943 | - | - | 1,943 | 1,606 | - | - | 1,606 |
| Total securities, restricted | 1,377 | - | - | 1,377 | 1,979 | - | - | 1,979 | 1,642 | - | - | 1,642 |
| Held to maturity: | | | | | | | | | | | | |
| State and municipal obligations | 10,012 | - | (23) | 9,989 | 21,213 | - | (82) | 21,131 | 14,396 | - | (17) | 14,379 |
| Total held to maturity | 10,012 | - | (23) | 9,989 | 21,213 | - | (82) | 21,131 | 14,396 | - | (17) | 14,379 |
| Total debt and equity securities | \$ 198,162 | \$ 421 | \$ (4,416) | \$ 194,167 | \$ 224,564 | \$ 2,100 | \$ (1,512) | \$ 225,152 | \$ 206,851 | \$ 4,222 | \$ (1,353) | \$ 209,499 |

Deposits and Borrowings

Overnight borrowings decreased \$12,200,000 to \$14,500,000 from the prior year-end as the Bank effectively managed liquidity during seasonal deposit outflows. Total deposits decreased \$1,286,000 or 0.3% as compared to 2004. The decrease in public funds continued during 2005 from the prior year. Demand deposits increased \$32,060,000 or 20.2%. Savings, N.O.W. and money market deposits decreased \$9,086,000 or 3.7%. Certificates of deposit of \$100,000 or more decreased \$16,285,000 or 46.1% from December 31, 2004 and other time deposits decreased \$7,975,000 or 24.3% as compared to the prior year. The decline of more volatile and expensive deposits was part of the management of the balance sheet during 2005 as well as a result of increased competition for deposits and other banks offering higher rates.

LIQUIDITY

The objective of liquidity management is to ensure the sufficiency of funds available to respond to the needs of depositors and borrowers, and to take advantage of unanticipated earnings enhancement opportunities for Company growth. Liquidity management addresses the ability to meet deposit withdrawals either on demand or contractual maturity, to repay other borrowings as they mature and to make new loans and investments as opportunities arise.

The Company's principal source of liquidity is dividends from the Bank. Due to regulatory restrictions (see Note 1(l) to the Consolidated Financial Statements), dividends from the Bank to the Company at December 31, 2005 were limited to \$15,076,000, which represents the Bank's 2005 retained net income and the net undivided profits from the previous two years. The dividends received from the Bank are used primarily for dividends to the shareholders and stock repurchases. In the event that the Company subsequently expands its current operations, in addition to dividends from the Bank, it will need to rely on its own earnings, additional capital raised and other borrowings to meet liquidity needs.

The Bank's most liquid assets are cash and cash equivalents, securities available for sale and securities held to maturity due within one year. The levels of these assets are dependent upon the Bank's operating, financing, lending and investing activities during any given period. Other sources of liquidity include loan and security principal repayments and maturities, lines of credit with other financial institutions including the Federal Home Loan Bank, and growth in core deposits. While scheduled loan amortization, maturing securities and short-term investments are a relatively predictable source of funds, deposit flows and loan and mortgage-backed securities prepayments are greatly influenced by general interest rates, economic conditions and competition. The Bank adjusts its liquidity levels as appropriate to meet funding needs such as seasonal deposit outflows, loans, and asset and liability management objectives. Historically, the Bank has relied on its deposit base, drawn through its full-service branches that serve its market area, as its principal source of funding. The Bank seeks to retain existing deposits and loans and maintain customer relationships by offering quality service and competitive interest rates to its customers, while managing the overall cost of funds needed to finance its strategies. The Bank's Asset/Liability and Funds Management Policy allows for wholesale borrowings of up to 15% of total assets. At December 31, 2005, the Bank had aggregate lines of credit of \$47,000,000 with unaffiliated correspondent banks to provide short-term credit for liquidity requirements. Of these aggregate lines of credit, \$27,000,000 is available on an unsecured basis. The Bank also has the ability, as a member of the Federal Home Loan Bank ("FHLB") system, to borrow against unencumbered residential mortgages owned by the Bank. The Bank also has a master repurchase agreement with the FHLB, which increases its borrowing capacity. In addition, the Bank has an approved broker relationship for the purpose of issuing brokered certificates of deposit. As of December 31, 2005, the amount of overnight borrowings was \$14,500,000.

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Management continually monitors the liquidity position and believes that sufficient liquidity exists to meet all of our operating requirements. Based on the objectives determined by the Asset and Liability Committee, the Bank's liquidity levels may be affected by the use of short-term and wholesale borrowings. The Asset and Liability Committee is comprised of members of senior management and the Board. Excess short-term liquidity is invested in overnight federal funds sold.

The following represents commitments outstanding at December 31, 2005:

| | Total Amounts Committed | Less than One Year | One to Three Years | Four to Five Years | Over Five Years |
|--|-------------------------------|-----------------------|--------------------------|-----------------------|--------------------|
| (In thousands) | | | | | |
| Operating leases | \$ 2,424 | \$ 493 | \$ 781 | \$ 183 | \$ 967 |
| Purchase obligation | 250 | 250 | - | - | - |
| Standby letters of credit | 1,955 | 1,433 | 522 | - | - |
| Loan commitments outstanding ⁽¹⁾ | 11,839 | 11,839 | - | - | - |
| Unused equity lines | 42,432 | 3,313 | 16,085 | 9,405 | 13,629 |
| Unused construction lines | 1,324 | 145 | - | - | 1,179 |
| Unused lines of credit | 23,154 | 11,396 | 6,562 | 734 | 4,462 |
| Unused overdraft lines | 12,268 | 9,194 | 2,441 | 628 | 5 |
| Total commitments outstanding | \$ 95,646 | \$ 38,063 | \$ 26,391 | \$ 10,950 | \$ 20,242 |

(1) Of the \$11,839,000 of loan commitments outstanding, \$987,000 are fixed rate commitments and \$10,852,000 are variable rate commitments.

CAPITAL RESOURCES

Stockholders' equity decreased to \$46,651,000 at December 31, 2005 from \$47,213,000 at December 31, 2004 as a result of undistributed net income; less the change in net unrealized appreciation in securities available for sale, net of tax; and the repurchase of treasury shares net of the issuance of shares of common stock pursuant to the equity incentive plan. The ratio of average stockholders' equity to average total assets increased to 8.71% at year end 2005 from 8.30% at year end 2004.

The Company's capital strength is paralleled by the solid capital position of the Bank, as reflected in the excess of its regulatory capital ratios over the minimum risk-based capital adequacy ratio levels required for classification as a "well capitalized" institution by the FDIC (see Note 11 to the Consolidated Financial Statements). Management believes that the current capital levels along with future retained earnings will allow the Bank to maintain a position exceeding required capital levels and which is sufficient to support Company growth. Additionally, the Company has the ability to issue additional common stock and/or trust preferred securities should the need arise.

The Company had returns on average equity of 20.15%, 22.82%, and 22.58% and returns on average assets of 1.76%, 1.89%, and 1.91% for the years ended December 31, 2005, 2004, and 2003, respectively.

The Company utilizes cash dividends and stock repurchases to manage capital levels. Cash paid for dividends totaled \$5,561,000 in 2005 as compared to dividends paid in 2004 of \$5,790,000 that included the special dividend and dividends paid of \$2,943,000 in 2003. The dividend payout ratio for 2005 was 58.88%. The Company continues its

trend of uninterrupted dividends.

On May 17, 2004, the Company re-approved its stock repurchase plan allowing the repurchase of up to 5% of its current outstanding shares, 180,810 shares. There is no expiration date for the share repurchase plan. The Company considers opportunities for stock repurchases carefully, although opportunities to repurchase shares at the volumes required by law have been limited over the past years. During 2005, 75,926 shares were repurchased at a total cost of approximately \$2,134,000 or an average price per share of \$28.12.

On June 21, 2004, the Company declared a three-for-two stock split. The stock split was payable in the form of a stock dividend to shareholders of record as of July 9, 2004. The stock split increased outstanding common shares from 4,257,597 to 6,386,306.

IMPACT OF INFLATION AND CHANGING PRICES

The Consolidated Financial Statements and notes thereto presented herein have been prepared in accordance with U.S. generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. The primary effect of inflation on the operations of the Company is reflected in increased operating costs. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, changes in interest rates have a more significant effect on

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the performance of a financial institution than do the effects of changes in the general rate of inflation and changes in prices. Changes in interest rates could adversely affect our results of operations and financial condition. Interest rates do not necessarily move in the same direction, or in the same magnitude, as the prices of goods and services. Interest rates are highly sensitive to many factors, which are beyond the control of the Company, including the influence of domestic and foreign economic conditions and the monetary and fiscal policies of the United States government and federal agencies, particularly the Federal Reserve Bank.

IMPACT OF PROSPECTIVE ACCOUNTING STANDARDS

For discussion regarding the impact of new accounting standards, refer to Note 1(r) of Notes to Consolidated Financial Statements.

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Table of Contents**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Management considers interest rate risk to be the most significant market risk for the Company. Market risk is the risk of loss from adverse changes in market prices and rates. Interest rate risk is the exposure to adverse changes in the net income of the Company as a result of changes in interest rates.

The Company's primary earnings source is net interest income, which is affected by changes in the level of interest rates, the relationship between rates, the impact of interest rate fluctuations on asset prepayments, the level and composition of deposits and liabilities, and the credit quality of earning assets. The Company's objectives in its asset and liability management are to maintain a strong, stable net interest margin, to utilize its capital effectively without taking undue risks, to maintain adequate liquidity, and to reduce vulnerability of its operations to changes in interest rates.

The Company's Asset and Liability Committee evaluates periodically, but at least four times a year, the impact of changes in market interest rates on assets and liabilities, net interest margin, capital and liquidity. Risk assessments are governed by policies and limits established by senior management, which are reviewed and approved by the full Board of Directors at least annually. The economic environment continually presents uncertainties as to future interest rate trends. The Asset and Liability Committee regularly utilizes a model that projects net interest income based on increasing or decreasing interest rates, in order to be better able to respond to changes in interest rates.

Significant increases in the level of market interest rates may adversely affect the fair value of securities and other interest earning assets. At December 31, 2005, \$179,672,000 or 92.5% of the Company's securities had fixed interest rates. Changes in interest rates affect the value of the Company's interest earning assets and in particular its securities portfolio. Generally, the value of securities fluctuates inversely with changes in interest rates. Decreases in the fair value of securities available for sale, therefore, could have an adverse effect on stockholder's equity. Increases in interest rates could result in decreases in the market value of interest earning assets, which could adversely affect the Company's results of operations if sold. The Company is also subject to reinvestment risk associated with changes in interest rates. Increases in market interest rates also could affect the type (fixed-rate or adjustable-rate) and amount of loans originated by the Company and the average life of loans and securities, which can impact the yields earned on the Company's loans and securities. Changes in interest rates may affect the average life of loans and mortgage related securities. In periods of decreasing interest rates, the average life of loans and securities held by the Company may be shortened to the extent increased prepayment activity occurs during such periods which, in turn, may result in the investment of funds from such prepayments in lower yielding assets. 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 result in decreasing loan prepayments with respect to fixed rate loans, and therefore an increase in the average life of such loans, may result in a decrease in loan demand, and make it more difficult for borrowers to repay adjustable rate loans.

