AuburnBank

A Century of Service

1907 2007

AuburnBank

2006 Annual Report

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2006 Annual Report

AUBURN NATIONAL BANCORPORATION, INC.

Corporate Information

Corporate Headquarters

100 N. Gay Street
P.O. Box 3110
Auburn, AL 36831-3110
Phone: 334-821-9200
Fax: 334-887-2796
www.auburnbank.com

Independent Auditors

KPMG LLP
Wachovia Tower
Suite 1800
420 20th Street N.
Birmingham, AL 35203

Shareholder Services

Shareholders desiring to change the name, address or ownership of Auburn National Bancorporation, Inc. common stock or to report lost certificates should contact our Transfer Agent:

Registrar and Transfer Company
10 Commerce Drive
Cranford, NJ 07016-3572
Phone: 1-800-368-5948
Fax: 1-908-497-2318
e-mail: info@rtco.com

For frequently asked questions, visit the Transfer Agent's home page at www.rtco.com

Annual Meeting

Tuesday, May 8, 2007
3:00 p.m. (Central Time)
AuburnBank Center
132 N. Gay Street
Auburn, AL 36830

Investor Relations

A copy of the Company's annual report on Form 10-K, filed with the Securities and Exchange Commission (SEC), as well as our other SEC filings and our latest press releases are available free of charge through a link on our internet web-site at www.auburnbank.com. Requests for these documents may also be made by emailing Investor Relations at investorrelations@auburnbank.com or by contacting Investor Relations by telephone or mail at the Company's corporate headquarters.

Common Stock Listing

Auburn National Bancorporation, Inc. Common Stock is traded on the Nasdaq Capital Market under the symbol AUBN.

Dividend Reinvestment and Stock Purchase Plan

Auburn National Bancorporation, Inc. offers a Dividend Reinvestment Plan (DRIP) for automatic reinvestment of dividends in the stock of the company. Participants in the DRIP may also purchase additional shares with optional cash payments. For additional information or for an authorization form, please contact Investor Relations.

Direct Deposit of Dividends

Dividends may be automatically deposited into a shareholder's checking or savings account free of charge. For more information, contact Investor Relations.

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AUBURN NATIONAL BANCORPORATION, INC.

2006 Annual Report

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Corporate Profile

Auburn National Bancorporation, Inc. is a one-bank holding company established in 1984, and incorporated under the laws of the State of Delaware. Its assets were $635 million as of December 31, 2006. Since its inception, Auburn National Bancorporation has wholly owned AuburnBank.

AuburnBank has been operating continuously since 1907 when it was established as the first financial institution in Auburn, Alabama.

Headquartered in Auburn, AuburnBank provides a wide range of services including traditional checking and savings accounts, loans, and internet banking. These services are available to individuals, families, and businesses, and offered at our many convenient locations.

In addition to its principal office, AuburnBank operates full-service branches in Opelika, Hurtsboro, and Notasulga, Alabama. In-store branches are located in Auburn Kroger as well as Wal-Mart SuperCenter stores in Auburn, Opelika, and Phenix City, Alabama. Mortgage loan offices are also located in Phenix City, Valley, Mountain Brook and Orange Beach, Alabama. An extensive network of automated teller machines is operated throughout East Alabama.

2006 was a profitable and productive year for AuburnBank. Positive trends in the measurement of earnings, asset quality, efficiency and growth continued, thus allowing an increase in your 2007 first quarter dividend by 9%.

One hundred years ago the first financial institution in Auburn opened its doors chartered under the name Bank of Auburn. From the very beginning, Bank of Auburn pledged to Be the Best Community Bank serving individuals, businesses, the College and the City. Today, 100 years later, AuburnBank continues to enjoy the rich heritage of being the only remaining locally owned and operated financial institution founded in Auburn. Our founding principles are the same today as they were 100 years ago. We strive to do business honestly and with integrity. We continue to assist our customers, both individuals and businesses, achieve their financial goals by providing the best quality customer service coupled with sound prudent advice.

We continue to encourage our employees to be involved in the communities we serve through their participation in community activities and civic and charitable organizations of their choice. In addition, AuburnBank continues a founding tradition of generously contributing its expertise, financial resources and employer support to many community organizations, projects and service programs to enhance the quality of life within our community. We have also followed our legacy of placing a high value on maintaining our financial strength and stability. Steady growth, consistent earnings, strong reserves and control of risk factors provide safety for our depositors and increasing returns for our shareholders.

Our commitment to excellence serves as a foundation on which customer loyalty and trust is built. This foundation has provided AuburnBank with unprecedented growth and success. Our focus is clear and our mission continues to reflect our founding owners' objectives. A sincere thank you to all of our customers, shareholders, employees and directors who have contributed in past years in making this milestone possible and to the many who continue to provide the support, leadership and commitment in making Auburn's first bank your partner, your neighbor and your friend.

AuburnBank, a Century of Service — we thank you and look forward to a year of celebration and reflection with you.

Auburn National Bancorporation's initial public offering was held in 1995. The common stock is traded on the NASDAQ Capital Market under the symbol "AUBN".

Robert W. Dumas

Robert W. Dumas
President & CEO
AuburnBank

To Our Shareholders and Friends

AuburnBank is having a birthday party and since we are 100 years old, it is going to last most of the year. It will take this long to say thank you to our customers and to reflect on the principles and practices that sustain us and have guided us through a century of service.

In 1906, a small group of men from the university and the business community decided to do something about a real inconvenience and shortcoming in Auburn. They assembled a total of 33 shareholders and $10,000 in paid-in capital and opened the Bank of Auburn on January 3, 1907. This leap of faith was based on a need and a desire to serve and help the community. It was not about how much we could make or how big we could be, but how much service we could give.

Service — this is what we have done for an entire century and the results have been productive for our customers, owners, and communities.

The faith and foresight of those who founded AuburnBank with limited capital in a rented store on a dirt street has grown to a profitable ($6,585,000 net income) financial institution with $635 million in assets that serves East Alabama from 8 locations. Our dividends have increased 11 times over the last 12 years and the market values our stock at over $100 million.

Our plans include expanding our area of service and growing in size and earning capacity. We have another branch opening by late summer and we will be adding to the Loan Production Offices we have outside of our primary banking area.

This reflects a good work ethic on our part and our traditional concern for the well being of our customers. This is a practice that we follow. I am confident we will continue to make a reasonable return on our investment, meet the needs of our customers and, as a community bank, make a difference in all the areas we serve.

We are glad we are having this birthday celebration with you and look forward to sharing many, many more.

E.L. Spencer, Jr.
Chairman, Board of Directors
AuburnBank and ANBC

THE VISION

Banks exist to protect your money, so you don't have to keep your savings under the mattress. They also exist to help the community by investing the money entrusted to them, making loans and charging interest to repay shareholders. Community banks invest that money in their own hometowns, allowing local businesses to expand and grow. And a growing community is a thriving community.

A hundred years ago, some vision was required to see the sleepy little town of Auburn — population 1,500 — as a likely place for a bank.

Nevertheless, Sheldon Toomer, a local pharmacist convinced a handful of college professors, Dr. Charles Allen Cary, Dr. Bennett Battle Ross, and Thomas Bragg, along with a local doctor, Dr. Oliver M. Steadham, a farmer, Thomas O. Wright, and the owner of a downtown general store, W. Pierce Zuber, to found Auburn's very own bank. The seven founders coaxed and cajoled a total of 33 investors — almost all from Auburn — to commit to buying $25,000 worth of stock. The Bank of Auburn — the future AuburnBank — was born.

The biggest investor, William Eugene Holloway, a Montgomery banker, was named president of the new banking institution. Since he didn't live in

town and rarely visited, another director, Dr. Cary, was named vice chair to preside at board meetings in the president's absence. The job didn't pay a penny. The president wasn't paid for years, either. Nor were the founding directors, even though they worked hard to solicit business for the infant bank.

From the very beginning, AuburnBank worked together with Auburn city government. The bank loaned the city $200 the first summer, and in 1910 initiated a tradition of financially supporting the community by donating to the Auburn Water Works Fund.

Although the bank paid a respectable dividend to those 33 shareholders that first year, profit wasn't the primary motive for most of them.

They wanted to promote the community and see businesses flourish, providing livelihoods for local people. They believed in Auburn.

The people at AuburnBank still want to promote the community and see businesses flourish, even though assets had grown to some $635 million by the end of 2006. The bank donates thousands of dollars to worthy causes every year, and one recent Christmas a mother-daughter team of employees spent the day serving food to the needy. The bank has the wherewithal to make a $5 million loan, but the heart to make a $700 loan to a woman with limited credit history who didn't have money for the holidays.

“We do answer our phones, balance a lot of

checkbooks, and try to protect our customers from scam artists," the current chairman of the board, E. L. Spencer, Jr., told stockholders at the 2006 annual meeting.

At AuburnBank's two branches in tiny area communities, employees have even read medication directions to confused customers. In fact, the very existence of those branches, in Hurtsboro and Notasulga, shows that AuburnBank is a community bank with compassion — a bank that cares. Branch offices of other regional banks had already pulled out of these struggling communities.

"It's your conscience, what is expected," said Spencer. "If you do what's right for the community, it's right for the bank."

AuburnBank Board of Directors

2007 Board of Directors

Seated left to right: Robert W. Dumas, E.L. Spencer, Jr., C. Wayne Alderman

Standing left to right: Anne M. May, Dr. Emil F. Wright, Jr., Edward Lee Spencer, III, Terry W. Andrus, J.E. Evans, David E. Housel, William F. Ham, Jr.

Auburn National Bancorporation, Inc. and AuburnBank

Board of Directors

Terry W. Andrus
President, East Alabama
Medical Center

C. Wayne Alderman
Secretary to ANBC
Dean of Enrollment Services and
former Dean, College of Business,
Auburn University

Robert W. Dumas
President & CEO, AuburnBank

J.E. Evans
Owner, Evans Realty

William F. Ham, Jr.
Mayor, City of Auburn &
Owner, Varsity Enterprises

David E. Housel
Director of Athletics Emeritus,
Auburn University

Anne M. May
Partner, Machen, McChesney
& Chastain, CPAs

E.L. Spencer, Jr.
Chairman, AuburnBank and ANBC,
Business Owner

Edward Lee Spencer, III
Investor

Dr. Emil F. Wright, Jr.
Vice Chairman
AuburnBank and ANBC,
Retired Ophthalmologist

AuburnBank Officers

E.L. Spencer, Jr.
Chairman

Robert W. Dumas
President & Chief
Executive Officer

Jo Ann Hall
Executive Vice President,
Chief Operations Officer/
Chief Risk Officer

Terrell E. Bishop
Senior Vice President,
Senior Mortgage Loan Officer

James E. Dulaney
Senior Vice President,
Business Development/Marketing

W. Thomas Johnson
Senior Vice President,
Senior Lender

Marla Kickliter
Senior Vice President,
Compliance/Internal Auditor

Shannon O'Donnell
Senior Vice President,
Credit Administration

C. Eddie Smith
Senior Vice President,
City President, Opelika Branch

Patty Allen
Vice President,
Commercial/Consumer Loans

Kris Blackmon
Vice President,
Asset/Liability Manager
Chief Investment Officer

S. Mark Bridges
Vice President,
Commercial/Consumer Loans

Laura Carrington
Vice President,
Human Resource Officer

Kathy Crawford
Vice President,
Commercial/Consumer Loans

Ginnie Y. Lunsford
Vice President,
Consumer Loans/
Loan Operations

Susan K. McChesney
Vice President, IT/IS

Julia McCreight
Vice President,
Mortgage Loans

David Reaves
Vice President,
Mortgage Loans

Jerry Siegel
Vice President, IT/IS
Chief Technology Officer

Robert Smith
Vice President,
Commercial/Consumer Loans

Scottie Arnold
Assistant Vice President,
Operations/Retail
Internet Banking

David Hedges
Asst. Vice President, Controller

Barbara Wilcox
Assistant Vice President,
Bank Security/BSA Officer

Julie Ambrose
Mortgage Loan Officer

Adicia Coulter
Customer Relations Officer

Suzanne Gibson
Portfolio Manager

Andrea Jackson
Portfolio Manager

Charlotte Lang
Assistant BSA and Operations Officer

Woody Odom
Information Systems Officer

Kenna C. Runge
Mortgage Loan Officer

Jeff Stewart
Consumer Loan Officer

Christy A. Young
Loan Review Officer

Opelika Branch Advisory Board

2007 Opelika Branch Advisory Board

Seated left to right: C. Eddie Smith, J. Tutt Barrett, William G. Dyas, Michael James
Standing left to right: William H. Brown, R. Kraig Smith, M.D.,
William P. Johnston, Doug M. Horn
Not pictured: Hugh Dean Fuller, John W. Mitchell, M.D.,
Sherrie M. Stanyard, Robert G. Young

J. Tutt Barrett
Attorney, Dean and Barrett

William H. Brown
Owner, Brown Agency, Inc.

William G. Dyas
Businessman

Hugh Dean Fuller
Businessman

Doug M. Horn
Owner, Doug Horn Roofing
& Contracting Co.

Michael James
Senior Vice President,
Castone Corporation

William P. Johnston
President, J & M Bookstore

John W. Mitchell, M.D.
Cardiologist, East Alabama
Medical Center

C. Eddie Smith
President,
AuburnBank of Opelika

R. Kraig Smith, M.D.
Lee OBGYN

Sherrie Murphy Stanyard
Senior Account Manager,
Craftmaster Printers, Inc.

Robert G. Young
Vice President, Sales
Young's Plant Farm, Inc.

Financial Highlights

Auburn National Bancorporation, Inc.
Financial Highlights
(Dollars in thousands, except per share data)

	For the Year Ended December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
Earnings					
Net Interest Income*	$15,980	$15,994	$15,626	$14,636	$15,318
Provision for Loan Losses	330	485	600	675	1,680
Net Earnings	6,585	6,470	6,510	5,419	5,055
Per Share:					
Net Earnings	1.74	1.69	1.68	1.39	1.30
Cash Dividends	0.64	0.58	0.50	0.48	0.44
Book Value	12.93	11.58	11.57	10.38	10.16
Shares Issued	3,957,135	3,957,135	3,957,135	3,957,135	3,957,135
Weighted Average Shares Outstanding	3,777,721	3,830,002	3,870,198	3,894,969	3,894,649
Financial Condition					
Total Assets	$635,126	$608,154	$591,161	$590,115	$505,027
Loans	281,983	282,059	251,129	244,652	254,344
Investment Securities	301,938	274,961	282,199	285,319	190,918
Total Deposits	469,648	454,995	429,339	434,042	395,191
Long Term Debt	100,404	105,422	105,441	105,589	53,436
Shareholder's Equity	48,418	43,954	44,504	40,408	39,582
Selected Ratios					
Return on Average Total Assets	1.06%	1.08%	1.10%	1.05%	1.04%
Return on Average Total Equity	14.66%	14.26%	15.69%	13.47%	13.66%
Average Stockholders' Equity to Average Assets	7.20%	7.56%	7.03%	7.78%	7.65%
Allowance for Loan Losses as a % of Loans	1.43%	1.36%	1.38%	1.76%	2.01%
Loans to Total Deposits	60.04%	61.99%	58.49%	56.37%	64.36%

**Certain reclassifications have been made to prior years' financial information to conform to the current year presentation.*

AUBURNBANK
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KPMG

Report of Independent Registered Public Accounting Firm

The Board of Directors
Auburn National Bancorporation, Inc.:

We have audited the accompanying consolidated balance sheets of Auburn National Bancorporation, Inc. and subsidiaries (the Company) as of December 31, 2006 and 2005, and the related consolidated statements of earnings, stockholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Auburn National Bancorporation, Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006 in conformity U.S. generally accepted accounting principles.

KPMG LLP

Birmingham, Alabama
March 27, 2007

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2006 and 2005

Assets		2006	2005
Cash and due from banks	$	16,875,025	13,704,096
Federal funds sold		—	10,237,409
Cash and cash equivalents		16,875,025	23,941,505
Interest-earning deposits with other banks		150,868	2,140,856
Investment securities held to maturity (fair value of $514,517 and $636,962 for December 31, 2006 and 2005, respectively)		513,424	633,478
Investment securities available for sale		301,424,234	274,327,424
Loans held for sale		3,109,015	1,400,269
Loans		281,982,696	282,059,247
Less allowance for loan losses		(4,043,955)	(3,843,374)
Loans, net		277,938,741	278,215,873
Premises and equipment, net		2,181,969	2,428,619
Rental property, net		3,613,674	1,236,583
Other assets		29,318,875	23,829,154
Total assets	$	635,125,825	608,153,761
Liabilities and Stockholders' Equity			
Deposits:			
Noninterest-bearing	$	79,101,735	70,784,282
Interest-bearing		390,546,049	384,211,006
Total deposits		469,647,784	454,995,288
Federal funds purchased and securities sold under agreements to repurchase		14,401,113	1,731,391
Other borrowed funds		93,187,006	98,205,256
Note payable to trust		7,217,000	7,217,000
Accrued expenses and other liabilities		2,254,821	2,050,348
Total liabilities		586,707,724	564,199,283
Stockholders' equity:			
Preferred stock of $0.01 par value. Authorized 200,000 shares; issued shares – none		—	—
Common stock of $0.01 par value. Authorized 8,500,000 shares; issued 3,957,135 shares		39,571	39,571
Additional paid-in capital		3,748,205	3,734,425
Retained earnings		51,087,166	46,918,896
Accumulated other comprehensive loss, net of tax		(2,335,384)	(3,981,772)
Less treasury stock, at cost – 213,348 shares and 162,119 shares for December 31, 2006 and 2005, respectively		(4,121,457)	(2,756,642)
Total stockholders' equity		48,418,101	43,954,478
Total liabilities and stockholders' equity	$	635,125,825	608,153,761

See accompanying notes to consolidated financial statements.

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARIES

Consolidated Statements of Earnings

Years ended December 31, 2006, 2005, and 2004

	2006	2005	2004
Interest and dividend income:			
Loans, including fees	$ 22,304,365	19,682,315	16,763,236
Investment securities:			
Taxable	10,882,198	9,475,483	9,821,817
Tax-exempt	2,009,409	1,857,737	1,417,907
Federal funds sold	365,019	260,989	118,321
Interest-earning deposits with other banks	63,775	38,204	12,634
Total interest and dividend income	35,624,766	31,314,728	28,133,915
Interest expense:			
Deposits	14,706,163	10,519,733	8,124,708
Securities sold under agreements to repurchase and federal funds purchased	325,450	90,871	32,032
Other borrowings	4,613,245	4,710,160	4,351,595
Total interest expense	19,644,858	15,320,764	12,508,335
Net interest income	15,979,908	15,993,964	15,625,580
Provision for loan losses	330,000	485,000	600,000
Net interest income after provision for loan losses	15,649,908	15,508,964	15,025,580
Noninterest income:			
Service charges on deposit accounts	1,387,216	1,497,117	1,489,612
Investment securities gains, net	9,664	11,306	733,428
Other	3,252,156	4,884,080	4,815,857
Total noninterest income	4,649,036	6,392,503	7,038,897
Noninterest expense:			
Salaries and benefits	6,714,141	6,658,516	6,293,979
Net occupancy expense	1,057,754	1,078,826	1,234,234
Other	3,630,333	5,485,646	5,677,252
Total noninterest expense	11,402,228	13,222,988	13,205,465
Earnings before income taxes	8,896,716	8,678,479	8,859,012
Income tax expense	2,311,788	2,208,916	2,349,236
Net earnings	$ 6,584,928	6,469,563	6,509,776
Earnings per share – basic	1.74	1.69	1.68
Earnings per share – diluted	1.74	1.69	1.68
Weighted average shares outstanding – basic	3,777,721	3,830,002	3,870,198
Weighted average shares outstanding – diluted	3,778,055	3,830,794	3,871,273

See accompanying notes to consolidated financial statements.

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARY

Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss)

Years ended December 31, 2006, 2005, and 2004

	Comprehensive income (loss)	Common stock Shares	Common stock Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total
Balances at December 31, 2003		3,957,135	$ 39,571	3,712,246	38,092,829	(828,816)	(607,946)	40,407,884
Comprehensive income:								
Net earnings	$ 6,509,776	—	—	—	6,509,776	—	—	6,509,776
Other comprehensive income due to unrealized gain on investment securities available for sale and derivative, net	467,707	—	—	—	—	467,707	—	467,707
Total comprehensive income	$ 6,977,483							
Cash dividends paid ($0.50 per share)		—	—	—	(1,933,544)	—	—	(1,933,544)
Purchase of treasury stock (3,000 shares)		—	—	—	—	—	(972,394)	(972,394)
Sale of treasury stock (750 shares)		—	—	11,332	—	—	13,487	24,819
Balances at December 31, 2004		3,957,135	39,571	3,723,578	42,669,061	(361,109)	(1,566,853)	44,504,248
Comprehensive income (loss):								
Net earnings	$ 6,469,563	—	—	—	6,469,563	—	—	6,469,563
Other comprehensive loss due to unrealized loss on investment securities available for sale and derivative, net	(3,620,663)	—	—	—	—	(3,620,663)	—	(3,620,663)
Total comprehensive income	$ 2,848,900							
Cash dividends paid ($0.58 per share)		—	—	—	(2,219,728)	—	—	(2,219,728)
Purchase of treasury stock (53,745 shares)		—	—	—	—	—	(1,202,139)	(1,202,139)
Sale of treasury stock (1,900 shares)		—	—	10,847	—	—	12,350	23,197
Balances at December 31, 2005		3,957,135	39,571	3,734,425	46,918,896	(3,981,772)	(2,756,642)	43,954,478
Comprehensive income:								
Net earnings	$ 6,584,928	—	—	—	6,584,928	—	—	6,584,928
Other comprehensive income due to unrealized gain on investment securities available for sale and derivative, net	1,646,388	—	—	—	—	1,646,388	—	1,646,388
Total comprehensive income	$ 8,231,316							
Cash dividends paid ($0.64 per share)		—	—	—	(2,416,658)	—	—	(2,416,658)
Purchase of treasury stock (53,229 shares)		—	—	—	—	—	(1,377,815)	(1,377,815)
Sale of treasury stock (2,000 shares)		—	—	13,780	—	—	13,000	26,780
Balances at December 31, 2006		3,957,135	$ 39,571	3,748,205	51,087,166	(2,335,384)	(4,121,457)	48,418,101

See accompanying notes to consolidated financial statements.

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2006, 2005, and 2004

		2006	2005	2004
Cash flows from operating activities:				
Net earnings	$	6,584,928	6,469,563	6,509,776
Adjustments to reconcile net earnings to net cash (used in) provided by operating activities:				
Depreciation and amortization		396,041	444,200	492,732
Net amortization of investment security discounts/premiums		469,545	994,182	1,246,042
Provision for loan losses		330,000	485,000	600,000
Deferred tax benefit		(388,942)	(1,639,770)	(1,079,698)
Loans originated for sale		(80,803,104)	(86,399,869)	(63,708,998)
Proceeds from sale of loans		79,743,513	87,778,809	66,657,583
Loss on sale of premises and equipment		158	2,661	2,305
(Gain) loss on sale and calls of investment securities		(9,664)	(11,306)	183,633
Net gain on sale of loans held for sale		(649,155)	(669,259)	(348,173)
Gain on exchange of privately-held stock investment		—	—	(917,061)
(Gain) loss on sale of other real estate		(7,010)	(15,428)	6,984
(Increase) decrease in interest receivable		(679,209)	(253,802)	68,748
(Increase) decrease in other assets		(6,122,330)	1,058,393	991,820
Increase (decrease) in interest payable		450,314	234,986	(247,079)
Increase (decrease) in accrued expenses and other liabilities		151,101	(601,732)	1,954,272
Net cash (used in) provided by operating activities		(533,814)	7,876,628	12,412,886
Cash flows from investing activities:				
Proceeds from sales of investment securities available for sale		31,145,690	33,346,426	77,533,760
Proceeds from maturities/calls/paydowns of investment securities available for sale		33,769,541	38,879,781	40,209,751
Purchases of investment securities available for sale		(89,735,847)	(72,388,252)	(115,486,766)
Proceeds from maturities/calls/paydowns of investment securities held to maturity		119,959	174,900	428,908
Net increase in loans		(328,468)	(25,609,338)	(6,196,353)
Purchases of premises and equipment		(11,605)	(59,494)	(135,073)
Proceeds from sale of premises and equipment and other real estate		280,094	385,763	279,051
Additions to rental property		(2,490,893)	(15,129)	(11,499)
Net decrease (increase) in interest-earning deposits with other banks		1,989,988	(1,435,560)	(439,567)
Proceeds from sale of privately-held stock investment		—	—	(1,044,061)
Decrease (increase) in investment in FHLB stock		192,600	(3,700)	(683,000)
Net cash used in investing activities		(25,068,941)	(26,724,603)	(5,544,849)

(Continued)

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2006, 2005, and 2004

	2006	2005	2004
Cash flows from financing activities:			
Net increase in noninterest-bearing deposits	$ 8,317,453	5,420,669	4,856,468
Net increase (decrease) in interest-bearing deposits	6,335,043	20,235,849	(9,559,838)
Net increase (decrease) in securities sold under agreements to repurchase	12,669,722	(5,881,531)	958,590
Borrowings from FHLB	—	28,000,000	10,000,000
Repayments to FHLB	(5,018,250)	(28,018,249)	(10,018,250)
Repayments of other borrowed funds	—	—	(130,433)
Purchase of treasury stock	(1,377,815)	(1,202,139)	(972,394)
Sale of treasury stock	26,780	23,197	24,819
Dividends paid	(2,416,658)	(2,219,728)	(1,933,544)
Net cash provided by (used in) financing activities	18,536,275	16,358,068	(6,774,582)
Net (decrease) increase in cash and cash equivalents	(7,066,480)	(2,489,907)	93,455
Cash and cash equivalents at beginning of year	23,941,505	26,431,412	26,337,957
Cash and cash equivalents at end of year	$ 16,875,025	23,941,505	26,431,412
Supplemental information on cash payments:			
Interest paid	$ 19,194,544	15,085,778	12,755,414
Income taxes paid	4,320,041	3,292,413	1,843,388
Supplemental information on noncash transactions:			
Real estate acquired through foreclosure	275,600	285,834	338,825
Loans held for sale transferred to loan portfolio	—	5,766,585	—

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies

Auburn National Bancorporation, Inc. (the Company) provides a full range of banking services to individual and corporate customers in Lee County, Alabama and surrounding counties through its subsidiary, AuburnBank (the Bank). The Company and the Bank are subject to competition from other financial institutions. The Company and the Bank are also subject to the regulations of certain federal and state agencies and undergo periodic examinations by those regulatory authorities. The Company does not have any segments other than banking that are considered material.

The accounting policies followed by the Company and its subsidiary and the methods of applying these principles conform with accounting principles generally accepted in the United States of America and with general practice within the banking industry. Certain principles which significantly affect the determination of financial position, results of operations and cash flows are summarized below.

(a) Basis of Financial Statement Presentation

The consolidated financial statements have been prepared in conformity with United States generally accepted accounting principles. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near–term relate to the determination of the allowance for loan losses. In connection with the determination of the allowance for loan losses, management obtains independent appraisals for significant properties that serve as collateral.

Management believes that the allowance for losses on loans is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank’s allowance for losses on loans. Such agencies may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

The Bank’s real estate loans are secured by real estate located principally in Lee County, Alabama and surrounding areas. In addition, foreclosed real estate owned by the Bank is typically located in this same area. Accordingly, the ultimate collectibility of a substantial portion of the Bank’s loan portfolio and the recovery of real estate owned are susceptible to changes in market conditions in this area.

(b) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiary, AuburnBank.

(c) Cash Equivalents

Cash equivalents include amounts due from banks and federal funds sold. Federal funds are generally sold for one–day periods.

(d) Investment Securities

The Company accounts for investment securities under the provisions of Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities* whereby investment securities are classified in one of three portfolios: (i) trading account securities, (ii) held to maturity securities, and (iii) securities available for sale. Trading account securities are stated at fair value. The Company does not have trading account securities. Investment securities held to maturity are those for which the Company has both the intent and ability to hold until maturity and are stated at cost adjusted for amortization of premiums and accretion of discounts. Investment securities available for sale are stated at fair value with any unrealized gains and losses reported as a separate component of stockholders' equity, net of taxes, until realized.

Accretion of discounts and amortization of premiums are calculated using a method that approximates the effective interest method over the anticipated life of the security, taking into consideration prepayment assumptions. Gains and losses from the sale of investment securities are computed under the specific identification method.

A decline in the fair value below cost of any available for sale or held to maturity security that is deemed other than temporary results in a charge to earnings and the establishment of a new cost basis for the security.

(e) Loans

Loans that the Company has the intent and ability to hold for the foreseeable future or until maturity are recorded at principal amounts outstanding, net of unearned income and allowance for loan losses. Interest on loans is credited to income on the effective interest method.