The Company utilizes the results of a detailed and dynamic simulation model to quantify the estimated exposure to net interest income to sustained interest rate changes. Management routinely monitors simulated net interest income sensitivity over a rolling two-year horizon. The simulation model captures the impact of changing interest rates on the interest income received and the interest expense paid on all assets and liabilities reflected on the Company's Statement of Condition. This sensitivity analysis is compared to the asset and liability policy limits that specify a maximum tolerance level for net interest income exposure over a one-year horizon given both a 200 basis point upward and downward shift in interest rates. A parallel and pro rata shift in rates over a twelve-month period is assumed. The following reflects the Company's net interest income sensitivity analysis at December 31, 2005:

| | 2005 |
|--------------------|------------------|
| Change in Interest | Potential Change |

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| Rates in Basis Points (RATE SHOCK) (Dollars in thousands) | in Net Interest Income | |
|---|---------------------------|-------------|
| | \$ Change | % Change |
| 200 | \$ (1,620) | (6.16)% |
| Static | - | - |
| (200) | \$ (438) | (1.67)% |

The preceding sensitivity analysis does not represent a Company forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions including, but not limited to, the nature and timing of interest rate levels and yield curve shapes, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, and reinvestment and replacement of asset and liability cash flows. While assumptions are developed based upon perceived current economic and local market conditions, the Company cannot make any assurances as to the predictive nature of these assumptions including how customer preferences or competitor influences may change.

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Also, as market conditions vary from those assumed in the sensitivity analysis, actual results will also differ due to prepayment and refinancing levels likely deviating from those assumed, the varying impact of interest rate change caps or floors on adjustable rate assets, the potential effect of changing debt service levels on customers with adjustable rate loans, depositor early withdrawals, prepayment penalties and product preference changes and other internal and external variables. Furthermore, the sensitivity analysis does not reflect actions that management might take in responding to, or anticipating changes in interest rates and market conditions.

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Table of Contents**Item 8. Financial Statements and Supplementary Data****CONSOLIDATED STATEMENTS OF CONDITION**

(In thousands, except share and per share amounts)

| | December 31, 2005 | December 31, 2004 |
|--|----------------------|----------------------|
| ASSETS | | |
| Cash and due from banks | \$ 15,649 | \$ 8,744 |
| Interest earning deposits with banks | 26 | 118 |
| Total cash and cash equivalents | 15,675 | 8,862 |
| Securities available for sale, at fair value | 182,801 | 202,042 |
| Securities, restricted | 1,377 | 1,979 |
| Securities held to maturity (fair value of \$9,989 and \$21,131, respectively) | 10,012 | 21,213 |
| Total securities, net | 194,190 | 225,234 |
| Loans | 302,264 | 296,134 |
| Less: | | |
| Allowance for loan losses | (2,383) | (2,188) |
| Loans, net | 299,881 | 293,946 |
| Banking premises and equipment, net | 15,640 | 13,817 |
| Accrued interest receivable | 2,624 | 2,469 |
| Other assets | 5,434 | 2,872 |
| Total Assets | \$ 533,444 | \$ 547,200 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Demand deposits | \$ 190,426 | \$ 158,366 |
| Savings, N.O.W. and money market deposits | 233,728 | 242,814 |
| Other time deposits | 24,850 | 32,825 |
| Certificates of deposit of \$100,000 or more | 19,021 | 35,306 |
| Total deposits | 468,025 | 469,311 |
| Overnight borrowings | 14,500 | 26,700 |
| Accrued interest payable | 328 | 273 |
| Other liabilities and accrued expenses | 3,940 | 3,703 |
| Total Liabilities | 486,793 | 499,987 |
| Stockholders' equity: | | |
| Common stock, par value \$0.01 per share: | | |
| Authorized: 20,000,000 shares; 6,386,306 issued; 6,206,539 and 6,254,489 shares, | | |
| outstanding at December 31, 2005 and 2004, respectively | 64 | 64 |
| Surplus | 21,631 | 21,462 |
| Undivided profits | 31,813 | 27,856 |
| Less: Treasury stock at cost, 179,767 and 131,617 shares at December 31, 2005 and 2004, respectively | (4,285) | (2,330) |
| Unearned stock awards | (108) | (121) |

| | | |
|---|-------------------|-------------------|
| | 49,115 | 46,931 |
| Accumulated other comprehensive income (loss): | | |
| Net unrealized (loss) gain on securities, net of taxes of (\$1,596) and \$267 at December 31, 2005 and 2004, respectively | (2,376) | 403 |
| Net minimum pension liability, net of taxes of \$59 and \$81 at December 31, 2005 and 2004, respectively | (88) | (121) |
| Total Stockholders' Equity | 46,651 | 47,213 |
| Total Liabilities and Stockholders' Equity | \$ 533,444 | \$ 547,200 |

See accompanying notes to Consolidated Financial Statements.

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Table of Contents**CONSOLIDATED STATEMENTS OF INCOME**

(In thousands, except per share amounts)

| Year Ended December 31, | 2005 | 2004 | 2003 |
|--|-----------------|------------------|-----------------|
| Interest income: | | | |
| Loans (including fee income) | \$ 20,724 | \$ 18,850 | \$ 17,971 |
| Mortgage-backed securities | 4,160 | 4,137 | 4,012 |
| State and municipal obligations | 1,947 | 1,615 | 1,559 |
| U.S. Treasury and government agency securities | 1,520 | 2,187 | 2,285 |
| Federal funds sold | 265 | 98 | 74 |
| Other securities | 95 | 34 | 66 |
| Deposits with banks | 2 | 2 | 1 |
| Total interest income | 28,713 | 26,923 | 25,968 |
| Interest expense: | | | |
| Savings, N.O.W. and money market deposits | 3,022 | 1,331 | 1,478 |
| Certificates of deposit of \$100,000 or more | 550 | 475 | 477 |
| Other time deposits | 470 | 457 | 597 |
| Other borrowed money | 205 | 55 | 5 |
| Federal funds purchased | 72 | 33 | 44 |
| Total interest expense | 4,319 | 2,351 | 2,601 |
| Net interest income | 24,394 | 24,572 | 23,367 |
| Provision for loan losses | 300 | 300 | - |
| Net interest income after provision for loan losses | 24,094 | 24,272 | 23,367 |
| Other income: | | | |
| Service charges on deposit accounts | 2,104 | 2,328 | 2,278 |
| Fees for other customer services | 1,484 | 1,341 | 1,185 |
| Title fee income | 1,293 | 866 | 342 |
| Net securities gains | 116 | 734 | 826 |
| Other operating income | 108 | 171 | 85 |
| Total other income | 5,105 | 5,440 | 4,716 |
| Other expenses: | | | |
| Salaries and employee benefits | 8,347 | 7,456 | 6,900 |
| Net occupancy expense | 1,234 | 1,283 | 1,226 |
| Furniture and fixture expense | 857 | 980 | 1,013 |
| Advertising | 401 | 356 | 378 |
| Data/Item processing | 397 | 374 | 322 |
| Other operating expenses | 3,411 | 3,115 | 3,158 |
| Total other expenses | 14,647 | 13,564 | 12,997 |
| Income before provision for income taxes | 14,552 | 16,148 | 15,086 |
| Provision for income taxes | 4,929 | 5,771 | 5,488 |
| Net income | \$ 9,623 | \$ 10,377 | \$ 9,598 |
| Basic earnings per share | \$ 1.54 | \$ 1.66 | \$ 1.55 |
| Diluted earnings per share | \$ 1.53 | \$ 1.64 | \$ 1.53 |

All per share amounts have been adjusted for the stock split.

See accompanying notes to Consolidated Financial Statements.

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Table of Contents**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

(In thousands, except share and per share amounts)

| | Common Stock | | Comprehensive | | Undivided | Treasury | Unearned | Accumulated Other Comprehensive Income | Total |
|--|-----------------------|--------|---------------|-----------------------|-----------|------------|-----------------|---|-----------|
| | Shares Outstanding | Amount | Surplus | Income ⁽¹⁾ | Profits | Stock | Stock Awards | (Loss) | |
| Balance at December 31, 2002 | 4,117,986 | \$ 43 | \$ 21,125 | | \$ 17,239 | \$ (2,524) | | \$ 4,088 | \$ 39,971 |
| Net income | | | | 9,598 | 9,598 | | | | 9,598 |
| Stock awards vested | 4,872 | | 42 | | | 81 | \$ 40 | | 163 |
| Stock awards granted | | | 34 | | | 87 | (121) | | - |
| Exercise of stock options, net of tax benefit | 32,737 | | (7) | | 38 | 447 | | | 478 |
| Cash dividends declared, \$0.78 per share | | | | | (4,893) | | | | (4,893) |
| Other comprehensive income, net of tax | | | | | | | | | |
| Unrealized net losses in securities available for sale | | | | (2,597) | | | | (2,597) | (2,597) |
| Minimum pension liability adjustment | | | | 74 | | | | 74 | 74 |
| Comprehensive Income | | | | 7,075 | | | | | |
| Balance at December 31, 2003 | 4,155,595 | 43 | 21,194 | | 21,982 | (1,909) | (81) | 1,565 | 42,794 |
| Net income | | | | 10,377 | 10,377 | | | | 10,377 |
| Stock awards vested | 5,040 | | 30 | | | 66 | 73 | | 169 |
| Stock awards granted | | | 58 | | | 55 | (113) | | - |
| Exercise of stock options, net of tax benefit | 24,417 | | 201 | | | 69 | | | 270 |
| Treasury stock purchases | (20,000) | | | | | (611) | | | (611) |
| Cash dividends declared, \$0.72 per share | | | | | (4,503) | | | | (4,503) |
| Effect of three-for-two stock split (in the form of a | | | | | | | | | |

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| | | | | | | | | | |
|--|-----------|-------|-----------|---------|-----------|------------|----------|------------|-----------|
| Stock dividend) | 2,089,437 | 21 | (21) | | | | | | - |
| Other comprehensive income, net of tax | | | | | | | | | |
| Unrealized net losses in securities available for sale | | | | (1,333) | | | (1,333) | | (1,333) |
| Minimum pension liability adjustment | | | | 50 | | | 50 | | 50 |
| Comprehensive Income | | | | 9,094 | | | | | |
| Balance at December 31, 2004 | 6,254,489 | 64 | 21,462 | | 27,856 | (2,330) | (121) | 282 | 47,213 |
| Net income | | | | 9,623 | 9,623 | | | | 9,623 |
| Stock awards vested | 6,155 | | 36 | | | 28 | 65 | | 129 |
| Stock awards granted | | | 52 | | | 38 | (90) | | - |
| Stock awards forfeited | | | (17) | | | (21) | 38 | | - |
| Exercise of stock options, net of tax benefit | 21,821 | | 98 | | | 134 | | | 232 |
| Treasury stock purchases | (75,926) | | | | | (2,134) | | | (2,134) |
| Cash dividends declared, \$0.91 per share | | | | | (5,666) | | | | (5,666) |
| Other comprehensive income, net of tax | | | | | | | | | - |
| Unrealized net losses in securities available for sale | | | | (2,779) | | | (2,779) | | (2,779) |
| Minimum pension liability adjustment | | | | 33 | | | 33 | | 33 |
| Comprehensive Income | | | | 6,877 | | | | | |
| Balance at December 31, 2005 | 6,206,539 | \$ 64 | \$ 21,631 | | \$ 31,813 | \$ (4,285) | \$ (108) | \$ (2,464) | \$ 46,651 |

(1) Disclosure of reclassification amount:

| December 31, | 2005 | 2004 | 2003 |
|--|------------|----------|------------|
| Comprehensive Income Items: | | | |
| Unrealized loss arising during the period, net of tax of \$1,820, \$591 and \$1,357 in 2005, | \$ (2,708) | \$ (891) | \$ (2,098) |

2004 and 2003

Less: reclassification
adjustment, net of
taxes

of \$46, \$293, \$327

in 2005, 2004 and
2003

for losses included

in income

| | | | |
|----|----------------|------------|------------|
| | 71 | 442 | 499 |
| \$ | (2,779) | \$ (1,333) | \$ (2,597) |

*All per share amounts have been adjusted for the stock split.
See accompanying notes to Consolidated Financial Statements.*

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Table of Contents**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

| Year Ended December 31, | 2005 | 2004 | 2003 |
|--|-----------------|-----------------|-----------------|
| Operating activities: | | | |
| Net Income | \$ 9,623 | \$ 10,377 | \$ 9,598 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for loan losses | 300 | 300 | - |
| Depreciation and amortization | 847 | 950 | 956 |
| Amortization and accretion, net | 786 | 1,261 | 2,059 |
| Earned or allocated expense of restricted stock awards | 65 | 73 | 40 |
| SERP expense | 153 | 149 | 142 |
| Net securities gains | (116) | (734) | (826) |
| (Increase) decrease in accrued interest receivable | (155) | (110) | 249 |
| Benefit (provision) for deferred income taxes | 21 | (179) | (37) |
| (Increase) decrease in other assets | (986) | 1,118 | (2,526) |
| Increase in accrued and other liabilities | 405 | 436 | 243 |
| Net cash provided by operating activities | 10,943 | 13,641 | 9,898 |
| Investing activities: | | | |
| Purchases of securities available for sale | (32,463) | (96,157) | (146,393) |
| Purchases of securities held to maturity | (13,262) | (21,213) | (14,421) |
| Proceeds from sales of securities available for sale | 21,965 | 56,005 | 71,637 |
| Proceeds from maturing securities available for sale | 2,995 | 4,750 | 4,752 |
| Proceeds from maturing securities held to maturity | 24,463 | 14,396 | 11,022 |
| Proceeds from principal payments on mortgage-backed securities | 22,032 | 23,980 | 51,592 |
| Net increase in loans | (6,235) | (23,202) | (24,950) |
| Purchases of banking premises and equipment | (2,670) | (3,144) | (2,752) |
| Net cash provided (used) by investing activities | 16,825 | (44,585) | (49,513) |
| Financing activities: | | | |
| Net (decrease) increase in deposits | (1,286) | 12,165 | 50,750 |
| (Decrease) increase in other borrowings | (12,200) | 20,800 | (6,400) |
| Payment for the purchase of Treasury stock | (2,134) | (611) | - |
| Net proceeds from exercise of stock options issued pursuant to equity incentive plan | 216 | 203 | 440 |
| Cash dividends paid | (5,551) | (5,790) | (2,943) |
| Net cash (used) provided by financing activities | (20,955) | 26,767 | 41,847 |

| | | | |
|--|------------------|----------|-----------|
| Increase (decrease) in cash and cash equivalents | 6,813 | (4,177) | 2,232 |
| Cash and cash equivalents beginning of year | 8,862 | 13,039 | 10,807 |
| Cash and cash equivalents end of year | \$ 15,675 | \$ 8,862 | \$ 13,039 |

Supplemental Information-Cash Flows:

| | | | |
|---|-----------------|----------|----------|
| Cash paid for: | | | |
| Interest | \$ 4,264 | \$ 2,344 | \$ 2,726 |
| Income taxes | \$ 5,023 | \$ 5,336 | \$ 5,501 |
| Noncash investing and financing activities: | | | |
| Dividends declared and unpaid | \$ 1,428 | \$ 1,313 | \$ 2,609 |

See accompanying notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Bridge Bancorp, Inc. (the “Company”) is incorporated under the laws of the State of New York as a single bank holding company. The Company’s business currently consists of the operations of its wholly-owned subsidiary, The Bridgehampton National Bank (the “Bank”). The Bank includes its real estate investment trust subsidiary, Bridgehampton Community, Inc. and a financial subsidiary; the now dissolved Bridgehampton Abstract Holding LLC, which had a 100% ownership in an investment in Bridge Abstract LLC (“Bridge Abstract”). Effective April 1, 2004, Bridgehampton Abstract Holding LLC ownership interest in Bridge Abstract increased to 100% from 51% ownership. Subsequent to December 31, 2004, Bridgehampton Abstract Holding LLC was dissolved. The financial statements have been prepared in accordance with U.S. generally accepted accounting principles and to general practices within the financial institution industry. The following is a description of the significant accounting policies that the Company follows in preparing its Consolidated Financial Statements.

a) Basis of Financial Statement Presentation

The accompanying Consolidated Financial Statements are prepared on the accrual basis of accounting and include the accounts of the Company and its wholly-owned subsidiary, the Bank. All material intercompany transactions and balances have been eliminated.

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 as of the date of each consolidated statement of condition and the related consolidated statement of income for the years then ended. Future results could differ from those estimates. The allowance for loan losses, fair values of financial instruments, deferred taxes, prepayment speeds on mortgage-backed securities, and pension are particularly subject to change.

b) Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold, which mature overnight. Cash flows are reported net for customer loan and deposit transactions and overnight borrowings.

c) Securities

The Company is required to report readily-marketable equity and debt securities in one of the following categories: (i) “held-to-maturity” (management has a positive intent and ability to hold to maturity), which are to be reported at amortized cost and (ii) “available for sale” (all other debt and marketable equity securities), which are to be reported at fair value, with unrealized gains and losses reported net of tax, as accumulated other comprehensive income, a separate component of stockholders’ equity. Restricted securities, as disclosed on the balance sheet including Federal Home Loan Bank stock and Federal Reserve Bank stock, are carried at cost.

Premiums and discounts on securities are amortized to expense and accreted to income over the estimated life of the respective securities using the interest method. Gains and losses on the sales of securities are recognized upon realization based on the specific identification method. Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses. In estimating other-than-temporary losses, management considers: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, and (3) the Company’s ability and intent to hold the security for a period sufficient to

allow for any anticipated recovery in fair value.

d) Loans and Loan Interest Income Recognition

Loans are stated at the principal amount outstanding, less net deferred origination fees. Loan origination and commitment fees and certain direct and indirect costs incurred in connection with loan originations are deferred and amortized to income over the life of the related loans as an adjustment to yield. When a loan prepays, the remaining unamortized net deferred origination fees are recognized in the current year. Interest on loans is credited to income based on the principal outstanding during the period. Loans that are 90 days past due are automatically placed on nonaccrual and previously accrued interest is reversed and charged against interest income. However, if the Bank has reasonable assurance that loan will be fully collectible based upon individual loan evaluation assessing such factors as collateral and collectibility, accrued interest will be recognized as earned. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered

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by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience minor payment delays and payment shortfall generally are not classified as impaired.

e) Allowance for Loan Losses

The Bank monitors its entire loan portfolio on a regular basis, with consideration given to detailed analyses of classified loans, repayment patterns, current delinquencies, probable incurred losses, past loss experience, current economic conditions, and various types of concentrations of credit. Additions to the allowance are charged to expense and realized losses, net of recoveries, are charged to the allowance. Based on the determination of management and the Classification Committee, the overall level of reserves is periodically adjusted to account for the inherent and specific risks within the entire portfolio. Based on the Classification Committee's review of the classified loans and the overall reserve levels as they relate to the entire loan portfolio at December 31, 2005, management believes the allowance for loan losses is adequate.

A loan is considered a potential charge-off when it is in default of either principal or interest for a period of 90, 120 or 180 days, depending upon the loan type, as of the end of the prior month. In addition to date criteria, other triggering events may include, but are not limited to, notice of bankruptcy by the borrower or guarantor, death of the borrower, and deficiency balance from the sale of collateral.

While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in conditions. In addition, various regulatory agencies, as an integral part of the examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to, or charge-offs against, the allowance based on their judgment about information available to them at the time of their examination.

f) Banking Premises and Equipment

Buildings, furniture and fixtures and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method using a useful life of fifty years for buildings and a range of two to ten years for equipment, furniture and fixtures. Leasehold improvements are amortized over the lives of the respective leases or the service lives of the improvements whichever is shorter. Land is recorded at cost.

Improvements and major repairs are capitalized, while the cost of ordinary maintenance, repairs and minor improvements is charged to operations.

g) Other Real Estate Owned

Other real estate owned consists of real estate acquired by foreclosure or deed in lieu of foreclosure and is recorded at the lower of the net unpaid principal balance at the foreclosure date plus acquisition costs or fair value. Subsequent valuation adjustments are made if fair value less estimated costs to sell the property falls below the carrying amount. At December 31, 2005 and 2004, the Company carried no other real estate owned.

h) Loan Commitments and Related Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer-financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay.

i) Income Taxes

The Company follows the asset and liability approach, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities, computed using enacted tax rates. Deferred tax assets are recognized if it is more likely than not that a future benefit will be realized. It is management's position, as currently supported by the facts and circumstances, that no valuation allowance is necessary against any of the Company's deferred tax assets.

j) Treasury Stock

Repurchases of common stock are recorded as treasury stock at cost. Treasury stock is reissued using the first in, first out method.

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k) Earnings Per Share

Diluted earnings per share, which reflects the potential dilution that could occur if outstanding stock options were exercised and if stock awards were fully vested and resulted in the issuance of common stock that then shared in the earnings of the Company, is computed by dividing net income by the weighted average number of common shares and common stock equivalents.

l) Dividends

Cash available for dividend distribution to shareholders of the Company must initially come from dividends paid by the Bank to the Company. The approval of the Regional Administrator of National Banks is required if the total of all dividends declared by the Bank in any calendar year exceeds the total of the Bank's net income of that year combined with its retained net income of the preceding two years. The Bank had approximately \$15,076,000 available as of December 31, 2005, which may be paid to the Company as a dividend without prior approval.

m) Stock Activity

On June 21, 2004, the Board of Directors declared a three-for-two stock split, in the form of a stock dividend, payable July 23, 2004 to stockholders of record as of July 9, 2004. The stock split increased outstanding common shares from 4,257,597 to 6,386,306. All references in the Consolidated Financial Statements and Notes thereto for per share amounts, and market prices of the common stock have been restated giving retroactive recognition to the stock split.