It is the policy of the Company to discontinue the accrual of interest when principal or interest payments become more than ninety days delinquent. When a loan is placed on a nonaccrual basis, any interest previously accrued but not collected is reversed against current income unless the collateral for the loan is sufficient to cover the accrued interest. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are recorded on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

The Company accounts for impaired loans in accordance with SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended by SFAS No. 118, *Accounting by Creditors for Impairment of a Loan – Income Recognition and Disclosures*. Under the provisions of SFAS No. 114 and SFAS No. 118, management considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. A loan is also considered impaired if its terms are modified in a troubled debt restructuring and the restructuring agreement specifies an interest rate below the rate that the Company is willing to accept for a new loan with comparable risk. When a loan is considered impaired, the amount of impairment is measured based on the present value of expected future cash flows discounted at the note's effective interest rate, unless the loan is collateral–dependent, in which case the fair value of the collateral is used to determine the amount of impairment. Impairment losses are included in the allowance for loan losses through the provision for loan losses. Impaired loans are charged to the allowance when such loans are deemed to be uncollectible. Subsequent recoveries are added to the allowance.

When a loan is considered impaired, cash receipts are applied under the contractual terms of the loan agreement, first to principal and then to interest income. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to interest income, to the extent that any interest has not been recognized. Any further cash receipts are recorded as recoveries of any amount previously charged off.

The Company originates mortgage loans to be held for sale only for loans that have been pre–approved by the investor. The Company bears minimal interest rate risk on these loans. Such loans are stated at the lower of cost or aggregate fair value.

(f) Allowance for Loan Losses

The amount of provision for loan losses charged to earnings is based on actual loss experience, periodic specific reviews of significant and nonperforming loan relationships, and management's evaluation of the loan portfolio under current economic conditions. Such provisions, adjusted for loan charge–offs and recoveries, comprise the allowance for loan losses. Provision amounts are largely determined based on loan classifications determined through credit quality reviews using estimated loss factors based on historical loss experience. Such loss factors are adjusted periodically based on changes in loss experience.

Loans are charged against the allowance when management determines such loans to be uncollectible. Subsequent recoveries are credited to the allowance.

(g) Premises and Equipment

Land is stated at cost. Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed principally on a straight–line method for buildings, furniture, fixtures, and equipment over the estimated useful lives of the assets, which range from three to 39 years.

(h) Rental Property

Rental property consists of land, buildings, furniture, fixtures, and equipment which are rented by the Company to the Bank and to unrelated other parties. Rental property is stated at cost less accumulated depreciation. Depreciation is computed principally on a straight–line method for buildings, furniture, fixtures, and equipment over the shorter of estimated useful lives of the assets or the lease period.

(i) Other Real Estate

Real estate acquired through foreclosure or in lieu of foreclosure is carried at the lower of cost or fair value, as determined by independent appraisals, adjusted for estimated selling costs. Any write–down at the time of foreclosure is charged to the allowance for loan losses. Subsequent declines in fair value below acquisition cost and gains or losses on the sale of these properties are credited or charged to earnings.

(j) Derivative Financial Instruments and Hedging Activities

As part of its overall interest rate risk management activities, the Company utilizes derivative instruments (i) to modify the repricing characteristics of assets and liabilities and (ii) to hedge the fair value risk of fixed–rate liabilities. The primary instruments utilized by the Company are interest rate swaps and interest rate floor and cap arrangements. Interest rate swap transactions generally involve the exchange of fixed and floating rate interest payment obligations without the exchange of the underlying principal amounts. Entering into interest rate swap agreements involves not only the risk of dealing with counterparties and their ability to meet the terms of the contracts but also the risk associated with the movements in interest rates. These risks are considered in the Bank's overall asset liability management program. Notional principal amounts often are used to express the volume of these transactions; however, the amounts potentially subject to credit risk are much smaller. The Bank utilizes periodic financial statements issued by the counterparty to analyze the creditworthiness of the counterparty prior to entering into a contract and to monitor changes in the financial condition of the counterparty throughout the term of the contract.

The fair value of these derivative financial instruments is based on dealer quotes or third–party financial models and are recorded as assets or liabilities and are recognized on the balance sheet at their fair value. Changes in the fair value of a derivative that is designated and qualifies as a fair value hedge along with the gain or loss on the hedged asset or liability that are attributable to the risk being hedged is recognized in earnings in the period of change. If the hedged exposure is a cash flow exposure, the effective portion of the gain or loss on the derivative instrument is recorded initially as a component of accumulated other comprehensive income, and subsequently reclassified into earnings when the forecasted transaction affects earnings. Any amounts excluded from the assessment of hedge effectiveness, as well as the ineffective portion of the gain or loss, are reported in earnings immediately. If the derivative instrument is not designated as a hedge, the gain or loss would be recognized in earnings in each period. The net settlement on the Company's fair value hedges is recorded in earnings on an accrual basis.

(k) Income Taxes

Income taxes are accounted for under the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company files its federal income tax returns on a consolidated basis.

(l) Earnings per Share

Basic earnings per share are computed on the weighted average number of shares outstanding in accordance with SFAS No. 128, *Earnings Per Share*. In May 1994, the Company reserved 450,000 shares of common stock for issuance under stock option plans. This plan expired in May 2004. During 2003, the Company granted 4,000 options with an exercise price of $13.39 which was equal to the closing market price on the date of grant. These options expired on December 31, 2006. During 2002, the Company granted 3,000 options with an exercise price of $11.35 which was equal to the closing market price on the date of grant. These options expired on December 31, 2005. No options were granted in 2006, 2005 and 2004.

A reconciliation of the numerator and denominator of the basic EPS computation to the diluted EPS computation for the three years ended December 31 is as follows:

		2006	2005	2004
Basic:				
Net income	$	6,584,928	6,469,563	6,509,776
Average common shares outstanding		3,777,721	3,830,002	3,870,198
Earnings per share	$	1.74	1.69	1.68
Diluted:				
Net income	$	6,584,928	6,469,563	6,509,776
Average common shares outstanding		3,777,721	3,830,002	3,870,198
Dilutive effect of options issued		334	792	1,075
Average diluted shares outstanding		3,778,055	3,830,794	3,871,273
Earnings per share	$	1.74	1.69	1.68

The Company had no options that were issued and not included in the calculation of diluted earnings per share for the years ended December 31, 2006, 2005 and 2004.

(m) Stock–based compensation

Prior to January 1, 2006, the Company accounted for its stock compensation plans under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees ("APB 25"), and related Interpretations, as permitted by FASB No. 123, Accounting for Stock-Based Compensation. Accordingly, no stock-based employee compensation cost related to stock options was recognized in the consolidated statement of earnings for the year ended December 31, 2005 and 2004, as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

In December 2005, the FASB issued SFAS No. 123(R), Share-Based Payment, which revised SFAS No. 123, Accounting for Stock-Based Compensation. This statement supersedes APB 25. SFAS

123(R) addresses the accounting for share-based payment transactions with employees and other third parties, eliminates the ability to account for share-based compensation transactions using APB 25 and requires that the compensation costs relating to such transactions be recognized in the consolidated statement of earnings. The Company adopted SFAS 123(R) effective January 1, 2006, which did not have a material effect on the consolidated balance sheets or statements of earnings for the Company as all options outstanding were fully vested at that date.

The following table illustrates the effect on net earnings and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123(R) to options granted under the plan in the period presented. For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes-Merton option-pricing formula and amortized to expense over the options' vesting periods.

		2005	2004
		(In thousands, except per share data)	
Net earnings – as reported	$	6,469,563	6,509,776
Deduct:			
Total stock–based employee compensation expense determined under fair value based method for all options, net of related tax effects		2,588	7,738
Net earnings – pro forma	$	6,466,975	6,502,038
Earnings per share – as reported			
Basic	$	1.69	1.68
Diluted		1.69	1.68
Earnings per share – pro forma			
Basic	$	1.69	1.68
Diluted		1.69	1.68

The Company granted 4,000 options on January 1, 2003 with an exercise price of $13.39 which was equal to the closing market price on the date of grant. Each option had a fair value of $2.02 and $2.06 at December 31, 2005 and 2004, respectively. These options vested on the date of grant and expired on December 31, 2006. During 2006, 2005 and 2004, 2,000, 800 and 800 options were exercised, respectively. At December 31, 2006 no options were outstanding.

The Company granted 3,000 options on January 1, 2002 with an exercise price of $11.35 which was equal to the closing market price on the date of grant. These options expired on December 31, 2005. Each option had a fair value of $3.51 at December 31, 2004. During 2005 and 2004, 1,100 and 1,200 options were exercised, respectively.

(n) Recent Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments." SFAS 155 is an amendment of SFAS 133 and SFAS 140. SFAS 155 permits companies to elect, on a deal-by-deal basis, to apply a fair-value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. The Company will be required to apply the provisions of SFAS 155 to all financial instruments acquired or issued after January 1, 2007. The Company does not expect the adoption of SFAS 155 will have a material effect on the consolidated financial statements of the Company.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets – an amendment of FASB Statement 140." SFAS 156 amends SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities," with respect to the accounting for separately recognized servicing assets and liabilities. SFAS 156 addresses the recognition and measurement of separately recognized servicing assets and liabilities and provides an approach to simplify efforts to obtain hedge-like accounting. SFAS 156 is effective as of the beginning of the first fiscal year that begins after September 15, 2006. The Company does not expect the adoption of SFAS 156 will have a material effect on the consolidated financial statements of the Company.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109." This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken, or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of FIN 48 will have a material effect on the consolidated financial statements of the Company.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosure about fair value measurements. The statement does not require any new fair value measurements, however, does clarify the proper measurement of fair value as the hypothetical price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or receive the assumed liability (an entry price) at the measurement date. The Company will be required to adopt this standard beginning January 1, 2008. The Company does not expect the adoption of SFAS 157 will have a material effect on the consolidated financial statements of the Company.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 (SAB 108), "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB 108 requires the use of both an income statement approach and a balance sheet approach when evaluating whether an error is material to an entity's financial statements, based on all relevant quantitative and qualitative factors. The SEC issued SAB 108 to address what the SEC identified as diversity in practice whereby entities were

(Continued)

using either an income statement approach or a balance sheet approach, but not both. SAB 108 became effective December 31, 2006, and any material adjustments arising from the adoption of SAB 108 were required to be recorded as a cumulative effect adjustment to beginning retained earnings. The Company completed its analysis in accordance with SAB 108 using both the income statement approach and the balance sheet approach and concluded the Company had no prior year misstatements that were material to its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, "An Amendment to Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." SFAS 158 requires the recognition on the balance sheet of the overfunded or underfunded status of a defined benefit postretirement obligation measured as the difference between the fair value of plan assets and the benefit obligation. Recognition of "delayed" items should be considered in other comprehensive income. This statement is effective for fiscal years ending after December 15, 2006. Adoption of SFAS No. 158 did not have a material impact on the consolidated financial statements of the Company.

In February 2007, the FASB issued SFAS No.159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115." SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the Board's long-term measurement objectives for accounting for financial instruments. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007, with early adoption permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157, Fair Value Measurements. Management is currently evaluating this statement and its effect on the consolidated financial statements of the Company.

(o) Reclassifications

Certain amounts in 2005 and 2004 were reclassified to conform with the presentation in 2006. These reclassifications had no effect on the Company's previously reported total stockholders' equity or net earnings during the periods involved.

(2) Cash and Due from Banks

The Bank is required to maintain certain average cash reserve balances in accordance with Federal Reserve requirements. There were no required balances as of December 31, 2006 and 2005.

(3) Investment Securities

The amortized cost and fair value of investment securities at December 31, 2006, were as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Investment securities held to maturity:				
State and political subdivisions	$ 340,000	—	—	340,000
Mortgage-backed securities	173,424	1,127	34	174,517
	$ 513,424	1,127	34	514,517
Investment securities available for sale:				
U.S. government agencies, excluding mortgage-backed securities	$ 100,723,133	193,936	809,413	100,107,656
State and political subdivisions	48,932,404	654,739	68,894	49,518,249
Corporate securities	10,704,838	51,646	170,234	10,586,250
Collateralized mortgage obligations	14,978,700	34,219	300,035	14,712,884
Mortgage-backed securities	129,977,465	203,748	3,682,018	126,499,195
	$ 305,316,540	1,138,288	5,030,594	301,424,234

The composition of the investment securities with an unrealized loss position at December 31, 2006 and 2005 is shown below including the investment securities with an unrealized loss of less than twelve months and twelve months or longer.

	Investments With an Unrealized Loss of Less than 12 Months		Investments With an Unrealized Loss of 12 Months or Longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
December 31, 2006:						
U.S. government agencies, excluding mortgage-backed securities	$ 24,377,601	38,501	48,749,379	770,912	73,126,980	809,413
State and political subdivisions	5,646,442	51,126	902,228	17,768	6,548,670	68,894
Corporate securities	5,106,900	143,284	980,800	26,950	6,087,700	170,234
Collateralized mortgage obligations	—	—	10,110,148	300,035	10,110,148	300,035
Mortgage-backed securities	19,121	34	108,082,278	3,682,018	108,101,399	3,682,052
	$ 35,150,064	232,945	168,824,833	4,797,683	203,974,897	5,030,628

	Investments With an Unrealized Loss of Less than 12 Months		Investments With an Unrealized Loss of 12 Months or Longer		Total	
	Fair value	**Unrealized losses**	**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized losses**
December 31, 2005:						
U.S. government agencies, excluding mortgage-backed securities	$ 15,278,527	188,598	43,151,212	1,114,665	58,429,739	1,303,263
State and political subdivisions	19,013,670	213,141	509,330	9,940	19,523,000	223,081
Corporate securities	1,000,000	9,819	—	—	1,000,000	9,819
Collateralized mortgage obligations	7,605,956	150,329	8,666,958	337,211	16,272,914	487,540
Mortgage-backed securities	47,299,320	1,255,935	86,933,037	3,806,147	134,232,357	5,062,082
	$ 90,197,473	1,817,822	139,260,537	5,267,963	229,458,010	7,085,785

Management evaluates securities for other-than-temporary impairment when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than costs, (2) the financial condition and near-term prospects of the issuer, and (3) 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. The declines in fair value noted above were attributable to increases in interest rates and not attributable to credit quality. Since the Company has the ability and intent to hold all of these investments until a market price recovery or maturity, these investments were not considered other-than-temporarily impaired.

The amortized cost and fair value of investment securities at December 31, 2005 were as follows:

	Amortized cost	**Gross unrealized gains**	**Gross unrealized losses**	**Fair value**
Investment securities held to maturity:				
State and political subdivisions	$ 355,000	—	—	355,000
Mortgage-backed securities	278,478	3,505	21	281,962
	$ 633,478	3,505	21	636,962
Investment securities available for sale:				
U.S. government agencies, excluding mortgage-backed securities	$ 62,733,001	5,625	1,303,263	61,435,363
State and political subdivisions	48,888,702	371,986	223,081	49,037,607
Corporate securities	10,171,066	58,858	9,819	10,220,105
Collateralized mortgage obligations	17,036,006	938	487,540	16,549,404
Mortgage-backed securities	142,126,936	20,070	5,062,061	137,084,945
	$ 280,955,711	457,477	7,085,764	274,327,424

The amortized cost and fair value of investment securities at December 31, 2006 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties.