The transactions affecting common stock issued and outstanding and treasury stock are reflected in the table below:

| | Common Stock | | |
|-------------------------------------|------------------|-------------------------------------|-------------------|
| | Shares Issued | Shares Issued and Outstanding | Treasury Stock |
| Balance at December 31, 2003 | 4,257,597 | 4,155,595 | 102,002 |
| Stock awards vested | | 5,040 | (5,040) |
| Exercise of stock options | | 21,417 | (21,417) |
| Purchase of Treasury stock | | (3,000) | 3,000 |
| Effect of three-for-two stock split | 2,128,798 | 2,089,526 | 39,272 |
| Fractional shares | (89) | (89) | |
| Exercise of stock options | | 3,000 | (3,000) |
| Purchase of Treasury stock | | (17,000) | 17,000 |
| Balance at December 31, 2004 | 6,386,306 | 6,254,489 | 131,817 |
| Stock awards vested | | 6,155 | (6,155) |
| Stock awards granted | | | |
| Stock awards forfeited | | | |
| Exercise of stock options | | 21,821 | (21,821) |
| Purchase of Treasury stock | | (75,926) | 75,926 |
| Balance at December 31, 2005 | 6,386,306 | 6,206,539 | 179,767 |

n) Segment Reporting

While management monitors the revenue streams of the various products and services, the identifiable segments are not material and operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

o) Stock Based Compensation Plans

Employee compensation expense under stock options is reported using the intrinsic value method. No stock-based compensation cost is reflected in net income, as all the options granted had an exercise price equal to the market price of the underlying common stock at date of grant. The following table illustrates the effect on net income and earnings per share if expense was measured using the fair value recognition provisions of Statement of Financial Accounting Standard (SFAS) No. 123 (revised 2004), "*Accounting for Stock-Based Compensation.*"

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| For the Year Ended | | 2005 | 2004 | 2003 |
|--|-----------|----------|-----------|----------|
| (In thousands, except per share amounts) | | | | |
| Net | As | | | |
| Income: | Reported: | \$ 9,623 | \$ 10,377 | \$ 9,598 |
| Pro Forma: | | 9,606 | 10,332 | 9,514 |
| Diluted | As | | | |
| EPS: | Reported: | \$ 1.53 | \$ 1.64 | \$ 1.53 |
| Pro Forma: | | 1.53 | 1.64 | 1.52 |
| | As | | | |
| Basic EPS: | Reported: | \$ 1.54 | \$ 1.66 | \$ 1.55 |
| Pro Forma: | | 1.54 | 1.65 | 1.53 |

The fair value of each option granted is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for the following years:

| For the Year Ended | 2005 | 2004 | 2003 |
|-------------------------|-------|-------|-------|
| Risk free interest rate | 3.66% | 3.02% | 3.10% |
| Expected dividend yield | 3.76% | 2.75% | 3.19% |
| Expected volatility | 21.3% | 23.5% | 44.4% |

p) Comprehensive Income

Comprehensive income includes net income and all other changes in equity during a period, except those resulting from investments by owners and distributions to owners. Other comprehensive income includes revenues, expenses, gains and losses that under generally accepted accounting principles are included in comprehensive income but excluded from net income. Comprehensive income and accumulated other comprehensive income are reported net of related income taxes. Accumulated other comprehensive income for the Company includes unrealized holding gains or losses on available for sale securities and the minimum pension liability. Such gains or losses are net of reclassification adjustments for realized gains (losses) on sales of available for sale securities.

q) Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

r) New Accounting Standards

In June 2005, the FASB decided not to provide additional guidance on the meaning of other-than-temporary impairment, and issued FASB Staff Position ("FSP FAS") 115-1 with references to existing other-than-temporary impairment guidance, such as SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," SEC Staff Accounting Bulletin No. 59, "Accounting for Noncurrent Marketable Equity Securities," and APB Opinion No. 18,

“*The Equity Method of Accounting for Investments in Common Stock.*” FSP FAS 115-1 will codify the guidance set forth in Emerging Issues Task Force Topic D-44 and clarify that an investor should recognize an impairment loss no later than when the impairment is deemed other than temporary, even if a decision to sell has not been made. FSP FAS 115-1 will be effective for other-than-temporary impairment analysis conducted in periods beginning after December 15, 2005.

SFAS 123R, “*Accounting for Stock-Based Compensation, Revised,*” requires all public companies to record compensation cost for stock options provided to employees in return for employee service. The cost is measured at the fair value of the options when granted, and this cost is expensed over the employee service period, which is normally the vesting period of the options. The Securities and Exchange Commission in April 2005 amended the compliance dates for SFAS 123R from periods beginning after September 15, 2005 to the beginning of the next fiscal year. Historically substantially all of the options granted by the Company have vested immediately; compensation expense would be recorded on the date of grant. The effect on results of operations will depend on the level of future option grants and the calculation of the fair value of the options granted at such future date and so cannot currently be predicted.

The effect of these new standards on the Company’s financial position and results of operations is not expected to be material upon and after adoption.

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s) Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

2. SECURITIES

A summary of the amortized cost, gross unrealized gains, gross unrealized losses and estimated fair value of securities is as follows:

| December 31, (In thousands) | 2005 | | | | | | | | 2004 |
|--|-------------------|------------------------------|-------------------------------|----------------------------|-------------------|------------------------------|-------------------------------|----------------------------|------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | |
| Available for sale: | | | | | | | | | |
| U.S. Treasury and government agency securities | \$ 38,443 | \$ 7 | \$ (788) | \$ 37,662 | \$ 53,736 | \$ 519 | \$ (216) | \$ 54,039 | |
| State and municipal obligations | 51,392 | 387 | (559) | 51,220 | 40,027 | 1,098 | (81) | 41,044 | |
| Mortgage-backed securities | 96,938 | 27 | (3,046) | 93,919 | 107,609 | 483 | (1,133) | 106,959 | |
| Total available for sale | 186,773 | 421 | (4,393) | 182,801 | 201,372 | 2,100 | (1,430) | 202,042 | |
| Restricted: | | | | | | | | | |
| Federal Reserve Bank Stock | 36 | - | - | 36 | 36 | - | - | 36 | |
| Federal Home Loan Bank Stock | 1,341 | - | - | 1,341 | 1,943 | - | - | 1,943 | |
| Total restricted | 1,377 | - | - | 1,377 | 1,979 | - | - | 1,979 | |
| Held to maturity: | | | | | | | | | |
| State and municipal obligations | 10,012 | - | (23) | 9,989 | 21,213 | - | (82) | 21,131 | |
| Total held to maturity | 10,012 | - | (23) | 9,989 | 21,213 | - | (82) | 21,131 | |
| Total debt and equity securities | \$ 198,162 | \$ 421 | \$ (4,416) | \$ 194,167 | \$ 224,564 | \$ 2,100 | \$ (1,512) | \$ 225,152 | |

Securities with unrealized losses at year-end 2005 and 2004, aggregated by category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

| December 31, (In thousands) | 2005 | | 2004 |
|--------------------------------|------|--|------|
|--------------------------------|------|--|------|

| | Less than 12 months Unrealized Fair Value | | Greater than 12 months Unrealized Fair Value | | Less than 12 months Unrealized Fair Value | | Greater than 12 months Unrealized Fair Value | |
|--|--|----------|---|----------|--|--------|---|--------|
| | Losses | | Losses | | Losses | | Losses | |
| U.S. Treasury and government agency securities | \$ 14,132 | \$ 243 | \$ 18,048 | \$ 546 | \$ 26,832 | \$ 216 | \$ - | \$ - |
| State and municipal obligations | 31,635 | 266 | 9,214 | 316 | 26,343 | 127 | 1,070 | 35 |
| Mortgage-backed securities | 42,354 | 860 | 50,736 | 2,185 | 35,146 | 336 | 30,816 | 798 |
| Total temporarily impaired securities | \$ 88,121 | \$ 1,369 | \$ 77,998 | \$ 3,047 | \$ 88,321 | \$ 679 | \$ 31,886 | \$ 833 |

Unrealized losses on securities have not been recognized into income, as the losses on these securities would be expected to dissipate as they approach their maturity dates. The Company evaluates securities for other-than-temporary impairment periodically with increased frequency when economic or market concerns warrant such evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

The following table sets forth the fair value, amortized cost, maturities and approximated weighted average yield (based on the estimated annual income divided by the average book value) at December 31, 2005. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Yields on tax-exempt obligations have been computed on a tax-equivalent basis.

Table of ContentsDecember 31,
2005(Dollars in
thousands)

| | Within One Year | | | After One But Within Five Years | | | After Five But Within Ten Years | | | After Ten Years | | | V |
|--|-------------------------|-----------------------------|-------|------------------------------------|-----------------------------|-------|------------------------------------|-----------------------------|-------|-------------------------|-----------------------------|-------|---|
| | Fair Value Amount | Amortized Cost Amount | Yield | Fair Value Amount | Amortized Cost Amount | Yield | Fair Value Amount | Amortized Cost Amount | Yield | Fair Value Amount | Amortized Cost Amount | Yield | |
| Available for sale: | | | | | | | | | | | | | |
| U.S. Treasury and government agency securities | \$ 394 | \$ 401 | 3.42% | \$ 37,268 | \$ 38,042 | 5.64% | \$ - | \$ - | -% | \$ - | \$ - | -% | |
| Mortgage-backed securities | - | - | - | 11,542 | 11,968 | 5.65 | 16,563 | 17,027 | 6.38 | 65,814 | 67,943 | 6.62 | |
| State and municipal obligations | 5,318 | 5,281 | 6.84 | 21,469 | 21,564 | 4.98 | 15,269 | 15,315 | 5.38 | 9,164 | 9,232 | 5.69 | |
| Total available for sale | 5,712 | 5,682 | 6.60 | 70,279 | 71,574 | 5.44 | 31,832 | 32,342 | 5.91 | 74,978 | 77,175 | 6.50 | |
| Restricted securities: | | | | | | | | | | | | | |
| Federal Reserve Bank Stock | - | - | - | - | - | - | - | - | - | - | - | - | |
| Federal Home Loan Bank Stock | - | - | - | - | - | - | - | - | - | - | - | - | 1 |
| Total restricted | - | - | - | - | - | - | - | - | - | - | - | - | 1 |
| Held to maturity: | | | | | | | | | | | | | |
| State and municipal obligations | 9,989 | 10,012 | 4.53 | - | - | - | - | - | - | - | - | - | |
| Total held to maturity | 9,989 | 10,012 | 4.53 | - | - | - | - | - | - | - | - | - | |
| Total debt and equity securities | \$ 15,701 | \$ 15,694 | 5.28% | \$ 70,279 | \$ 71,574 | 5.44% | \$ 31,832 | \$ 32,342 | 5.91% | \$ 74,978 | \$ 77,175 | 6.50% | 1 |

There were \$21,965,000, \$56,005,000 and \$71,637,000 of proceeds on sales of available for sale securities in 2005, 2004, and 2003, respectively. Gross gains of approximately \$180,000, \$1,126,000, and \$1,461,000 were realized on sales of available for sale securities during 2005, 2004, and 2003, respectively. Gross losses of approximately \$65,000, \$392,000, and \$635,000 were realized on sales of available for sale securities during 2005, 2004, and 2003, respectively. There were no sales of held to maturity securities during 2005, 2004, and 2003.