		Amortized cost	Fair value
Investment securities held to maturity:			
Due after ten years	$	340,000	340,000
Mortgage-backed securities		173,424	174,517
Total	$	513,424	514,517
Investment securities available for sale:			
Due after one year through five years	$	44,446,446	43,922,315
Due after five years through ten years		40,876,839	40,770,710
Due after ten years		64,332,252	64,932,880
Subtotal		149,655,537	149,625,905
Corporate securities		10,704,838	10,586,250
Mortgage-backed securities		129,977,465	126,499,195
Collateralized mortgage obligations		14,978,700	14,712,884
Total	$	305,316,540	301,424,234

Proceeds from the sale of investment securities available for sale during the years ended December 31, 2006, 2005, and 2004 were $31,145,690, $33,346,426, and $77,533,760, respectively. Gross gains of $260,981, $123,208, and $405,507 were realized on the sales for the years ended December 31, 2006, 2005, and 2004, respectively. Gross losses of $251,317, $111,902, and $589,140 were realized on the sales for the years ended December 31, 2006, 2005 and 2004, respectively. In addition, the Company sold a privately-held investment in 2004 for a realized gain of $917,061. Also in 2004, the Company sold its ownership in First Data stock and realized a loss of $214,818.

Investment securities with an aggregate fair value of $190,831,677 and $192,188,818 at December 31, 2006 and 2005, respectively, were pledged to secure public and trust deposits as required by law and for other purposes.

The Company maintains a diversified investment portfolio, including held to maturity and available–for–sale securities, with limited concentration in any given region, industry, or economic characteristic.

Included in other assets is stock in the Federal Home Loan Bank ("FHLB") of Atlanta. FHLB stock is carried at cost, has no contractual maturity, has no quoted fair value, and no ready market exists. The investment in the stock is required of every member of the FHLB system. The investment in the stock was $5,406,300 and $5,598,900 at December 31, 2006 and 2005, respectively.

(4) Loans

At December 31, 2006 and 2005, the composition of the loan portfolio was as follows:

		2006	2005
Commercial, financial, and agricultural	$	52,588,735	51,490,822
Leases – commercial		761,449	1,488,292
Real estate – construction:			
Commercial		4,683,777	2,039,161
Residential		9,911,845	8,832,065
Real estate – mortgage:			
Commercial		142,092,480	148,118,376
Residential		62,596,235	59,756,144
Consumer installment		9,348,175	10,334,387
Total loans		281,982,696	282,059,247
Less allowance for loan losses		4,043,955	3,843,374
Loans, net	$	277,938,741	278,215,873

During 2006 and 2005, certain executive officers and directors of the Company and the Bank, including companies with which they are associated, were loan customers of the Bank. Total loans outstanding to these persons at December 31, 2006 and 2005 amounted to $7,146,650 and $5,375,880, respectively. The change from 2005 to 2006 reflects payments of $6,184,612 and advances of $7,955,382. In management's opinion, these loans were made in the ordinary course of business at normal credit terms, including interest rate and collateral requirements, and do not represent more than normal credit risk.

A summary of the transactions in the allowance for loan losses for the years ended December 31, 2006, 2005 and 2004 is as follows:

		2006	2005	2004
Balance at beginning of year	$	3,843,374	3,455,515	4,312,554
Provision charged to earnings		330,000	485,000	600,000
Loan recoveries		59,712	258,654	309,042
Loans charged off		(189,131)	(355,795)	(1,766,081)
Balance at end of year	$	4,043,955	3,843,374	3,455,515

The Company had no impaired loans at December 31, 2006 and 2005.

For the year ended December 31, 2006, the Company had no average recorded investment in impaired loans. For the years ended December 31, 2005 and 2004, the average recorded investment in impaired loans was $85,561 and $339,593, respectively. The Company did not recognize any interest income on impaired loans in 2006, 2005, or 2004.

Nonperforming loans, consisting of loans on nonaccrual status and accruing loans past due greater than 90 days, amounted to $71,857 and $108,441 at December 31, 2006 and 2005, respectively. Nonaccrual loans were $71,857 and $108,441, at December 31, 2006 and 2005, respectively. Interest that would have been recorded on nonaccrual loans had they been in accruing status was approximately $4,000, $36,000 and $92,000, in 2006, 2005, and 2004, respectively.

The Company had no real estate acquired by foreclosure at December 31, 2006 and 2005.

The Company originates real estate mortgage loans which are sold in the secondary market. The Company retains the servicing for residential real estate loans that are sold to the Federal National Mortgage Association ("FNMA"). The Company's loan servicing portfolio consisted of 1,415 loans with an outstanding balance of $140,836,207, 1,499 loans with an outstanding balance of $152,790,298 and 1,518 loans with an outstanding balance of $154,020,527, as of December 31, 2006, 2005, and 2004, respectively.

(5) Premises and Equipment

Premises and equipment at December 31, 2006 and 2005 are summarized as follows:

	2006	2005
Land	$ 407,747	407,747
Buildings	3,047,875	3,047,875
Furniture, fixtures, and equipment	3,188,218	3,327,058
Total premises and equipment	6,643,840	6,782,680
Less accumulated depreciation	4,461,871	4,354,061
	$ 2,181,969	2,428,619

(6) Rental Property

Rental property at December 31, 2006 and 2005 are summarized as follows:

	2006	2005
Land	$ 2,196,622	390,900
Buildings	2,893,039	2,207,869
Furniture, fixtures, and equipment	212,737	226,737
Total rental property	5,302,398	2,825,506
Less accumulated depreciation	1,688,724	1,588,923
	$ 3,613,674	1,236,583

(Continued)

(7) Interest–Bearing Deposits

At December 31, 2006 and 2005, the composition of interest–bearing deposits was as follows:

	2006	2005
NOW	$ 58,942,390	68,203,383
Money market	119,370,172	115,415,273
Savings	19,157,280	19,572,723
Certificates of deposit under $100,000	82,789,594	84,966,427
Certificates of deposit and other time deposits of $100,000 and over	110,286,613	96,053,200
	$ 390,546,049	384,211,006

The following table presents the maturities of certificates of deposit and other time deposits of $100,000 or more at December 31, 2006:

Years ending December 31:	
2007	$ 75,899,081
2008	19,357,082
2009	11,303,742
2010	1,584,763
2011	2,141,945
Thereafter	—
	$ 110,286,613

During 2006 and 2005, certain executive officers and directors of the Company and Bank, including companies with which they are associated, were deposit customers of the Bank. Total deposits of these persons at December 31, 2006 and 2005 amounted to $14,061,974 and $11,142,655, respectively.

(8) Federal Funds Purchased and Securities Sold Under Agreements to Repurchase

As of December 31, 2006 and 2005, federal funds purchased and securities sold under agreements to repurchase were $14,401,113 and $1,731,391, respectively. The following summarizes pertinent data related to the federal funds purchased and securities sold under agreements to repurchase as of and for the years ended December 31, 2006, 2005, and 2004.

		2006	2005	2004
Weighted average borrowing rate at year end		5.28%	3.91%	2.23%
Weighted average borrowing rate during the year		4.77%	3.18%	1.20%
Average daily balance during the year	$	6,817,038	2,502,058	2,524,643
Maximum month-end balance during the year	$	14,401,113	4,078,104	7,612,922

(9) Other Borrowed Funds

Other borrowed funds at December 31, 2006 and 2005 consisted of the following:

	Maturity Dates	Weighted Average Interest rate		2006	2005
FHLB borrowings:					
Fixed rate	2009-2017	5.40%	$	10,187,006	10,205,256
Convertible - LIBOR based	2007-2015	4.27%		83,000,000	88,000,000
			$	93,187,006	98,205,256

Required annual principal payments on long–term debt for years subsequent to December 31, 2006 are as follows:

	FHLB Borrowings
2007	$ 10,018,250
2008	10,018,250
2009	5,018,250
2010	10,018,250
2011	5,018,250
Thereafter	53,095,756
Total	$ 93,187,006

The Bank's available line with the FHLB is 30% of the Bank's total assets, or $189,670,000 at December 31, 2006 and $181,880,000 at December 31, 2005. The Bank's remaining available line was $99,419,000 and $83,675,000 at December 31, 2006 and 2005, respectively. Interest expense on FHLB advances was $4,053,245, $4,281,410, and $4,045,403 in 2006, 2005, and 2004, respectively. The advances and line of credit are collateralized by the Bank's investment in the stock of the FHLB, all eligible first mortgage residential loans, and investment securities.

(10) Note Payable to Trust

The Company owns Auburn National Bancorporation Capital Trust I ("Trust"), a wholly-owned statutory business trust. The Company is the sole sponsor of the trust and owns $217,000 of the Trust's common securities. The Trust was created for the exclusive purpose of issuing capital trust preferred securities ("Trust Preferred Securities") in the aggregate amount of $7,000,000 and using the proceeds from the issuance of the common and preferred securities to purchase $7,217,000 of junior subordinated debentures ("Note Payable to Trust") issued by the Company. The sole asset of the Trust is the Note Payable to Trust. The Company's $217,000 investment in the Trust is included in other assets in the accompanying consolidated balance sheet and the $7,217,000 obligation of the Company is included in notes payable.

The Trust Preferred Securities bear a floating interest rate equal to the prime rate of interest plus 0.125% reset quarterly. Distributions are payable quarterly. The Trust Preferred Securities are subject to mandatory redemption upon repayment of the Note Payable to Trust at their stated maturity date or their earlier redemption in an amount equal to their liquidation amount plus accumulated and unpaid distributions to the date of redemption. The Company guarantees the payment of distributions and payments for redemption or liquidation of the Trust Preferred Securities to the extent of funds held by the Trust. The Company's obligations under the Note Payable to Trust together with the guarantee and other back-up obligations, in the aggregate, constitute a full and unconditional guarantee by the Company of the obligations of the Trust under the Trust Preferred Securities.

The Note Payable to the Trust is unsecured, bears interest at a rate equal to the prime rate of interest plus 0.125% reset quarterly and matures on December 31, 2033. Interest is payable quarterly. The Company may defer the payment of interest at any time for a period not exceeding 20 consecutive quarters provided that the deferral period does not extend past the stated maturity. During any such deferral period, distributions on the Trust Preferred Securities will also be deferred and the Company's ability to pay dividends on its shares of common stock will be restricted.

Subject to approval by the Federal Reserve Bank of Atlanta, the Trust Preferred Securities may be redeemed at our option on or after December 31, 2008. The Trust Preferred Securities may also be redeemed at any time in whole (but not in part) in the event of unfavorable changes in laws or regulations that result in (1) the Trust becoming subject to federal income tax on income received on the Note Payable to Trust, (2) interest payable by the parent company on the Note Payable to Trust becoming non-deductible for federal tax purposes, (3) the requirement for the Trust to register under the Investment Company Act of 1940, as amended, or (4) loss of the ability to treat the Trust Preferred Securities as "Tier I capital" under the Federal Reserve capital adequacy guidelines.

For regulatory purposes, the trust preferred securities are currently included in Tier 1 Capital so long as such securities do not exceed 25% of total Tier 1 capital. The Federal Reserve's new trust preferred capital rules, which took effect in early April 2006, permit the Company to treat its outstanding trust preferred securities as Tier 1 Capital for the first 25 years of the 30 year term of the related junior subordinated debentures. During the last five years preceding maturity, the amount included as capital will decline 20% per year.

(Continued)

(11) Other Comprehensive Income (Loss)

The following table sets forth the amounts of other comprehensive income (loss) included in stockholders' equity along with the related tax effect for the years ended December 31, 2006, 2005, and 2004.

	Pretax amount	Tax (expense) benefit	Net of tax amount
2006:			
Net unrealized holding gains on investment securities available for sale arising during the year	$ 2,745,645	(1,098,259)	1,647,386
Reclassification adjustment for net gains realized in net income	9,664	(3,866)	5,798
	2,735,981	(1,094,393)	1,641,588
Net unrealized holding gain on derivatives used as cash flow hedges arising during the year	8,000	(3,200)	4,800
Other comprehensive income	$ 2,743,981	(1,097,593)	1,646,388
2005:			
Net unrealized holding losses on investment securities available for sale arising during the year	$ (6,231,131)	2,492,452	(3,738,679)
Reclassification adjustment for net gains realized in net income	11,306	(4,522)	6,784
	(6,242,437)	2,496,974	(3,745,463)
Net unrealized holding gain on derivatives used as cash flow hedges arising during the year	208,000	(83,200)	124,800
Other comprehensive loss	$ (6,034,437)	2,413,774	(3,620,663)
2004:			
Net unrealized holding gains on investment securities available for sale arising during the year	$ 1,728,939	(691,575)	1,037,364
Reclassification adjustment for net gains realized in net income	733,428	(293,371)	440,057
	995,511	(398,204)	597,307
Net unrealized holding losses on derivatives used as cash flow hedges arising during the year	(216,000)	86,400	(129,600)
Other comprehensive income	$ 779,511	(311,804)	467,707

(12) Income Tax Expense

Total income tax expense (benefit) for the years ended December 31, 2006, 2005, and 2004 was allocated as follows:

		2006	2005	2004
Income from continuing operations	$	2,311,788	2,208,916	2,349,236
Stockholders' equity, for accumulated other comprehensive (loss) income		1,097,593	(2,413,774)	311,804

For the years ended December 31, 2006, 2005, and 2004 the components of income tax expense from continuing operations were as follows:

		2006	2005	2004
Current income tax expense:				
Federal	$	2,305,138	3,409,223	3,141,152
State		395,592	439,463	287,782
Total		2,700,730	3,848,686	3,428,934
Deferred income tax (benefit) expense:				
Federal		(342,693)	(1,480,834)	(974,782)
State		(46,249)	(158,936)	(104,916)
Total		(388,942)	(1,639,770)	(1,079,698)
	$	2,311,788	2,208,916	2,349,236

Total income tax expense differed from the amount computed by applying the statutory federal income tax rate of 34% to pretax earnings as follows:

		2006	2005	2004
Income tax expense at statutory rate	$	3,024,883	2,950,683	3,012,064
Increase (decrease) resulting from:				
Tax-exempt interest		(594,147)	(581,760)	(450,857)
State income taxes net of Federal income tax effect		230,566	185,148	120,692
Low-income housing credit		(227,823)	(227,823)	(227,823)
Dividends received deduction		(5,731)	(5,224)	(20,208)
Bank owned life insurance		(151,598)	(156,060)	(171,020)
Other		35,638	43,952	86,388
	$	2,311,788	2,208,916	2,349,236

(Continued)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2006 and 2005 are presented below:

		2006	2005
Deferred tax assets:			
Loans, principally due to allowance for loan losses	$	1,557,364	1,116,213
Principal amortization of leases		2,803,968	2,535,796
Unrealized loss on investment securities available for sale		1,556,920	2,651,313
Unrealized loss on derivatives		—	3,200
Other		151,601	152,776
Total deferred tax assets		6,069,853	6,459,298
Deferred tax liabilities:			
Premises and equipment, principally due to differences in depreciation		2,823,891	2,700,988
Investments, principally due to discount accretion		400,639	265,945
FHLB stock dividend		28,142	18,616
Prepaid expenses		106,252	103,634
Loans, principally due to differences in deferred loan fees		83,514	55,779
Other		115,604	93,874
Total deferred tax liabilities		3,558,042	3,238,836
Net deferred tax asset	$	2,511,811	3,220,462

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

(13) Retirement Plans

The Bank has a defined contribution retirement plan that covers substantially all employees. Participants become 20% vested in their accounts after two years of service and 100% vested after six years of service. Contributions to the plan are determined by the board of directors. Company contributions to the plan amounted to $107,385, $119,637, and $112,319, in 2006, 2005, and 2004, respectively, and are included in salaries and benefits expense.

(14) Guarantees, Derivatives, and Contingent Liabilities

Off–Balance–Sheet Arrangements

The Company is a party to financial instruments with off–balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such instruments involve elements of credit risk in excess of the amounts recognized in the consolidated financial statements.

The Company's exposure to credit loss in the event of nonperformance by the other party to these financial instruments is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on–balance–sheet instruments.

The financial instruments whose contract amounts represent credit risk as of December 31, 2006 are as follows:

Commitments to extend credit	$	51,665,729
Standby letters of credit		10,611,585

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit are commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. All guarantees expire within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company holds various assets as collateral supporting those commitments for which collateral is deemed necessary. The Company has recorded a liability for the estimated fair value of these standby letters of credit of approximately $104,000 and $82,000 at December 31, 2006 and 2005, respectively, based on the fees charged for these arrangements.

Minimum lease payments under leases classified as operating leases due in each of the five years subsequent to December 31, 2006, are as follows: 2007, $223,000; 2008, $141,000; 2009, $58,000; 2010, $30,000; 2011 and subsequent years, $0.

Derivatives

As of December 31, 2005, the Company had a cash flow hedge with a notional amount of $10 million for the purpose of converting the interest payments on floating rate money market accounts to a fixed rate. The Company started exchanging payments in March 2005 for this interest rate swap based on the three month Treasury bill investment rate. The Company recorded a liability for this swap of $8,000 for the year ended December 31, 2005. This interest rate swap was sold in August of 2006, before its scheduled maturity in July 2007 and as of December 31, 2006 the Company had no cash flow hedges. There was not any material hedge ineffectiveness from this cash flow hedge recognized in the income statement during the years ended December 31, 2006 and 2005, respectively. Additionally, the sale of the interest rate swap did not have a material effect on the Company's financial statements. The Company had no fair value hedges at December 31, 2006 and 2005.

Contingent Liabilities

The Company and the Bank are involved in various legal proceedings, arising in connection with their business. In the opinion of management, based upon consultation with legal counsel, the ultimate resolution of these proceedings will not have a material adverse effect upon the financial position or results of operations of the Company and Bank.

(15) Fair Value of Financial Instruments

SFAS No. 107, Disclosures about Fair Value of Financial Instruments ("SFAS 107"), requires disclosure of fair value information about financial instruments, whether or not recognized on the face of the balance sheet, for which it is practicable to estimate that value. The assumptions used in the estimation of the fair value of the Company's financial instruments are explained below. Where quoted market prices are not available, fair values are based on estimates using discounted cash flow and other valuation techniques. Discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following fair value estimates cannot be substantiated by comparison to independent markets and should not be considered representative of the liquidation value of the Company's financial instruments, but rather a good–faith estimate of the fair value of financial instruments held by the Company. SFAS 107 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements.

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

(a) Cash, Cash Equivalents, and Interest–Earning Deposits with Other Banks

Fair value equals the carrying value of such assets.

(b) Investment Securities

The fair value of investment securities is based on quoted market prices.

(c) Loans, including Loans Held for Sale

The fair value of loans is calculated using discounted cash flows. The discount rates used to determine the present value of the loan portfolio are estimated market discount rates that reflect the credit and interest rate risk inherent in the loan portfolio. The estimated maturities are based on the Company's historical experience with repayments adjusted to estimate the effect of current market conditions. The carrying amount of accrued interest approximates its fair value. The fair value of loans held for sale is estimated using market values.

(d) Derivatives

Fair value of interest rate swaps is based on prices quoted by the counterparty. These values represent the estimated amount the Company would receive or pay to terminate the contracts or agreements, taking into account current interest rates and, when appropriate, the creditworthiness of the counterparties.

(e) Deposits

As required by SFAS 107, the fair value of deposits with no stated maturity, such as noninterest–bearing demand deposits, NOW accounts, savings and money market deposit accounts, is equal to the carrying value. Certificates of deposit have been valued using discounted cash flows. The discount rates used are based on estimated market rates for deposits of similar remaining maturities.

(f) Short–term Borrowings

The fair values of federal funds purchased, securities sold under agreements to repurchase, and other short–term borrowings approximate their carrying value.

(g) Long–term Borrowings

The fair value of the Company's fixed rate long–term debt is estimated using discounted cash flows based on estimated current market rates for similar types of borrowing arrangements. The carrying amount of the Company's variable rate long–term debt approximates its fair value.

The carrying value and estimated fair value of the Company's financial instruments at December 31, 2006 and 2005 are as follows:

	2006		2005	
	Carrying amount	**Estimated fair value**	**Carrying amount**	**Estimated fair value**
	(in thousands)			
Financial assets:				
Cash and short-term investments	$ 17,026	17,026	26,082	26,082
Investment securities	301,937	301,939	274,961	274,964
Loans, net of allowance for loan losses (1)	281,048	278,616	279,616	276,046
Financial liabilities:				
Deposits	469,648	447,256	454,995	435,625
Short-term borrowings	14,401	14,401	1,731	1,731
Long-term borrowings	100,404	98,343	105,422	102,382
Interest rate contracts:				
Swaps	—	—	(8)	(8)

(1) includes loans held for sale

(16) Common Stock and Capital Requirements

The Company and Bank are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a material effect on the consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and 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 as calculated under regulatory accounting practices. The Company's and Bank's capital amounts and classification are also 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 Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk–weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2006, that the Company and Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2006, based on its most recent notification, the Bank is categorized 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 I risk–based, and Tier I leverage ratios as set forth in the table. Management is not aware of any conditions or events since that notification that management believes have changed the Bank's capital category.

The actual capital amounts and ratios and the aforementioned minimums as of December 31, 2006 and 2005 are as follows (dollars in thousands):

	Actual		Minimum for capital adequacy purposes		Minimum to be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(dollars in thousands)					
Auburn National Bancorporation, Inc.						
As of December 31, 2006						
Total capital (to risk-weighted assets)	$ 61,912	16.68%	29,700	8.00%	N/A	N/A
Tier I risk-based capital (to risk-weighted assets)	57,868	15.59%	14,850	4.00%	N/A	N/A
Tier I leverage capital (to average assets)	57,868	9.22%	25,102	4.00%	N/A	N/A
As of December 31, 2005						
Total capital (to risk-weighted assets)	$ 59,007	16.99%	27,790	8.00%	N/A	N/A
Tier I risk-based capital (to risk-weighted assets)	55,164	15.88%	13,895	4.00%	N/A	N/A
Tier I leverage capital (to average assets)	55,164	9.11%	24,220	4.00%	N/A	N/A
AuburnBank						
As of December 31, 2006						
Total capital (to risk-weighted assets)	57,068	15.55%	29,368	8.00%	36,710	10.00%
Tier I risk-based capital (to risk-weighted assets)	53,024	14.44%	14,684	4.00%	22,026	6.00%
Tier I leverage capital (to average assets)	53,024	8.51%	24,936	4.00%	31,170	5.00%
As of December 31, 2005						
Total capital (to risk-weighted assets)	56,846	16.33%	27,851	8.00%	34,813	10.00%
Tier I risk-based capital (to risk-weighted assets)	53,003	15.22%	13,925	4.00%	20,888	6.00%
Tier I leverage capital (to average assets)	53,003	8.78%	24,251	4.00%	30,314	5.00%

(Continued)

(17) Dividends from Subsidiary

Dividends paid by the Bank are a principal source of funds available to the Company for payment of dividends to its stockholders and for other needs. Applicable federal and state statutes and regulations impose restrictions on the amounts of dividends that may be declared by the subsidiary bank. State statutes restrict the Bank from declaring dividends in excess of the sum of the current year's earnings plus the retained net earnings from the preceding two years without prior approval. In addition to the formal statutes and regulations, regulatory authorities also consider the adequacy of the Bank's total capital in relation to its assets, deposits, and other such items. Capital adequacy considerations could further limit the availability of dividends from the Bank. At December 31, 2006, the Bank could have declared additional dividends of approximately $8,183,000 without prior approval of regulatory authorities. As a result of this limitation, approximately $35,562,000 of the Company's investment in the Bank was restricted from transfer in the form of dividends.

(18) Supplemental Information

Components of other noninterest income exceeding 1% of revenues for any of the years in the three–year period ended December 31, 2006, include:

	2006	2005	2004
Merchant discounts and fees on Master Card and Visa sales	$ 53,157	1,902,077	2,195,156
Gains on the sale of mortgage loans	649,155	669,259	348,173
Change in cash surrender value of bank owned life insurance	445,875	459,000	503,000
Servicing fees	375,490	389,185	391,115

Components of other noninterest expense exceeding 1% of revenues for any of the years in the three–year period ended December 31, 2006, include:

	2006	2005	2004
Master Card and Visa processing fees	$ —	1,931,622	2,194,296
Professional fees	476,150	491,039	470,646

(19) Parent Company Financial Information

The condensed financial information for Auburn National Bancorporation, Inc. (Parent Company Only) is presented as follows:

Parent Company Only
Condensed Balance Sheets
December 31, 2006 and 2005

Assets		**2006**	**2005**
Cash and due from banks	$	1,320,922	730,430
Investment in bank subsidiary		50,896,427	49,223,154
Rental property, net		3,613,674	1,236,583
Other assets		437,884	429,770
Total assets	$	56,268,907	51,619,937
Liabilities and Stockholders' Equity			
Accrued expenses and other liabilities	$	633,806	448,459
Note payable to trust		7,217,000	7,217,000
Total liabilities		7,850,806	7,665,459
Stockholders' equity:			
Preferred stock of $0.01 par value; Authorized 200,000 shares; issued shares – none		—	—
Common stock of $0.01 par value; Authorized 8,500,000 shares; issued 3,957,135 shares		39,571	39,571
Additional paid-in capital		3,748,205	3,734,425
Retained earnings		51,087,166	46,918,896
Accumulated other comprehensive loss, net of tax		(2,335,384)	(3,981,772)
Less:			
Treasury stock, at cost – 213,348 shares and 162,119 shares for December 31, 2006 and 2005, respectively		(4,121,457)	(2,756,642)
Total stockholders' equity		48,418,101	43,954,478
Total liabilities and stockholders' equity	$	56,268,907	51,619,937

(Continued)

Parent Company Only
Condensed Statements of Earnings
Years ended December 31, 2006, 2005, and 2004

	2006	2005	2004
Income:			
Cash dividends from bank subsidiary	$ 6,933,865	3,199,000	2,237,000
Interest on bank deposits	—	8,810	29,114
Loss on exchange of investment securities	—	—	(214,818)
Other income	386,656	380,040	380,869
Total income	7,320,521	3,587,850	2,432,165
Expense:			
Interest on borrowed funds	560,000	428,750	306,193
Net occupancy expense	1,000	1,024	2,306
Salaries and benefits	5,007	2,185	4,654
Other	430,508	433,556	398,583
Total expense	996,515	865,515	711,736
Earnings before income tax benefit and equity in undistributed earnings of subsidiary	6,324,006	2,722,335	1,720,429
Applicable income tax benefit	(234,037)	(182,375)	(197,693)
Earnings before equity in undistributed earnings of subsidiary	6,558,043	2,904,710	1,918,122
Equity in undistributed earnings of bank subsidiary	26,885	3,564,853	4,591,654
Net earnings	$ 6,584,928	6,469,563	6,509,776

(Continued)

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2006, 2005, and 2004

Parent Company Only
Condensed Statements of Cash Flows
Years ended December 31, 2006, 2005, and 2004

	2006	2005	2004
Cash flows from operating activities:			
Net earnings	$ 6,584,928	6,469,563	6,509,776
Adjustments to reconcile net earnings to net cash provided by operating activities			
Depreciation and amortization	113,802	108,750	109,402
Loss on exchange of investment securities	—	—	214,818
Equity in undistributed earnings of subsidiary	(26,885)	(3,564,853)	(4,591,654)
(Increase) decrease in other assets	(8,114)	(203,830)	(92,794)
Increase (decrease) in other liabilities	185,347	190,559	26,001
Net cash provided by operating activities	6,849,078	3,000,189	2,175,549
Cash flows from investing activities:			
Proceeds from sale of investment securities available for sale	—	—	808,614
Return of investment in Bank	—	(1,000,000)	—
Additions to rental property	(2,490,893)	(15,129)	(11,498)
Net cash (used in) provided by investing activities	(2,490,893)	(1,015,129)	797,116
Cash flows from financing activities:			
Repayments of other borrowed funds	—	—	(130,432)
Dividends paid	(2,416,658)	(2,219,728)	(1,933,544)
Purchase of treasury stock	(1,377,815)	(1,202,139)	(972,394)
Sale of treasury stock	26,780	23,197	24,819
Net cash used in financing activities	(3,767,693)	(3,398,670)	(3,011,551)
Net increase (decrease) in cash and cash equivalents	590,492	(1,413,610)	(38,886)
Cash and cash equivalents at beginning of year	730,430	2,144,040	2,182,926
Cash and cash equivalents at end of year	$ 1,320,922	730,430	2,144,040

(Continued)

(20) Quarterly Financial Data (Unaudited)

The supplemental quarterly financial data for the years ended December 31, 2006 and 2005 is summarized as follows:

		Quarter ended			
		March 31, 2006	**June 30, 2006**	**September 30, 2006**	**December 31, 2006**
Interest and dividend income	$	8,372,488	9,004,356	9,192,649	9,055,273
Interest expense		4,445,600	4,903,601	5,067,501	5,228,156
Net interest income		3,926,888	4,100,755	4,125,148	3,827,117
Provision for loan losses		105,000	105,000	85,000	35,000
Net earnings		1,644,244	1,732,990	1,660,649	1,547,045
Net earnings per share – basic and diluted		0.43	0.46	0.44	0.41

		Quarter ended			
		March 31, 2005	**June 30, 2005**	**September 30, 2005**	**December 31, 2005**
Interest and dividend income	$	7,309,259	7,674,143	8,063,343	8,267,983
Interest expense		3,358,021	3,697,372	4,000,486	4,264,885
Net interest income		3,951,238	3,976,771	4,062,857	4,003,098
Provision for loan losses		150,000	150,000	120,000	65,000
Net earnings		1,579,461	1,534,533	1,625,534	1,730,035
Net earnings per share – basic and diluted		0.41	0.40	0.42	0.46

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is designed to provide a better understanding of various factors related to the Company's results of operations and financial condition. Such discussion and analysis should be read in conjunction with "BUSINESS" and "FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA." In addition, this discussion and analysis also contains forward-looking statements, so you should also refer to "SPECIAL CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS."