Securities having a fair value of approximately \$123,314,000 and \$110,479,000 at December 31, 2005 and 2004, respectively, were pledged to secure public deposits.

There was no investment that exceeded 10% of stockholders' equity at December 31, 2005.

3. LOANS

The following table sets forth the major classifications of loans:

| December 31, (In thousands) | 2005 | 2004 |
|--|------------|------------|
| Real estate mortgage loans | \$ 242,928 | \$ 236,812 |
| Commercial, financial, and agricultural loans | 31,644 | 34,342 |
| Installment/consumer loans | 9,827 | 6,685 |
| Real estate construction loans | 17,960 | 18,452 |
| Total loans | 302,359 | 296,291 |
| Unearned income | (95) | (157) |
| | 302,264 | 296,134 |
| Allowance for loan losses | (2,383) | (2,188) |
| Net loans | \$ 299,881 | \$ 293,946 |

Table of Contents**Lending Risk**

The principal business of the Bank is lending, primarily in commercial real estate loans, construction loans, home equity loans, land loans, consumer loans, residential mortgages and commercial loans. The Bank considers its primary lending area to be eastern Long Island in Suffolk County, New York and a substantial portion of the Bank's loans are secured by real estate in this area. Accordingly, the ultimate collectibility of such a loan portfolio is susceptible to changes in market and economic conditions in this region.

Allowance for Loan Losses

The following table sets forth changes in the allowance for loan losses.

| December 31, (In thousands) | 2005 | 2004 | 2003 |
|---|----------|----------|----------|
| Allowance for loan losses | | | |
| balance at beginning of period | \$ 2,188 | \$ 2,144 | \$ 2,294 |
| Charge-offs: | | | |
| Real estate mortgage loans | 7 | 3 | 38 |
| Commercial, financial and agricultural loans | 153 | 302 | 163 |
| Installment/consumer loans | 129 | 65 | 148 |
| Total | 289 | 370 | 349 |
| Recoveries: | | | |
| Real estate mortgage loans | 17 | 23 | 13 |
| Real estate construction loans | 100 | - | - |
| Commercial, financial and agricultural loans | 37 | 61 | 90 |
| Installment/consumer loans | 30 | 30 | 96 |
| Total | 184 | 114 | 199 |
| Net (charge-offs) recoveries | (105) | (256) | (150) |
| Provision for loan losses charged to operations | 300 | 300 | - |
| Balance at end of period | \$ 2,383 | \$ 2,188 | \$ 2,144 |

Past Due, Nonaccrual and Restructured Loans

Nonaccrual loans at December 31, 2005 and 2004 were \$658,000 and \$1,695,000, respectively. There were no loans 90 days or more past due that were still accruing or any restructured loans at December 31, 2005 and 2004. Gross interest income on nonaccrual loans that would have been recorded under original terms during the year ended December 31, 2005, 2004, and 2003 were \$38,000, \$16,000, and \$9,000, respectively. Gross interest income recorded on these loans during the year ended December 31, 2005, 2004 and 2003 were \$17,000, \$12,000, and \$6,000, respectively.

As of December 31, 2005 and 2004, the Bank did not have any impaired loans as defined in SFAS No. 114.

Related Party Loans

Certain directors, executive officers, and their related parties, including their immediate families and companies in which they are principal owners, were loan customers of the Bank during 2005 and 2004.

The following table sets forth selected information about related party loans at December 31, 2005.

| | Balance Outstanding |
|-------------------------------------|------------------------|
| (In thousands) | |
| Balance at December 31, 2004 | \$ 1,220 |
| New loans | - |
| Effective change in related parties | 56 |
| Advances | 682 |
| Repayments | (170) |
| Balance at December 31, 2005 | \$ 1,788 |

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4. BANKING PREMISES AND EQUIPMENT

Banking premises and equipment consist of:

| December 31, (In thousands) | 2005 | 2004 |
|--|-----------|-----------|
| Land | \$ 6,142 | \$ 6,142 |
| Construction in progress | 426 | 87 |
| Building and improvements | 8,632 | 7,036 |
| Furniture and fixtures | 6,797 | 6,110 |
| Leasehold improvements | 1,234 | 1,226 |
| | 23,231 | 20,601 |
| Less: accumulated depreciation and amortization | (7,591) | (6,784) |
| | \$ 15,640 | \$ 13,817 |

The Company has a purchase commitment outstanding at December 31, 2005 for purchase of real estate in the Town of Southold for \$250,000.

5. DEPOSITS

Time Deposits

The following table sets forth the remaining maturities of the Bank's time deposits at December 31, 2005.

| (In thousands) | Less than \$100,000 | \$100,000 or Greater | Total |
|-------------------------------|------------------------|-------------------------|-----------|
| 3 months or less | \$ 9,515 | \$ 11,284 | \$ 20,799 |
| Over 3 thru 6 months | 5,327 | 2,469 | 7,796 |
| Over 6 thru 12 months | 5,700 | 2,762 | 8,462 |
| Over 12 months thru 24 months | 2,727 | 1,661 | 4,388 |
| Over 24 months thru 36 months | 1,267 | 641 | 1,908 |
| Over 36 months thru 48 months | 312 | 204 | 516 |
| Over 48 months thru 60 months | - | - | - |
| Over 60 months | 2 | - | 2 |
| Total | \$ 24,850 | \$ 19,021 | \$ 43,871 |

Deposits from principal officers, directors and their affiliates at year-end 2005 and 2004 were approximately \$3,526,000 and \$4,177,000, respectively.

6. INCOME TAXES

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

| Year Ended December 31, (In thousands) | 2005 | 2004 | 2003 |
|---|----------|----------|----------|
| Current: | | | |
| Federal | \$ 4,087 | \$ 4,453 | \$ 4,361 |
| State | 863 | 1,139 | 1,090 |

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| | | | |
|-----------|-----------------|-----------------|-----------------|
| | 4,950 | 5,592 | 5,451 |
| Deferred: | | | |
| Federal | (22) | 152 | 30 |
| State | 1 | 27 | 7 |
| | (21) | 179 | 37 |
| Total | \$ 4,929 | \$ 5,771 | \$ 5,488 |

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The reconciliation of the expected Federal income tax expense at the statutory tax rate to the actual provision follows:

| Year Ended December 31, (Dollars in thousands) | 2005 | | 2004 | | 2003 | |
|---|----------|--------------------------------------|----------|--------------------------------------|----------|--------------------------------------|
| | Amount | Percentage of Pre-tax Earnings | Amount | Percentage of Pre-tax Earnings | Amount | Percentage of Pre-tax Earnings |
| Federal income tax expense computed by applying the statutory rate to income before income taxes | \$ 4,984 | 34% | \$ 5,531 | 34% | \$ 5,280 | 35% |
| Tax exempt interest | (665) | (4) | (552) | (4) | (544) | (4) |
| State taxes, net of Federal income tax benefit | 568 | 5 | 767 | 5 | 721 | 5 |
| Other | 42 | 1 | 25 | 1 | 31 | - |
| Provision for income taxes | \$ 4,929 | 36% | \$ 5,771 | 36% | \$ 5,488 | 36% |

Deferred tax assets and liabilities are comprised of the following:

| December 31, (In thousands) | 2005 | 2004 |
|--|----------|--------|
| Deferred tax assets: | | |
| Allowance for loan losses | \$ 1,026 | \$ 924 |
| Depreciation | 15 | - |
| Total | 1,041 | 924 |
| Deferred tax liabilities: | | |
| Pension expense | (211) | (184) |
| Other | (203) | (78) |
| Depreciation | - | (57) |
| Total | (414) | (319) |
| Total before other comprehensive income | 627 | 605 |
| SFAS No. 115 deferred tax asset (liability) | 1,596 | (267) |
| Minimum pension liability adjustment | 59 | 81 |
| Net deferred tax asset | \$ 2,282 | \$ 419 |

Since the Bank has exceeded the threshold of \$500,000,000 in average assets, the tax basis in the bad debt reserve prior to January 1, 2004 is to be recaptured for federal tax purposes. The Bank intends to recapture this using the deferral method and has previously provided for the taxes relating to this recapture. Subsequent to January 1, 2004, the Bank is on a specific charge-off method for federal tax purposes.

7. EMPLOYEE BENEFITS

a) Pension Plan and Supplemental Executive Retirement Plan

The Bank maintains a noncontributory pension plan through the New York State Bankers Association Retirement System covering all eligible employees. The Bank uses a September 30 measurement date for this plan.

During 2001, the Bank adopted the Bridgehampton National Bank Supplemental Executive Retirement Plan (“SERP”). The SERP provides benefits to certain employees, designated by the Compensation Committee of the Board of Directors, whose benefits under the Pension Plan are limited by the applicable provisions of the Internal Revenue Code. The benefit under the SERP is equal to the additional amount the employee would be entitled to under the Pension Plan and the 401(k) Plan in the absence of such Internal Revenue Code limitations. The assets of the SERP are held in a rabbi trust in order to maintain the tax-deferred status of the individuals in the plan. As a result, the assets of the trust are reflected on the Consolidated Statements of Condition of the Company. The effective date of the SERP was January 1, 2001. SERP expense was \$208,000, \$149,000, and \$142,000 in 2005, 2004 and 2003, respectively. Subsequent to December 31, 2005, a payout of approximately \$105,000 will be made pursuant to a severance agreement with the former Chief Operating Officer.