The purpose of this discussion is to focus on significant changes in the financial condition and results of operations of the Company during the three years ended December 31, 2006, 2005 and 2004. This discussion and analysis is intended to supplement and highlight information contained in the accompanying consolidated financial statements and the selected financial data presented elsewhere herein. Certain amounts in 2005 and 2004 were reclassified to conform with the presentation in 2006. These reclassifications had no effect on the Company's previously reported total stockholders' equity or net earnings during the periods involved.

Overview

The Company was incorporated in Delaware in 1990, and in 1994 it succeeded its Alabama predecessor as the bank holding company controlling the Bank. The Company's business is conducted primarily through the Bank.

Like most financial institutions, the Company's profitability depends largely upon the Bank's net interest income, which is the difference between the interest received on earning assets, such as loans and investment securities, and the interest paid on interest-bearing liabilities, principally deposits and borrowings. The Company's results of operations are also affected by the Bank's provision for loan losses; non-interest expenses, such as salaries, employee benefits, and occupancy expenses; and non-interest income, such as mortgage loan fees and service charges on deposit accounts.

Economic conditions, competition and federal monetary and fiscal policies also affect financial institutions. For example, 2006 was characterized by an inverted yield curve resulting in net interest margin compression. During 2006, net interest income contributed approximately 77% of the Bank's net operating revenue (sum of net interest income and noninterest income). In addition, lending activities are influenced by regional and local economic factors, such as housing supply and demand, competition among lenders, customer preferences and levels of personal income and savings in the Company's PSA.

Our balanced growth continued during 2006, with increases in total assets, investment securities, deposits and earnings per share. The following chart shows our growth in these areas from December 31, 2004 to December 31, 2006:

	December 31, 2006	% Change	December 31, 2005	% Change	December 31, 2004
		(Dollars in thousands, except per share data)			
Net Earnings	$ 6,585	1.8%	$ 6,470	-0.6%	$ 6,510
Net Earnings Per Share - basic and diluted	1.74	3.0%	1.69	0.6%	1.68
Total Assets	635,126	4.4%	608,154	2.9%	591,161
Investment Securities	301,938	9.8%	274,961	-2.6%	282,199
Loans	281,983	0.0%	282,059	12.3%	251,129
Deposits	469,648	3.2%	454,995	6.0%	429,339
Shareholders' Equity	48,418	10.2%	43,954	-1.2%	44,504
Return on Average Total Assets	1.06%	-1.9%	1.08%	-1.8%	1.10%
Return on Average Total Equity	14.66%	2.8%	14.26%	-9.1%	15.69%

Critical Accounting Policies

The accounting and financial reporting policies of the Company conform to United States generally accepted accounting principles and to general practices within the banking industry. The allowance for loan losses is an accounting policy applied by the Company that is deemed critical. Critical accounting policies are defined as policies that are important to the portrayal of the Company's financial condition and results of operations, and that require management's most difficult, subjective or complex judgements. The Company's financial results could differ significantly if different judgements or estimates are applied in the application of this policy. See "ALLOWANCE FOR LOAN LOSSES AND RISK ELEMENTS." Other policies also require subjective judgment and assumptions and may accordingly impact our results of operations as well.

Management analyzes the loan portfolio to determine the adequacy of the allowance for loan losses and the appropriate provision required to maintain a level management considers adequate to absorb anticipated loan losses. When management believes the collection of the principal of a loan is unlikely, a loan is charged off against the allowance for loan losses. Subsequent recoveries of principal are added back to the allowance for loan losses. Management's evaluation of the adequacy of the allowance for loan losses is based on a formal analysis which assesses the risks within the loan portfolio. In assessing the adequacy of the allowance, management reviews the size, quality and risk of loans in the portfolio. Management also considers such factors as the Bank's loan loss experience, the amount of past due and nonperforming loans, specific known risk, the status and amount of nonperforming assets, underlying collateral values securing loans, current and anticipated economic conditions and other factors that affect the allowance for loan losses. In 2006, the Bank's credit administration department reviewed approximately 56% of the total loan portfolio. In addition, the Bank has engaged an outside loan review consultant, to perform an independent review of the quality of the loan portfolio. In 2006, the outside loan review consultant reviewed approximately 33% of the total loan portfolio. The Company is closely monitoring certain portions of its loan portfolio that management believes to be of higher risk under the current economic situation.

Management believes the allowance for loan losses is adequate at December 31, 2006. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on economic changes and other changes that can effect the various borrowers. Certain economic and interest rate factors could have a material impact on the determination of the allowance for loan losses. The Bank's allowance for loan losses is also subject to regulatory examinations and determinations as to adequacy, which may take into account such factors as the methodology used to calculate the allowance for loan losses and the size of the allowance for loan losses in comparison to a group of peer banks identified by the regulators. During their routine examinations of banks, the Federal Reserve and the Alabama Superintendent may require a bank to make additional provisions to its allowance for loan losses where, in the opinion of the regulators, credit evaluations and allowance for loan loss methodology differ materially from those of management. See "SUPERVISION AND REGULATION."

Management, considering current information and events regarding a borrower's ability to repay its obligations, considers a loan to be impaired when the ultimate collectibility of all amounts due, according to the contractual terms of the loan agreement, is in doubt. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate. If the loan is collateral-dependent, the fair value of the collateral is used to determine the amount of the impairment. Impairment losses are included in the allowance for loan losses through a charge to the provision for loan losses. Cash receipts on accruing impaired loans are applied to principal and interest under the contractual terms of the loan agreement. Cash receipts on impaired loans that are not accruing interest are applied first to principal and then to interest income.

Commercial real estate mortgage loans were $142.1 million, which represented 50.4% of total loans outstanding, at December 31, 2006. The largest 10 commercial real estate mortgage relationships approximated $52.8 million, or 18.7% of the total loans outstanding at December 31, 2006. There are no significant concentrations of industries or loan types within the commercial real estate loan portfolio. The Bank's commercial real estate loans are secured by real estate located principally in Lee County, Alabama. Accordingly, the ultimate collectibility of a substantial portion of the Bank's loan portfolio is susceptible to changes in market conditions in this area. A rapidly rising interest rate environment could have a material adverse impact on certain borrowers' ability to pay. In the event of a recession or a significant increase in interest rates, the Bank's credit costs and losses could increase significantly. See "QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK."

Financial Condition

Total assets at December 31, 2006 and 2005 were $635,126,000 and $608,154,000, respectively, reflecting growth of $26,972,000 or 4.4%. This increase in total assets resulted primarily from an increase of $27,097,000 in investment securities available for sale. The primary sources of funding for these investment securities available for sale were an increase in total deposits of $14,653,000 and an increase in federal funds purchased and securities sold under agreement to repurchase of $12,670,000 during 2006.

Investment Securities

Investment securities held to maturity were $513,000 and $633,000 at December 31, 2006 and 2005, respectively. This decrease of $120,000, or 19.0%, in 2006 resulted primarily from scheduled paydowns, maturities and calls of principal amounts. The investment securities available for sale portfolio was $301,424,000 and $274,327,000 at December 31, 2006 and 2005, respectively. This increase of $27,097,000, or 9.9%, reflects purchases of $53,187,000 in U.S. agency securities, $16,650,000 in mortgage-backed securities, $7,850,000 in collateralized mortgage obligations ("CMOs"), $1,056,000 in corporate securities and $10,993,000 in state and political subdivision securities. This increase is offset by $33,770,000 of scheduled paydowns, maturities and calls of principal amounts. In addition, $10,229,000 of U.S. agency securities, $10,964,000 of state and political subdivisions, $6,425,000 of CMOs, and $3,528,000 of mortgage-backed securities were sold in 2006.

The composition of the Company's total investment securities portfolio reflects the Company's investment strategy to provide acceptable levels of interest income from portfolio yields while maintaining an appropriate level of liquidity to assist with controlling the Company's interest rate position.

The following table indicates the amortized cost of the portfolio of investment securities held to maturity at the end of the last three years:

	Amortized Cost December 31,		
	2006	2005	2004
		(In thousands)	
Investment Securities Held to Maturity:			
State and political subdivisions	$ 340	355	362
Mortgage-backed securities	173	278	447
Total investment securities held to maturity	$ 513	633	809

The following table indicates the fair value of the portfolio of investment securities available for sale at the end of the last three years:

	Fair Value December 31,		
	2006	2005	2004
		(In thousands)	
Investment Securities Available for Sale:			
U.S. government agencies	$ 100,108	61,435	57,800
State and political subdivisions	49,518	49,038	42,389
Mortgage-backed securities	126,499	137,085	157,375
Collateralized mortgage obligations	14,713	16,549	17,513
Corporate securities	10,586	10,220	6,313
Total investment securities available for sale	$ 301,424	274,327	281,390

The following tables present the maturities and weighted average yields of investment securities held-to-maturity at December 31, 2006:

		Maturities of Held-to-Maturity Investment Securities Amortized Cost			
		In one year or less	After one through five years	After five through ten years	After ten years
				(In thousands)	
State and political subdivisions	$	-	-	-	340
Mortgage-backed securities		10	59	27	77
Total investment securities held to maturity	$	10	59	27	417

	Weighted Average Yields of Held-to-Maturity Investment Securities			
	In one year or less	After one through five years	After five through ten years	After ten years
State and political subdivisions		-	-	3.69%
Mortgage-backed securities	7.86%	7.03%	7.19%	5.91%

The following tables present the maturities and weighted average yields of investment securities available-for-sale at December 31, 2006:

		Maturities of Available for Sale Investment Securities Amortized Cost		
		After one through five years	After five through ten years	After ten years
			(In thousands)	
U.S. government agencies	$	43,931	37,594	19,198
State and political subdivisions		515	3,283	45,135
Mortgage-backed securities		17,221	36,734	76,022
Collateralized mortgage obligations		-	1,565	13,414
Corporate securities		-	3,508	7,197
Total investment securities available for sale	$	61,667	82,684	160,966

	Weighted Average Yields of Available for Sale Investment Securities		
	After one through five years	After five through ten years	After ten years
U.S. government agencies	3.98%	4.92%	7.19%
State and political subdivisions (1)	4.19%	6.05%	6.04%
Mortgage-backed securities	3.68%	3.66%	4.82%
Collateralized mortgage obligations	-	3.88%	4.87%
Corporate securities	-	6.53%	7.15%

Loans Held for Sale

Total loans held for sale increased $1,709,000, or 122.1%, to $3,109,000 at December 31, 2006 compared to $1,400,000 at December 31, 2005. The increase in 2006 was a result of normal fluctuations due to timing of origination and sale of mortgage loans to the secondary market.

In addition to originating mortgage loans for its own portfolio, the Company also originates residential mortgage loans that are sold in the secondary market. In addition to selling real estate mortgage loans to the Federal National Mortgage Association ("FNMA") with the Bank retaining the servicing rights, the Bank has arranged with multiple mortgage servicing companies to originate and sell, without recourse, residential first mortgage real estate loans, with servicing rights released. During 2006, the Bank sold mortgage loans totaling approximately $9,832,000 to FNMA, with the Bank retaining the servicing rights, and sold mortgage loans totaling approximately $69,912,000 to mortgage servicing companies with servicing rights released. At December 31, 2006, the Bank was servicing loans totaling approximately $140,836,000. The Bank collects monthly servicing fees of 0.25% to 0.375% annually of the outstanding balances of loans serviced for FNMA. See "– EFFECTS OF INFLATION AND CHANGING PRICES."

Loans

Total loans were $281,983,000 at December 31, 2006, a decrease of $76,000 from total loans of $282,059,000 at December 31, 2005. Overall, total loans were consistent when comparing December 31, 2006 and 2005. Over 90% of the Company's loan portfolio at December 31, 2006 and 2005 consisted of commercial, financial, and agricultural loans and commercial and residential real estate mortgage loans. The commercial, financial and agricultural component of the loan portfolio increased $1,098,000 or 2.1% to $52,589,000 at December 31, 2006, from the 2005 balance of $51,491,000 and represented 18.6% of the total loan portfolio at December 31, 2006, as compared to 18.3% at December 31, 2005. The commercial real estate mortgage component of the loan portfolio decreased $6,026,000 or 4.1% to $142,092,000 at December 31, 2006, from the 2005 balance of $148,118,000 and represented 50.4% of the total loan portfolio at December 31, 2006, as compared to 52.5% at December 31, 2005. The residential real estate mortgage component of the loan portfolio increased $2,839,000 or 4.8% to $62,596,000 at December 31, 2006, from the 2005 balance of $59,757,000 and represented 22.2% of the total loan portfolio at December 31, 2006, as compared to 21.2% at December 31, 2005.

The following table presents the composition of the loan portfolio by major categories at the end of the last five years:

		2006	2005	2004	2003	2002
				(In thousands)		
Commercial, financial and agricultural	$	52,589	51,491	49,758	54,999	56,490
Leases – commercial		762	1,488	5,397	6,630	7,128
Real estate – construction:						
Commercial		4,684	2,039	945	2,099	1,392
Residential		9,912	8,832	5,426	4,866	4,768
Real estate – mortgage:						
Commercial		142,092	148,118	136,037	122,397	124,490
Residential		62,596	59,757	42,545	41,988	46,105
Consumer installment		9,348	10,334	11,021	11,673	13,971
Total loans	$	281,983	282,059	251,129	244,652	254,344
Less: Allowance for loan losses		(4,044)	(3,843)	(3,456)	(4,312)	(5,104)
Loans, net	$	277,939	278,216	247,673	240,340	249,240

The following table presents maturities by major loan classifications and the sensitivity of loans to changes in interest rates within each maturity category at December 31, 2006:

		Maturities of Loan Portfolio			
		Within one year	After one through five years	After five years	Total
			(In thousands)		
Commercial, financial and agricultural	$	30,170	22,051	368	52,589
Leases – commercial		169	593	--	762
Real estate – construction		12,646	1,950	--	14,596
Real estate – mortgage		47,248	94,171	63,269	204,688
Consumer installment		3,923	5,195	230	9,348
Total loans	$	94,156	123,960	63,867	281,983
Variable-rate loans	$	50,432	61,652	48,835	160,919
Fixed-rate loans		43,724	62,308	15,032	121,064
Total loans	$	94,156	123,960	63,867	281,983

Allowance for Loan Losses and Risk Elements

Interest on loans is normally accrued from the date an advance is made pursuant to the loan. The performance of loans is evaluated primarily on the basis of a review of each customer relationship over a period of time and the ongoing judgment of lending officers as to the ability of borrowers to meet the repayment terms of loans. If there is reasonable doubt as to the repayment of a loan in accordance with the agreed terms, the loan may be placed on a nonaccrual basis pending the sale of any collateral or a determination as to whether sources of repayment exist. This action may be taken even though the financial condition of the borrower or the collateral may be sufficient ultimately to reduce or satisfy the obligation. Generally, when a loan is placed on a nonaccrual basis, all payments are applied to reduce principal to the extent necessary to eliminate doubt as to the repayment of the loan. Thereafter, any interest income on a nonaccrual loan is recognized only on a cash basis.

The Company's policy generally is to place a loan on nonaccrual status when it is contractually past due 90 days or more as to payment of principal or interest. A loan may be placed on nonaccrual status at an earlier date when concerns exist as to the ultimate collection of principal or interest. At the time a loan is placed on nonaccrual status, interest previously accrued but not collected is reversed and charged against current earnings. Loans that are contractually past due 90 days or more that are well secured and are in the process of collection generally are not placed on nonaccrual status.

Lending officers are responsible for the ongoing review and administration of loans assigned to them. As such, they make the initial identification of loans which present some difficulty in collection or where circumstances indicate that the possibility of loss exists. The responsibilities of the lending officers include the collection effort on a delinquent loan. To strengthen internal controls in the collection of delinquencies, senior management and the Directors' Loan Committee are informed of the status of delinquent and "watch" or problem loans on a monthly basis. Senior management reviews the allowance for loan losses and makes recommendations to the Directors' Loan Committee as to loan charge-offs on a monthly basis.

The allowance for loan losses represents management's assessment of the risk associated with extending credit and its evaluation of the quality of the loan portfolio. Management analyzes the loan portfolio to determine the adequacy of the allowance for loan losses and the appropriate provision required to maintain a level considered adequate to absorb anticipated loan losses. In assessing the adequacy of the allowance, management reviews the size, quality and risk of loans in the portfolio. Management also considers such factors as the Bank's loan loss experience, the amount of past due and nonperforming loans, specific known risks, the status and amount of nonperforming assets, underlying collateral values securing loans, current and anticipated economic conditions and other factors which affect the allowance for loan losses. An analysis of the credit quality of the loan portfolio and the adequacy of the allowance for loan losses is prepared by the Bank's Credit Administration department and presented to the Directors' Loan Committee on a monthly basis. In addition, the Bank engages outside loan review consultants, to perform an independent review of the quality of the loan portfolio.

The Bank's allowance for loan losses is also subject to regulatory examinations and determinations as to adequacy, which may take into account such factors as the methodology used to calculate the allowance for loan losses and the size of the allowance for loan losses in comparison to a group of peer banks identified by the regulators. During their routine examinations of banks, the Federal Reserve and the Alabama Superintendent may require a bank to make additional provisions to its allowance for loan losses where, in the opinion of the regulators, credit evaluations and allowance for loan loss methodology differ materially from those of management. See "SUPERVISION AND REGULATION."

While it is the Bank's policy to charge off in the current period loans for which a loss is considered probable, there are additional risks of future losses that cannot be quantified precisely or attributed to particular loans or classes of loans. Because these risks include the state of the economy, management's judgment as to the adequacy of the allowance is necessarily approximate and imprecise.

The following table summarizes the levels of the allowance for loan losses at the end of the last five years and activity in the allowance during such years:

	Allowance for Loan Loss Activity for Year ended December 31,				
	2006	2005	2004	2003	2002
	(Dollars in thousands)				
Balance at beginning of period	$ 3,843	3,456	4,313	5,104	5,340
Provision for loan losses	330	485	600	675	1,680
Charge-offs:					
Commercial, financial and agricultural	37	39	215	416	1,210
Real estate	106	124	1,507	1,036	851
Consumer	46	193	44	125	212
Total charge-offs	189	356	1,766	1,577	2,273
Recoveries:					
Commercial, financial and agricultural	13	89	219	52	181
Real estate	11	100	11	8	67
Consumer	36	69	79	51	109
Total recoveries	60	258	309	111	357
Net charge-offs	129	98	1,457	1,466	1,916
Balance at end of period	$ 4,044	3,843	3,456	4,313	5,104
Ratio of allowance for loan losses to loans outstanding	1.43%	1.36%	1.38%	1.76%	2.01%
Ratio of net charge-offs to average loans outstanding	0.05%	0.13%	0.58%	0.59%	0.73%

The allowance for loan losses was $4,044,000 or 1.43% of total outstanding loans at December 31, 2006, compared to $3,843,000, or 1.36% of total outstanding loans at December 31, 2005. This increase in the allowance for loan losses as of December 31, 2006 compared to December 31, 2005 was primarily due to an increase in the average loan volume during 2006. Although the provision for loan losses decreased in 2006, the allowance for loan losses as a percentage of total loans increased due to a decrease in total loans outstanding. During 2006, the Company had loan charge-offs totaling $189,000 and recoveries of $60,000, as compared to $356,000 in charge-offs and recoveries of $258,000 in the prior year. Overall, net charge-offs remained low in 2006 and 2005 due to improved loan performance and credit quality.

Management believes that the $4,044,000 allowance for loan losses at December 31, 2006 (1.43% of total outstanding loans), is adequate to absorb known risks in the portfolio at such date. However, no assurance can be given that adverse economic circumstances generally, including current economic events, or other events, including additional loan review or examination findings or changes in borrowers' financial conditions, will not result in increased losses in the Bank's loan portfolio or in additional provisions to the allowance for loan losses. The Bank has been engaged in enhancing the review process for its loan approval and credit grading processes. The Bank has sought to better price its loans consistent with its costs of funds and its assessment of potential credit risk. The Bank does not currently allocate its allowance for loan losses among its various classifications of loans.

While management recognizes that there is more risk traditionally associated with commercial and consumer lending as compared to real estate mortgage lending, the Bank currently has a tiered approach to determine the adequacy of its allowance for loan losses. This methodology focuses on the determination of the specific and general loss allowances for certain loans classified as problem credits and uses a five-year historical loss factor to determine the loss allocation for the remainder of the loan portfolio as opposed to allocations based on major loan categories. Level I includes specific allowances that have been reserved for impaired loans where management has identified specific losses. Level II allowances are set aside to cover general losses associated with problem loans which possess more than a normal degree of credit risk, but where no specific losses have been identified. These loans have been criticized or classified by the Bank's regulators, external loan review personnel engaged by the Bank, or internally by management. The five-year historical loss factors, subject to certain minimum percentages considering regulatory guidelines, are applied to the Level II problem loans in determining the allocation. Level III is the allowance for the balance of the loan portfolio. The loans in this tier consist of all loans that are not classified as Level I or Level II problem credits, and less risk-free loans. Risk-free loans are defined as loans fully secured by cash or cash equivalents and readily marketable collateral. Local economic conditions are considered in determining the adequacy of the Company’s allowance for loan losses. The allocation for Level III is determined by applying the historical loss factor, derived from prior years’ actual experience, to the adjusted outstanding balance for this classification. At December 31, 2006, the allowance for loan losses was allocated to approximately $2.4 million for criticized and classified loans (Level II) and approximately $1.2 million for the general reserve (Level III). Since there were no impaired loans at December 31, 2006, none of the allowance for loan losses was allocated for impaired loans (Level I).

Nonperforming Assets

Nonperforming assets consist of loans on nonaccrual status, loans that have been renegotiated at terms more favorable to the borrower than those for similar credits, real estate and other assets acquired in partial or full satisfaction of loan obligations and accruing loans that are past due 90 days or more.

Nonperforming assets were $72,000, $108,000 and $816,000 at December 31, 2006, 2005 and 2004, respectively. These levels represent a decrease of $36,000, or 33.3%, for the year ended December 31, 2006, and a decrease of $708,000, or 86.8%, for the year ended December 31, 2005. The decrease in 2006 was mainly due to a decrease in nonaccrual loans. The decrease in 2005 was due to a decrease in nonaccrual loans and other real estate owned.

An analysis of the components of nonperforming assets at the end of the last five years is presented in the following table:

	Nonperforming Assets December 31,					
		2006	2005	2004	2003	2002
		(Dollars in thousands)				
Nonaccrual loans	$	72	108	711	1,704	2,532
Renegotiated loans		--	--	--	--	--
Other nonperforming assets (primarily other real estate)		--	--	105	--	582
Accruing loans 90 days or more past due		--	--	--	--	1,469
Total nonperforming assets	$	72	108	816	1,704	3,114
Nonaccrual loans and renegotiated loans as a percentage of total loans		0.03%	0.04%	0.28%	0.70%	1.00%
Nonaccrual loans, renegotiated loans and other nonperforming assets as a percentage of total loans		0.03%	0.04%	0.32%	0.70%	1.22%
Total nonperforming assets as a percentage of total loans		0.03%	0.04%	0.32%	0.70%	1.22%

If nonaccrual loans had performed in accordance with their original contractual terms, interest income would have increased approximately $4,000, $36,000 and $92,000 for the years ended December 31, 2006, 2005 and 2004, respectively. The Company did not recognize any interest income on nonaccrual loans for the years ended December 31, 2006, 2005 and 2004.

Other Potential Problem Loans

Potential problem loans consist of those loans where management has serious doubts as to the borrower's ability to comply with the present loan repayment terms. At December 31, 2006, the Company had identified 61 loans totaling approximately $5,188,000, or 1.8% of total loans, which were considered potential problem loans. At December 31, 2005, the Company had identified 65 loans totaling approximately $5,365,000, or 1.9% of total loans, which were considered potential problem loans. Such loans have been considered in the determination of the Level II allowance previously discussed.

Deposits

Total deposits increased $14,653,000, or 3.2%, to $469,648,000 at December 31, 2006, compared to $454,995,000 at December 31, 2005. Noninterest-bearing deposits were $79,102,000 and $70,784,000 while total interest-bearing deposits were $390,546,000 and $384,211,000 at December 31, 2006 and 2005, respectively. This trend is the result of management's decision to maintain a competitive position in its deposit rate structure coupled with the Bank's marketing efforts to attract local deposits and fund its loan growth. At December 31, 2006, as a percentage of total deposits, noninterest-bearing accounts comprised approximately 16.8%, while money market deposit accounts ("MMDAs"), negotiable order or withdrawal accounts ("NOWs"), and regular savings made up approximately 42.1%, certificates of deposit under $100,000 comprised approximately 17.6%, and certificates of deposit and other time deposits of $100,000 or more comprised 23.5%. At December 31, 2005, as a percentage of total deposits, noninterest-bearing accounts comprised approximately 15.6%, while MMDAs, NOWs and regular savings made up approximately 44.6%, certificates of deposit under $100,000 comprised approximately 18.7%, and certificates of deposit and other time deposits of $100,000 or more comprised 21.1%.

The composition of total deposits for the last three years is presented in the following table:

		December 31,					
		2006		2005		2004	
		Amount	% Change from prior year end	Amount	% Change from prior year end	Amount	% Change from prior year end
		(Dollars in thousands)					
Demand deposits	$	79,102	11.75%	70,784	8.29%	65,364	8.03%
Interest bearing deposits:							
NOWs		58,942	-13.58%	68,203	5.03%	64,938	-25.66%
MMDAs		119,370	3.43%	115,415	19.01%	96,983	22.95%
Savings		19,157	-2.12%	19,573	-0.42%	19,656	9.04%
Certificates of deposit under $100,000		82,790	-2.56%	84,967	-2.54%	87,185	2.09%
Certificates of deposit and other time deposits of $100,000 and over		110,287	14.82%	96,053	0.88%	95,213	-8.34%
Total interest bearing deposits		390,546	1.65%	384,211	5.56%	363,975	-2.56%
Total deposits	$	469,648	3.22%	454,995	5.98%	429,339	-1.08%

The average balances outstanding and the average rates paid for certain categories of deposits at the end of the last three years are disclosed in the "Consolidated Average Balances, Interest Income/Expense and Yields/Rates" table immediately following:

AUBURN NATIONAL BANCORPORATION, INC. & SUBSIDIARIES
Consolidated Average Balances, Interest Income/Expense and Yields/Rates
Taxable Equivalent Basis

	Twelve Months Ended December 31,								
	2006			2005			2004		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
	(Dollars in thousands)			(Dollars in thousands)					
ASSETS									
Interest-earning assets:									
Loans, net of unearned income (1)	$ 286,613	22,304	7.78%	275,972	19,682	7.13%	262,800	16,763	6.38%
Investment securities:									
Taxable	241,298	10,882	4.51%	234,577	9,475	4.04%	252,482	9,822	3.89%
Tax-exempt (2)	47,748	3,043	6.37%	44,892	2,814	6.27%	33,307	2,148	6.45%
Total investment securities	289,046	13,925	4.82%	279,469	12,289	4.40%	285,789	11,970	4.19%
Federal funds sold	7,321	365	4.99%	8,254	261	3.16%	8,819	118	1.34%
Interest-earning deposits with other banks	1,264	64	5.06%	1,276	38	2.98%	955	13	1.36%
Total interest-earning assets	584,244	36,658	6.27%	564,971	32,270	5.71%	558,363	28,864	5.17%
Allowance for loan losses	(3,967)			(3,722)			(4,378)		
Cash and due from banks	13,142			11,985			11,078		
Premises and equipment	2,304			2,559			2,764		
Rental property, net	2,248			1,297			1,376		
Other assets	25,956			22,857			21,106		
Total assets	$ **623,927**			**599,947**			**590,309**		
LIABILITIES & STOCKHOLDERS' EQUITY									
Interest-bearing liabilities:									
Deposits:									
NOWs	$ 65,029	1,595	2.45%	66,472	1,201	1.81%	76,313	864	1.13%
Savings and money market	142,610	5,238	3.67%	121,961	2,962	2.43%	118,218	1,723	1.46%
Certificates of deposits less than $100,000	84,227	3,836	4.55%	86,670	3,296	3.80%	87,581	2,937	3.35%
Certificates of deposits and other time deposits of $100,000 or more	104,446	4,037	3.87%	100,213	3,061	3.05%	94,032	2,601	2.77%
Total interest-bearing deposits	396,312	14,706	3.71%	375,316	10,520	2.80%	376,144	8,125	2.16%
Federal funds purchased and securities sold under agreements to repurchase	6,817	325	4.77%	2,675	91	3.40%	2,632	32	1.22%
Other borrowed funds	103,533	4,613	4.46%	105,431	4,710	4.47%	103,345	4,351	4.21%
Total interest-bearing liabilities	506,662	19,644	3.88%	483,422	15,321	3.17%	482,121	12,508	2.59%
Noninterest-bearing deposits	70,240			68,408			62,900		
Accrued expenses and other liabilities	2,120			2,758			3,803		
Stockholders' equity	44,905			45,359			41,485		
Total liabilities and stockholders' equity	$ **623,927**			**599,947**			**590,309**		
Net interest income		**$17,014**			**$16,949**			**$16,356**	
Net yield on total interest-earning assets			**2.91%**			**3.00%**			**2.93%**

(1) Loans on nonaccrual status have been included in the computation of average balances.
(2) Yields on tax-exempt securities have been computed on a tax-equivalent basis using an income tax rate of 34%.