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The following table sets forth the plans' changes in obligations and funded status projected as of September 30, 2005 and 2004 (measurement dates).

| At December 31, (In thousands) | Pension Benefits | | SERP Benefits | |
|---|------------------|----------|---------------|------------|
| | 2005 | 2004 | 2005 | 2004 |
| Change in benefit obligation | | | | |
| Benefit obligation at beginning of year | \$ 3,776 | \$ 3,382 | \$ 1,453 | \$ 1,016 |
| Service cost | 317 | 277 | 87 | 63 |
| Expenses | (40) | (35) | - | - |
| Interest cost | 223 | 200 | 71 | 52 |
| Benefits paid | (130) | (123) | - | - |
| Additional prior service cost | - | - | - | - |
| Assumption changes and other | 485 | 75 | (430) | 322 |
| Benefit obligation at end of year | \$ 4,631 | \$ 3,776 | \$ 1,181 | \$ 1,453 |
| Change in plan assets, at fair value | | | | |
| Plan assets at beginning of year | \$ 3,759 | \$ 2,508 | - | - |
| Actual return on plan assets | 445 | 295 | - | - |
| Employer contribution | - | 1,114 | - | - |
| Benefit paid | (130) | (123) | - | - |
| Expenses | (40) | (35) | - | - |
| Plan assets at end of year | \$ 4,034 | \$ 3,759 | - | - |
| Funded status (plan assets less benefit obligations) | | | | |
| | \$ (596) | \$ (16) | \$ (1,181) | \$ (1,453) |
| Unrecognized net actuarial loss | 1,107 | 795 | 78 | 531 |
| Unrecognized prior service cost | 137 | 147 | - | - |
| Unrecognized transition asset | (3) | (12) | 399 | 426 |
| Minimum additional pension liability | - | - | (147) | (202) |
| | \$ 645 | \$ 914 | \$ (851) | \$ (698) |

Prepaid benefit
(accrued) cost

Amounts recognized in the statement of condition consist of:

| At December 31, (In thousands) | Pension Benefits | | SERP Benefits | |
|--------------------------------------|------------------|--------|---------------|----------|
| | 2005 | 2004 | 2005 | 2004 |
| Prepaid benefit cost | \$ 645 | \$ 914 | \$ - | \$ - |
| Accrued benefit cost | - | - | (704) | (495) |
| Minimum additional pension liability | - | - | (147) | (202) |
| Other | - | - | - | - |
| Net amount recognized | \$ 645 | \$ 914 | \$ (851) | \$ (697) |

| At December 31, (In thousands) | Pension Benefits | | | SERP Benefits | | |
|--|------------------|--------|--------|---------------|--------|--------|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Components of net periodic benefit cost | | | | | | |
| Service cost | \$ 317 | \$ 277 | \$ 265 | \$ 87 | \$ 63 | \$ 59 |
| Interest cost | 223 | 200 | 175 | 71 | 52 | 46 |
| Expected return on plan assets | (296) | (208) | (185) | - | - | - |
| Amortization of net loss | 25 | 25 | 29 | - | 23 | 7 |
| Amortization of unrecognized prior service cost | 10 | 9 | 9 | - | - | - |
| Amortization of unrecognized transition (asset) obligation | (9) | (8) | (8) | 28 | 28 | 28 |
| Net periodic benefit cost | \$ 290 | \$ 295 | \$ 285 | \$ 186 | \$ 166 | \$ 140 |

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Other information for the pension and SERP are as follows:

| At December 31, (In thousands) | Pension Plan | | SERP | |
|---|--------------|-------|-------|--------|
| | 2005 | 2004 | 2005 | 2004 |
| Net minimum liability included in other comprehensive income | \$ - | \$ - | \$ 88 | \$ 121 |
| Accumulated benefit obligation | 3,463 | 2,907 | 851 | 697 |
| Expected contributions in 2006 | 666 | - | 148 | - |

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

| Year (In thousands) | Pension Payments |
|------------------------|---------------------|
| 2006 | \$ 137 |
| 2007 | 138 |
| 2008 | 137 |
| 2009 | 204 |
| 2010 | 205 |
| 2011-2015 | 1,110 |

The Company's pension plan weighted-average asset allocations at September 30, 2005 and 2004 by asset category are as follows:

| Plan Assets at September 30, | 2005 | 2004 |
|------------------------------|--------|--------|
| Asset Category: | | |
| Equity Securities | 58.8% | 64.7% |
| Debt Securities | 41.2 | 34.9 |
| Other | - | 0.4 |
| Total | 100.0% | 100.0% |

Investment Policies

The New York State Bankers Retirement System (the "System") was established in 1938 to provide for the payment of benefits to employees of participating banks. The System is overseen by a Board of Trustees ("Trustees"), who meet quarterly, and set the investment policy guidelines.

The System utilizes two investment management firms (which will be referred to as "Firm I" and "Firm II"). Firm I is investing approximately 68% of the portfolio and Firm II is investing approximately 32% of the portfolio. The System's investment objective is to exceed the investment benchmarks in each asset category. Each firm operates under a separate written investment policy approved by the Trustees and designed to achieve an allocation

approximating 60% invested in Equity Securities and 40% invested in Debt Securities.

Each Firm reports at least quarterly to the investment committee of the System and semi-annually to the Trustees.

Equities: The target allocation percentage for equity securities is 60% but may vary from 50%-70% at the investment manager's discretion.

Firm I is employed for its expertise as a Value Manager. It is allowed to invest a certain amount of the equity portfolio under its management in international securities and to hedge said international securities so as to protect against currency devaluations.

The equities managed by Firm II are in a commingled Large Cap Equity Fund. The portfolio is permitted to invest in a diversified range of securities in the US Equity markets. Although the portfolio holds primarily common stocks, from time to time the portfolio may invest in other types of investments on an opportunistic basis.

Fixed Income: For both investment portfolios, the target allocation percentage for debt securities is 40%, but may vary from 30% to 50% at the investment manager's discretion.

The Fixed Income Portfolio managed by Firm I operates with guidelines relating to types of debt securities, quality ratings, maturities,

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and maximum single and sector allocations.

The portfolio may trade foreign currencies in both spot and forward markets to affect securities transactions and to hedge underlying asset positions. The purchase and sale of futures and options on futures on foreign currencies and on foreign and domestic bonds, bond indices and short-term securities is permitted; however, purchases may not be used to leverage the portfolio. Currency transactions may only be used to hedge 0-100% of currency exposure of foreign securities.

The Fixed Income managed by Firm II is a Core Bond Fixed Income Fund. The portfolio investments are limited to US Dollar denominated, fixed income securities and selective derivatives designed to have similar attributes of such fixed income securities. The term “fixed income security” is defined to include instruments with fixed, floating, variable, adjustable, auction-rate, zero, or other coupon features.

Expected Long-Term Rate-of-Return

The expected long-term rate-of-return on plan assets reflects long-term earnings expectations on existing plan assets and those contributions expected to be received during the current plan year. In estimating that rate, appropriate consideration was given to historical returns earned by plan assets in the fund and the rates of return expected to be available for reinvestment. Average rates of return over the past 1, 3, 5 and 10-year periods were determined and subsequently adjusted to reflect current capital market assumptions and changes in investment allocations.

| At December 31, | Pension Benefits | | | SERP Benefits | | |
|--|------------------|-------|-------|---------------|-------|-------|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Weighted Average Assumptions Used to Determine Benefit Obligations | | | | | | |
| Discount rate | 5.50% | 6.00% | 6.00% | 4.68% | 4.90% | 5.14% |
| Rate of compensation increase | 4.50 | 4.00 | 4.00 | 5.00 | 4.00 | 4.00 |
| Expected long-term rate of return | 8.00 | 8.00 | 8.00 | - | - | - |
| Weighted Average Assumptions Used to Determine Net Periodic Benefit Cost (Income) | | | | | | |
| Discount rate | 6.00% | 6.00% | 6.25% | 4.90% | 5.14% | 5.14% |
| Rate of compensation increase | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 |
| Expected long-term rate of return | 8.00 | 8.00 | 8.50 | - | - | - |

b) 401(k) Plan

A savings plan is maintained under Section 401(k) of the Internal Revenue Code and covers substantially all current employees. Newly hired employees can elect to participate in the savings plan after completing six months of service. Under the provisions of the savings plan, employee contributions are partially matched by the Bank with cash

contributions. Participants can invest their account balances into several investment alternatives. The savings plan does not allow for investment in the Company's common stock. During the years ended December 31, 2005, 2004 and 2003 the Bank made cash contributions of \$114,000, \$110,000, and \$108,000, respectively.

c) Equity Incentive Plan

During 1996, the Bridge Bancorp, Inc. Equity Incentive Plan (the "Plan") was approved by the shareholders to provide for the grant of options to purchase up to a total of 648,000 shares of common stock of the Company and for the award of shares of common stock as a bonus. During 2001, a plan amendment to cover non-employee directors was adopted by the shareholders. Of the total 648,000 shares of common stock approved for issuance under the Plan, at December 31, 2005, 406,048 shares remain available for issuance.

The Compensation Committee of the Board of Directors determines options awarded under the Plan. The Company accounts for this Plan under APB Opinion No. 25, under which no compensation cost has been recognized for stock options granted. Historically, stock options granted by the Company are immediately exercisable.

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For the Year
Ended December
31,

| | 2005 | | 2004 | | 2003 | |
|--|-------------------------|--|-------------------------|--|-------------------------|--|
| | Number of Options | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price |
| Outstanding, beginning of the year | 102,429 | \$ 15.10 | 136,725 | \$ 13.22 | 163,575 | \$ 11.85 |
| Granted | 6,954 | \$ 28.85 | 14,845 | \$ 24.00 | 26,550 | \$ 15.47 |
| Exercised | (26,276) | \$ 13.09 | (49,141) | \$ 12.54 | (53,400) | \$ 10.11 |
| Forfeited | - | - | - | - | - | - |
| Outstanding and exercisable, end of the year | 83,107 | \$ 16.88 | 102,429 | \$ 15.10 | 136,725 | \$ 13.22 |
| Weighted average fair value of options granted | | \$ 4.39 | | \$ 4.45 | | \$ 5.00 |
| Weighted average remaining contractual life | | 4.79 years | | | | |

| | Number of | |
|-----------------------------|--------------|------------------|
| Range of Exercise Prices | Shares | Price |
| | 8,000 | \$ 9.78-\$11.00 |
| | 11,025 | \$ 12.53 |
| | 25,933 | \$ 13.17-14.67 |
| | 17,100 | \$ 15.47 |
| | 18,049 | \$ 24.00-\$30.60 |

The Company's Equity Incentive Plan also provides for issuance of restricted stock awards. During the years ended December 31, 2005 and 2004, the Company granted restricted stock awards of 1,239 and 4,570 shares, respectively. These awards vest over three years in January of each year following the date of the award. Such shares are subject to restrictions based on continued service as employees of the Company or employees of subsidiaries of the Company. Compensation expense attributable to these awards was approximately \$179,000, \$101,000 and \$98,000 for the years ended December 31, 2005, 2004, and 2003, respectively. Unearned compensation is recorded as a reduction of stockholders' equity until earned.

8. EARNINGS PER SHARE

The following is a reconciliation of earnings per share for December 31, 2005, 2004 and 2003. All share and per share amounts have been adjusted for the three-for-two stock split effective July 9, 2004.

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For the Year Ended December 31,
(In thousands, except per share data)

| | 2005 | 2004 | 2003 |
|--|-----------------|-----------|----------|
| Net income | \$ 9,623 | \$ 10,377 | \$ 9,598 |
| Common equivalent shares: | | | |
| Weighted average common shares outstanding | 6,241 | 6,255 | 6,197 |
| Weighted average common equivalent shares | 34 | 75 | 57 |
| Weighted average common and common equivalent shares | 6,275 | 6,330 | 6,254 |
| Basic earnings per share | \$ 1.54 | \$ 1.66 | \$ 1.55 |
| Diluted earnings per share | \$ 1.53 | \$ 1.64 | \$ 1.53 |

9. COMMITMENTS AND CONTINGENCIES AND OTHER MATTERS

In the normal course of business, there are various outstanding commitments and contingent liabilities, such as claims and legal actions, minimum annual rental payments under non-cancelable operating leases, guarantees and commitments to extend credit, which are not reflected in the accompanying consolidated financial statements. No material losses are anticipated as a result of these actions or claims.

a) Leases

The Company is obligated to make minimum annual rental payments under non-cancelable operating leases on its premises. Projected

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minimum rentals under existing leases are as follows:

| December 31, 2005 | |
|------------------------------|-----------------|
| (In thousands) | |
| 2006 | \$ 493 |
| 2007 | 368 |
| 2008 | 217 |
| 2009 | 197 |
| 2010 | 97 |
| Thereafter | 1,052 |
| Total minimum rentals | \$ 2,424 |

Certain leases contain renewal options and rent escalation clauses. In addition, certain leases provide for additional payments based upon real estate taxes, interest and other charges. Rental expenses under these leases for the years ended December 31, 2005, 2004 and 2003 approximated \$456,000, \$501,000, and \$492,000, respectively.

b) Loan commitments

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, often including obtaining collateral at exercise of the commitment.

The following represents commitments outstanding:

| December 31, | 2005 | 2004 |
|---|------------------|------------------|
| (In thousands) | | |
| Standby letters of credit | \$ 1,955 | \$ 1,803 |
| Loan commitments outstanding ⁽¹⁾ | 11,839 | 6,090 |
| Unused equity lines | 42,432 | 37,233 |
| Unused construction lines | 1,324 | 10,123 |
| Unused lines of credit | 23,154 | 21,751 |
| Unused overdraft lines | 12,268 | 11,408 |
| Total commitments outstanding | \$ 92,972 | \$ 88,408 |

(1) Of the \$11,839,000 of loan commitments outstanding, \$987,000 are fixed rate commitments and \$10,852,000 are variable rate commitments.

c) Other

During 2005, the Bank was required to maintain certain cash balances with the Federal Reserve Bank of New York for reserve and clearing requirements. These balances averaged \$1,678,000 in 2005.

During 2005, 2004 and 2003, the Bank maintained an overnight line of credit with the Federal Home Loan Bank of New York ("FHLB"). The Bank has the ability to borrow against its unencumbered residential mortgages and investment securities owned by the Bank. At December 31, 2005, the Bank had aggregate lines of credit of \$47,000,000 with unaffiliated correspondent banks to provide short-term credit for liquidity requirements. Of these aggregate lines of credit, \$27,000,000 is available on an unsecured basis. As of December 31, 2005, the Bank had \$14,500,000 in such borrowings outstanding.

In March 2001, the Bank entered into a Master Repurchase Agreement with the FHLB whereby the FHLB agrees to purchase securities from the Bank, upon the Bank's request, with the simultaneous agreement to sell the same or similar securities back to the Bank at a future date. Securities are limited, under the agreement, to government securities, securities issued, guaranteed or collateralized by any agency or instrumentality of the U.S. Government or any government sponsored enterprise, and non-agency AA and AAA rated mortgage-backed securities. At December 31, 2005, there was \$53,587,000 available for transactions under this agreement. There were no balances outstanding at year-end.

10. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value estimates are made at a specific point in time and are based on existing on-and off-balance sheet financial instruments. Such

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estimates are generally subjective in nature and dependent upon a number of significant assumptions associated with each financial instrument or group of financial instruments, including estimates of discount rates, risks associated with specific financial instruments, estimates of future cash flows, and relevant available market information. Changes in assumptions could significantly affect the estimates. In addition, fair value estimates do not reflect the value of anticipated future business, premiums or discounts that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument, or the tax consequences of realizing gains or losses on the sale of financial instruments.

The Company used the following method and assumptions in estimating the fair value of its financial instruments:

Cash and Due from Banks and Federal Funds Sold: Carrying amounts approximate fair value, since these instruments are either payable on demand or have short-term maturities.

Securities Available for Sale and Held to Maturity: The estimated fair values are based on independent dealer quotations and quoted market prices.

Loans: The estimated fair values of real estate mortgage loans and other loans receivable are based on discounted cash flow calculations that apply available market benchmarks when establishing discount factors for the types of loans. All nonaccrual loans are carried at their current fair value. Exceptions may be made for Prime based adjustable rate loans (with resets of one year or less), which would be discounted straight to Prime plus or minus an appropriate spread.

Deposits: The estimated fair value of certificates of deposits are based on discounted cash flow calculations that apply interest rates currently being offered by the Bank for deposits with similar remaining maturities to a schedule of aggregated expected monthly maturities. Stated value is fair value for all other deposits.

Borrowings: The estimated fair value of borrowed funds is based on the discounted value of contractual cash flows using interest rates currently in effect for borrowings with similar maturities and collateral requirements.

Accrued Interest Receivable and Payable: For these short-term instruments, the carrying amount is a reasonable estimate of the fair value.

Off-Balance-Sheet Liabilities: The fair value of off-balance-sheet commitments to extend credit is estimated using fees currently charged to enter into similar agreements.

The estimated fair values and recorded carrying values of the Bank's financial instruments are as follows:

| December 31, (In thousands) | 2005 | | 2004 | |
|---|--------------------|---------------|--------------------|---------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial Assets: | | | | |
| Cash and due from banks | \$ 15,649 | \$ 15,649 | \$ 8,744 | \$ 8,744 |
| Interest bearing deposits with banks | 26 | 26 | 118 | 118 |
| Securities available for sale | 182,801 | 182,801 | 202,042 | 202,042 |
| Securities restricted | 1,377 | 1,377 | 1,979 | 1,979 |
| Securities held to maturity | 10,012 | 9,989 | 21,213 | 21,131 |
| Loans | 299,881 | 305,096 | 293,946 | 294,640 |
| Accrued interest receivable | 2,624 | 2,624 | 2,469 | 2,469 |

| | | | | |
|--------------------------------------|----------------|----------------|---------|---------|
| Financial Liabilities: | | | | |
| Demand and other deposits | 468,025 | 467,544 | 469,311 | 469,211 |
| Overnight borrowings | 14,500 | 14,500 | 26,700 | 26,700 |
| Accrued interest payable | 328 | 328 | 273 | 273 |
| Off-Balance-Sheet Liabilities | | | | |
| Commitments to extend credit | 11,839 | - | 6,090 | - |

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11. REGULATORY MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies.

Failure to meet minimum capital requirements can result in certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and Bank's assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. The Company's and Bank's capital amounts and classification also are subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2005, that the Company and the Bank meet all capital adequacy requirements with which it must comply.

As of December 31, 2005, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table. Since that notification, there are no conditions or events that management believes have changed the institution's category.

The Company and the Bank's actual capital amounts and ratios are presented in the following table:

| Bridge Bancorp, Inc. (Consolidated) As of December 31, (Dollars in thousands) | 2005 | | | | | |
|--|---------------|--------------|--|--------------|--|--------------|
| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Provisions | |
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Total Capital (to risk weighted assets) | \$ 51,410 | 14.0% | \$ 29,399 | >8.0% | n/a | n/a |
| Tier 1 Capital (to risk weighted assets) | 49,115 | 13.4% | 14,699 | >4.0% | n/a | n/a |
| Tier 1 Capital (to average assets) | 49,115 | 9.1% | 21,517 | >4.0% | n/a | n/a |
| As of December 31, (Dollars in thousands) | 2004 | | | | | |
| | | | For Capital | | To Be Well Capitalized Under | |

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| | Actual | | Adequacy Purposes | | Prompt Corrective Action Provisions | |
|--|-----------|-------|----------------------|-------|---|-------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Total Capital (to risk weighted assets) | \$ 48,998 | 13.5% | \$ 28,940 | >8.0% | n/a | n/a |
| Tier 1 Capital (to risk weighted assets) | 46,649 | 12.9% | 14,470 | >4.0% | n/a | n/a |
| Tier 1 Capital (to average assets) | 46,649 | 8.3% | 22,468 | >4.0% | n/a | n/a |

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| Bridgehampton National Bank As of December 31, (Dollars in thousands) | 2005 | | | | | |
|--|-----------|-------|-------------------------------------|-------|---|--------|
| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Total Capital (to risk weighted assets) | \$ 51,234 | 14.0% | \$ 29,392 | >8.0% | \$ 35,805 | >10.0% |
| Tier 1 Capital (to risk weighted assets) | 48,851 | 13.3% | 14,696 | >4.0% | 21,483 | > 6.0% |
| Tier 1 Capital (to average assets) | 48,851 | 9.0% | 21,658 | >4.0% | 27,073 | > 5.0% |

| As of December 31, (Dollars in thousands) | 2004 | | | | | |
|--|-----------|-------|-------------------------------------|-------|---|--------|
| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Total Capital (to risk weighted assets) | \$ 47,773 | 13.2% | \$ 28,924 | >8.0% | \$ 36,154 | >10.0% |
| Tier 1 Capital (to risk weighted assets) | 45,585 | 12.6% | 14,462 | >4.0% | 21,693 | > 6.0% |
| Tier 1 Capital (to average assets) | 45,585 | 8.1% | 22,512 | >4.0% | 28,140 | > 5.0% |

12. BRIDGE BANCORP, INC. (PARENT COMPANY ONLY)

Condensed Statements of Financial Condition

| December 31, (In thousands, except share data) | 2005 | | 2004 | |
|---|------|--------|------|--------|
| ASSETS | | | | |
| Cash and cash equivalents | \$ | 80 | \$ | 1,024 |
| Dividend receivable | | 1,441 | | 1,339 |
| Other assets | | 82 | | 201 |
| Investment in the Bank | | 46,489 | | 45,988 |

| | | |
|---|------------------|------------------|
| Total Assets | \$ 48,092 | \$ 48,552 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities | | |
| Dividends payable | \$ 1,428 | \$ 1,313 |
| Other liabilities | 13 | 26 |
| Total Liabilities | 1,441 | 1,339 |
| Stockholders' Equity | | |
| Treasury stock at cost, 179,767 and 131,817 shares at December 31, 2005 and 2004, respectively | (4,285) | (2,330) |
| Total Stockholders' Equity | 46,651 | 47,213 |
| Total Liabilities and Stockholders' Equity | \$ 48,092 | \$ 48,552 |

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Condensed Statements of Income

| Year Ended December 31, (In thousands) | 2005 | 2004 | 2003 |
|---|----------|-----------|----------|
| Dividend income from the Bank | \$ 6,390 | \$ 5,104 | \$ 4,893 |
| Other operating expenses | 1 | - | 1 |
| Income before income taxes and equity in undistributed earnings of the Bank | 6,389 | 5,104 | 4,892 |
| Income tax provision | - | - | - |
| Income before equity in undistributed earnings of the Bank | 6,389 | 5,104 | 4,892 |
| Equity in undistributed earnings of the Bank | 3,234 | 5,273 | 4,706 |
| Net income | \$ 9,623 | \$ 10,377 | \$ 9,598 |

Condensed Statements of Cash Flows

| Year Ended December 31, (In thousands) | 2005 | 2004 | 2003 |
|---|----------|-----------|----------|
| Operating Activities: | | | |
| Net income | \$ 9,623 | \$ 10,377 | \$ 9,598 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Equity in undistributed earnings of the Bank | (3,234) | (5,273) | (4,706) |
| Income tax benefit from exercise of employee stock options | 16 | 7 | 38 |
| Decrease (increase) in other assets | 109 | 1,432 | (2,043) |
| Increase (decrease) in other liabilities | 11 | (5) | 166 |
| Net cash provided by operating activities | 6,525 | 6,538 | 3,053 |
| Cash flows used by financing activities: | | | |
| Net proceeds from issuance of common stock upon exercise of stock options | 216 | 203 | 440 |
| Payment for the purchase of treasury stock | (2,134) | (611) | - |
| Dividends paid | (5,551) | (5,790) | (2,943) |
| Net cash used by financing activities | (7,469) | (6,198) | (2,503) |
| Net increase in cash and cash equivalents | (944) | 340 | 550 |
| Cash and cash equivalents at beginning of year | 1,024 | 684 | 134 |
| Cash and cash equivalents at end of year | \$ 80 | \$ 1,024 | \$ 684 |

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13. QUARTERLY FINANCIAL DATA (Unaudited)

Selected Consolidated Quarterly Financial Data

| 2005 Quarter Ended, | March 31, | June 30, | September 30, | December 31, |
|---|------------------|-----------------|----------------------|---------------------|
| (In thousands, except per share amounts) | | | | |
| Interest income | \$ 6,912 | \$ 7,004 | \$ 7,373 | \$ 7,424 |
| Interest expense | 916 | 1,033 | 1,118 | 1,252 |
| Net interest income | 5,996 | 5,971 | 6,255 | 6,172 |
| Provision for loan losses | - | 150 | 150 | - |
| Net interest income after provision for loan losses | 5,996 | 5,821 | 6,105 | 6,172 |
| Other income | 1,021 | 1,339 | 1,391 | 1,354 |
| Other expenses | 3,568 | 3,645 | 3,771 | 3,663 |
| Income before income taxes | 3,449 | 3,515 | 3,725 | 3,863 |
| Provision for income taxes | 1,199 | 1,190 | 1,251 | 1,289 |
| Net income | \$ 2,250 | \$ 2,325 | \$ 2,474 | \$ 2,574 |
| Basic earnings per share | \$ 0.36 | \$ 0.37 | \$ 0.40 | \$ 0.41 |
| Diluted earnings per share | \$ 0.36 | \$ 0.37 | \$ 0.39 | \$ 0.41 |
| 2004 Quarter Ended, | | | | |
| (In thousands, except per share amounts) | | | | |
| | March 31, | June 30, | September 30, | December 31, |
| Interest income | \$ 6,443 | \$ 6,651 | \$ 6,955 | \$ 6,874 |
| Interest expense | 539 | 563 | 600 | 649 |
| Net interest income | 5,904 | 6,088 | 6,355 | 6,225 |
| Provision for loan losses | - | 50 | 100 | 150 |
| Net interest income after provision for loan losses | 5,904 | 6,038 | 6,255 | 6,075 |
| Other income | 1,591 | 1,215 | 1,284 | 1,350 |
| Other expenses | 3,403 | 3,296 | 3,383 | 3,482 |
| Income before income taxes | 4,092 | 3,957 | 4,156 | 3,943 |
| Provision for income taxes | 1,467 | 1,415 | 1,493 | 1,396 |
| Net income | \$ 2,625 | \$ 2,542 | \$ 2,663 | \$ 2,547 |
| Basic earnings per share | \$ 0.42 | \$ 0.41 | \$ 0.43 | \$ 0.41 |
| Diluted earnings per share | \$ 0.41 | \$ 0.40 | \$ 0.42 | \$ 0.41 |

Amounts have been restated for a three-for-two stock split, in the form of a stock dividend, effective July 9, 2004.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Audit Committee
Board of Directors
Bridge Bancorp, Inc.
Bridgehampton, New York

We have audited the accompanying balance sheets of Bridge Bancorp, Inc. as of December 31, 2005 and 2004, and the related statements of income, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2005. We also have audited management's assessment, included in the accompanying Report By Management On Internal Control Over Financial Reporting, that Bridge Bancorp, Inc. maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Bridge Bancorp, Inc.'s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these financial statements, an opinion on management's assessment, and an opinion on the effectiveness of the company's internal control over financial reporting 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Bridge Bancorp, Inc. as of December 31, 2005 and 2004, and the results of its operations and its 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. Also in our opinion, management's assessment that Bridge Bancorp, Inc. maintained effective

internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Furthermore, in our opinion, Bridge Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/ Crowe
Chizek and
Company
LLC
Crowe
Chizek and
Company
LLC

Livingston, New Jersey
February 17, 2006

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of December 31, 2005. Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective.

Report By Management On Internal Control Over Financial Reporting

Management of Bridge Bancorp, Inc. ("the Company") is responsible for establishing and maintaining an effective system of internal control over financial reporting. The Company's system of internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. There are inherent limitations in the effectiveness of any system of internal control over financial reporting, including the possibility of human error and circumvention or overriding of controls. Accordingly, even an effective system of internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the Company's systems of internal control over financial reporting as of December 31, 2005. This assessment was based on criteria for effective internal control over financial reporting described in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2005, the Company maintained effective internal control over financial reporting based on those criteria.

The Company's independent registered public accounting firm that audited the financial statements that are included in this annual report on Form 10-K, has issued an attestation report on management's assessment of the Company's internal control over financial reporting. The attestation report of Crowe Chizek and Company LLC appears on the previous page.

Changes in Internal Control Over Financial Reporting

There has been no change in the Company's internal control over financial reporting during the quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

None.

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PART III

Item 10. Directors and Executive Officers of the Registrant

“Item 1 - Election of Directors,” “Compliance with Section 16 (a) of the Exchange Act,” and “Code of Ethics” set forth in the Registrant’s Proxy Statement for the 2006 Annual Meeting of Shareholders are incorporated herein by reference.

Item 11. Executive Compensation

“Compensation of Directors,” “Compensation of Executive Officers,” “Performance Graph,” “Report of the Compensation Committee on Executive Compensation,” “Compensation Committee Interlocks and Insider Participation,” and “Employment Contracts and Severance Agreements” set forth in the Registrant’s Proxy Statement for the 2006 Annual Meeting of Shareholders are incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

“Beneficial Ownership” and “Item 1 - Election of Directors”, set forth in the Registrant’s Proxy Statement for the 2006 Annual Meeting of Shareholders are incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

“Certain Relationships and Related Transactions” set forth in the Registrant’s Proxy Statement for the 2006 Annual Meeting of Shareholders is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

“Item 2 - Ratification of the Appointment of Independent Auditors,” “Fees Paid to Crowe Chizek,” and “Policy on Audit Committee Pre-approval Of Audit and Non-audit Services of Independent Auditor” set forth in the Registrant’s Proxy Statement for the 2006 Annual Meeting of Shareholders is incorporated herein by reference.

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PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) The following Consolidated Financial Statements, including notes thereto, and financial schedules of the Company, required in response to this item are included in Part II, Item 8.

| | Page No. |
|--|----------|
| 1. Financial Statements | |
| <u>Consolidated Statements of Condition</u> | 24 |
| <u>Consolidated Statements of Income</u> | 25 |
| <u>Consolidated Statements of Stockholders' Equity</u> | 26 |
| <u>Consolidated Statements of Cash Flows</u> | 27 |
| <u>Notes to Consolidated Financial Statements</u> | 28 |
| <u>Report of Independent Registered Public Accountants</u> | 47 |

2. Financial Statement Schedules

Financial Statement Schedules have been omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or Notes thereto under Item 8, "Financial Statements and Supplementary Data."

3. Exhibits.

See Index of Exhibits on page 52.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BRIDGE
BANCORP, INC.
Registrant

March 15, 2006 /s/ Thomas J. Tobin
Thomas J. Tobin
President and Chief
Executive Officer

March 15, 2006 /s/ Janet T. Verneuille
Janet T. Verneuille,
S e n i o r V i c e
President, Chief
Financial Officer
and Treasurer

Pursuant to the requirements of the Securities and 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.

March 15, 2006 /s/ Raymond ,Director
Wesnofske
Raymond
Wesnofske

March 15, 2006 /s/ Thomas J. ,Director
Tobin
Thomas J. Tobin

March 15, 2006 /s/ Thomas E. ,Director
Halsey
Thomas E. Halsey

March 15, 2006 /s/ Marcia Z. ,Director
Hefter
Marcia Z. Hefter

March 15, 2006 ,Director

/s/ R. Timothy
Maran
R. Timothy Maran

March 15, 2006

/s/ Charles I. Massoud, Director
Massoud
Charles I.
Massoud

March 15, 2006

/s/ Howard H. Nolan, Director
Nolan
Howard H. Nolan

March 15, 2006

/s/ Dennis A. Suskind, Director
Suskind
Dennis A. Suskind

Table of Contents**EXHIBIT INDEX**

| Exhibit Number | Description of Exhibit | Exhibit |
|-----------------------|---|----------------|
| 3.1 | Certificate of Incorporation of the registrant (incorporated by reference to Registrant's amended Form 10, File No. 0-18546, filed October 15, 1990) | * |
| 3.1(i) | Certificate of Amendment of the Certificate of Incorporation of the Registrant (incorporated by reference to Registrant's Form 10, File No. 0-18546, filed August 13, 1999) | * |
| 3.2 | Revised By-laws of the Registrant (incorporated by reference to Registrant's Form 10-Q, File No. 0-18546, filed November 2, 2004) | * |
| 10.1 | Employment Contract - Thomas J. Tobin (incorporated by reference to Registrant's Form 10-Q, File No. 0-18546, filed November 7, 2001) | * |
| 10.2 | Employment Contract - Janet T. Verneuille (incorporated by reference to Registrant's Form 10-Q, File No. 0-18546, filed November 7, 2001) | * |
| 10.5 | Equity Incentive Plan (incorporated by reference to Registrant's Form 14A, File No. 0-18546, filed March 9, 2001) | * |
| 23 | <u>Accountants' Consent</u> | |
| 31.1 | <u>Certification of Principal Executive Officer pursuant to Rule 13a-14(a)</u> | |
| 31.2 | <u>Certification of Principal Financial Officer pursuant to Rule 13a-14(a)</u> | |
| 32.1 | <u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) and U.S.C. Section 1350</u> | |

* Denotes incorporated by reference.