The following table presents the maturities of certificates of deposit and other time deposits of $100,000 or more:

		Maturities of Time Deposits over $100,000 December 31, 2006
		(Dollars in thousands)
Three months or less	$	8,929
After three within six months		20,710
After six within twelve months		46,260
After twelve months		34,388
Total	$	110,287
Weighted Average rate on time deposits of $100,000 or more at period end		4.60%

Schedule of Short-term Borrowings [(1)]

The following table shows the maximum amount of short-term borrowings and the average and year-end amount of borrowings, as well as interest rates:

Year ended December 31	Maximum Outstanding at any Month-end	Average Balance	Interest Rate During Year	Ending Balance	Weighted Average Interest Rate at Year-end
		(Dollars in thousands)			
2006	$ 14,401	$ 6,817	4.77%	$ 14,401	5.28%
2005	4,078	2,502	3.18%	1,731	3.91%
2004	7,613	2,525	1.20%	7,613	2.23%

(1) Consists of federal funds purchased and securities sold under agreements to repurchase.

Contractual Obligations

The following table presents additional information about our contractual obligations as of December 31, 2006, which by their terms have contractual maturity and termination dates subsequent to December 31, 2006:

(In thousands)

FHLB advances	93,187	10,018	15,037	15,036	53,096
Operating lease obligations	452	223	199	30	-
Note payable to trust	7,217	-	-	-	7,217
Total	$ 100,856	$ 10,241	$ 15,236	$ 15,066	$ 60,313

Note Payable to Trust

The Company owns all the common securities of a Delaware statutory trust, Auburn National Bancorporation Capital Trust I. This unconsolidated subsidiary issued approximately $7,000,000 million in trust preferred securities, guaranteed by the Company on a junior subordinated basis. The Company obtained these proceeds through a note payable to the trust in the form of junior subordinated debentures. As of December 31, 2006, $7,000,000 of the $7,217,000 note payable to trust was classified as Tier 1 Capital for regulatory purposes. For regulatory purposes, the trust preferred securities are currently included in Tier 1 Capital so long as such securities do not exceed 25% of total Tier 1 capital. The Federal Reserve's new trust preferred capital rules, which took effect in early April 2006, permit the Company to treat its outstanding trust preferred securities as Tier 1 Capital for the first 25 years of the 30 year term of the related junior subordinated debentures. During the last five years preceding maturity, the amount included as capital will decline 20% per year.

Off-Balance Sheet Arrangements

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such instruments involve elements of credit risk in excess of the amounts recognized in the consolidated financial statements.

The Company's exposure to credit loss in the event of nonperformance by the other party to these financial instruments is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

The financial instruments whose contract amounts represent credit risk as of December 31, 2006 are as follows:

Commitments to extend credit	$	51,665,000
Standby letters of credit		10,612,000

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit are commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. All guarantees expire within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company holds various assets as collateral supporting those commitments for which collateral is deemed necessary.

Capital Resources and Stockholders' Equity

The Company's consolidated stockholders' equity increased $4,464,000 or 10.2% to $48,418,000 at December 31, 2006 from $43,954,000 at December 31, 2005. The increase in stockholders' equity for 2006 is mainly due to an increase in the fair value of investment securities available for sale and net earnings for 2006. This is offset by cash dividends paid and treasury stock repurchases in 2006. The Company has funded its capital growth primarily through retained earnings since its 1995 common stock offering. The Company has $7,000,000 of trust preferred securities that count as Tier 1 Capital for regulatory purposes. See "SUPERVISION AND REGULATION."

During 2006, cash dividends of $2,417,000 or $0.64 per share, were declared on the common stock as compared to $2,220,000 or $0.58 per share, in 2005. The Company plans to continue a dividend payout policy that provides cash returns to its investors and allows the Company to maintain adequate capital to support future growth and capital adequacy; however, the Company is dependent on dividends from the Bank as discussed subsequently. Management believes that a strong capital position is important to the continued profitability of the Company and provides a foundation for future growth as well as promoting depositor and investor confidence in the institution. See "SUPERVISION AND REGULATION."

Certain financial ratios for the Company for the last three years are presented in the following table:

	Equity and Asset Ratios December 31, 2006	2005	2004
Return on average assets	1.06%	1.08%	1.10%
Return on average equity	14.66%	14.26%	15.69%
Dividend payout ratio	36.78%	34.32%	29.76%
Average equity to average asset ratio	7.20%	7.56%	7.03%

The Bank is subject to the regulatory capital requirements administered by the Federal Reserve and the Company must maintain capital required by the Alabama Superintendent. Failure to meet minimum capital requirements can initiate certain mandatory actions, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification of the Bank are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Management believes, as of December 31, 2006, that the Bank meets all capital adequacy requirements to which it is subject. See "SUPERVISION AND REGULATION."

The following table sets forth the Bank's actual capital levels and the related required capital levels at December 31, 2006:

	Actual Capital Amount	Actual Ratio	Required Capital Amount	Required Ratio
	(Dollars in thousands)			
Tier 1 risk-based capital	$ 53,024	14.44%	$ 14,684	≥ 4%
Leverage ratio	53,024	8.51%	24,936	3 - 5%
Total risk-based capital	57,068	15.55%	29,368	≥ 8%

Liquidity

Liquidity is the Company's ability to convert assets into cash equivalents in order to meet daily cash flow requirements, primarily for deposit withdrawals, loan demand and maturing liabilities. Without proper management, the Company could experience higher costs of obtaining funds due to insufficient liquidity, while excessive liquidity can lead to a decline in earnings due to the cost of foregoing alternative higher-yielding investment opportunities.

At the Bank, asset liquidity is provided primarily through cash, the repayment and maturity of investment securities, and the sale and repayment of loans.

Sources of liability liquidity include customer deposits, federal funds purchased and investment securities sold under agreements to repurchase. Although deposit growth historically has been a primary source of liquidity, such balances may be influenced by changes in the banking industry, interest rates available on other investments, general economic conditions, competition and other factors. The Bank has participated in the FHLB's advance program to obtain funding for its growth. Advances include both fixed and variable terms and are taken out with varying maturities. This line is collateralized by a blanket lien against the Bank's one-to-four family residential mortgage loans and investment securities. At December 31, 2006, the Bank had $93,187,000 in advances from FHLB.

Net cash used in operating activities of $534,000 for the year ended December 31, 2006 consisted primarily of an increase in other assets offset by net earnings. In addition, the Company had $79,744,000 in proceeds from the sale of loans that were originated for resale. This was offset by $80,803,000 in loans originated for resale. Net cash used in investing activities of $25,069,000 principally resulted from investment securities purchases of $89,736,000. This is offset by proceeds from maturities, calls and paydowns of investment securities available for sale and held to maturity of $33,770,000 and proceeds from sales of investment securities available for sale of $31,146,000. The $18,536,000 in net cash provided by financing activities resulted primarily from an increase of $6,335,000 in interest-bearing deposits, an increase of $8,317,000 in non-interest bearing deposits, and an increase in federal funds sold and securities sold under agreements to repurchase of $12,670,000. This is offset by repayments on borrowings from FHLB of $5,018,000 and cash dividends paid of $2,417,000.

The Company depends mainly on dividends, management fees and lease payments from the Bank for its liquidity. The Company only receives cash dividends from the Bank if the cash flow from other sources is not sufficient to maintain a positive cash flow, also giving consideration to regulatory restrictions. Accordingly, the Bank paid the Company $6,934,000, $3,199,000, and $2,237,000 in cash dividends for 2006, 2005, and 2004 respectively. The Company provides services to the Bank for which it is paid a management fee comparable to the fee an unaffiliated vendor would receive. In addition, the Bank leases premises and equipment from the Company for its operations. Leases between the Bank and the Company are based on the same terms and conditions as leases to unaffiliated parties leasing space in the same building. The Bank paid the Company $17,000 in management fees for the years ended December 31, 2006 and 2005, respectively. The Bank also paid $149,000 and $180,000 in lease payments for the years ended December 31, 2006 and 2005, respectively. These funds were used to purchase property for future expansion, pay operating expenses and fund dividends to the Company's shareholders. In addition, the Bank makes transfers to the Company, under its tax sharing agreement, for payment of consolidated tax obligations. The tax sharing agreement calls for the allocation of the consolidated tax liability or benefit between the Company and each subsidiary based on their individual tax positions as if each entity filed a separate tax return.

The Bank's loan to deposit ratio decreased slightly to 60.04% at December 31, 2006 from 61.99% at December 31, 2005. The Bank has been monitoring its liquidity, and has sought to better price its loans consistent with its costs of funds and the Bank's assessment of potential credit risk.

Interest Rate Sensitivity Management

An integral part of the funds management of the Company and the Bank is to maintain a reasonably balanced position between interest rate sensitive assets and liabilities. The Bank's Asset/Liability Management Committee ("ALCO") is charged with the responsibility of managing, to the degree prudently possible, its exposure to "interest rate risk," while attempting to provide earnings enhancement opportunities. The dollar difference between rate sensitive assets and liabilities for a given period of time is referred to as the rate sensitive gap ("GAP"). A GAP ratio is calculated by dividing rate sensitive assets by rate sensitive liabilities. Due to the nature of the Bank's balance sheet structure and the market approach to pricing of liabilities, management and the Board of Directors recognize that achieving a perfectly matched GAP position in any given time frame would be extremely rare. ALCO has determined that an acceptable level of interest rate risk would be for net interest income to fluctuate no more than 10.0% given a change in selected interest rates of up or down 200 basis points over any 12-month period. Using an increase of 200 basis points and a decrease of 200 basis points, at December 31, 2006, the Bank's net interest income would increase approximately 5.74% in a falling rate environment and would decrease approximately 5.61% in a rising rate environment. Interest rate scenario models are prepared using software created and licensed by The Bankers Bank.

For purposes of measuring interest rate sensitivity, Company management provides growth assumptions to incorporate over the 12-month period. Although demand and savings accounts are subject to immediate withdrawal, all passbook savings and regular NOW accounts are reflected in the model as repricing based on industry data from a third party. For repricing GAP, these accounts are repricing immediately.

Certificates of deposit are spread according to their contractual maturity. Investment securities and loans reflect either the contractual maturity, call date, repricing date or in the case of mortgage-related products, a market prepayment assumption.

Interest Sensitivity Analysis
December 31, 2006

	Immediate	One to Three Months	Four to Twelve Months	One to Five Years	Over Five Years and Non-rate Sensitive	Total
			(In thousands)			
Earning Assets:						
Loans (1)	$ -	148,525	36,359	90,190	10,017	285,091
Taxable investment securities	-	26,982	25,299	126,294	73,845	252,420
Tax-exempt investment securities	-	-	-	9,107	40,411	49,518
Federal funds sold	-	-	-	-	-	-
Interest-earning deposits with other banks	151	-	-	-	-	151
Total interest-earning assets	151	175,507	61,658	225,591	124,273	587,180
Interest-bearing liabilities:						
NOW	-	29,314	4,687	24,941	-	58,942
Savings and money market	-	120,332	2,880	15,315	-	138,527
Certificates of deposits less than $100,000	3,476	13,189	36,167	29,958	-	82,790
Certificates of deposits and other time deposits of $100,000 or more	5,291	8,598	64,432	31,966	-	110,287
Federal funds purchased and securities sold under agreements to repurchase	14,401	-	-	-	-	14,401
Other borrowed funds	10,000	3	9	60,062	23,113	93,187
Total interest-bearing liabilities	33,168	171,436	108,175	162,242	23,113	498,134
Interest sensitivity gap	(33,017)	4,071	(46,517)	63,349	101,160	89,046
Cumulative interest sensitivity gap	$ (33,017)	(28,946)	(75,463)	(12,114)	89,046	

(1) includes loans held for sale

The interest sensitive assets at December 31, 2006 that reprice or mature within 12 months were $237,316,000 while the interest sensitive liabilities that reprice or mature within the same time frame were $312,779,000. At December 31, 2006, the 12 month cumulative GAP position was a negative $75,463,000 resulting in a GAP ratio of interest sensitive assets to interest sensitive liabilities of 0.76%. This negative GAP indicates that the Company has more interest-bearing liabilities than interest-earning assets that reprice within the GAP period. ALCO realizes that GAP is limited in scope since it does not capture all the options of repricing opportunities in the balance sheet. Therefore, ALCO places its emphasis on income at risk and economic value of equity measurements.

The Bank may enter into interest rate protection contracts to help manage its interest rate exposure. These contracts include interest rate swaps, caps and floors. Interest rate swap transactions involve the exchange of fixed and floating rate interest payment obligations based on the underlying notional principal amounts. Interest rate caps and floors are purchased by the Bank for a non-refundable fixed amount. The Bank receives interest based on the underlying notional principal amount if the specified index rises above the cap rate or falls below the floor strike rate. Notional principal amounts are used to express the volume of these transactions, but because they are never exchanged, the amounts subject to credit risk are much smaller. Risks associated with interest rate contracts include interest rate risk and creditworthiness of the counterparty. These risks are considered in the Bank's overall asset liability management program. The Bank utilizes periodic financial statements issued by the counterparty to analyze the creditworthiness of the counterparty prior to entering into a contract and to monitor changes in the financial condition of the counterparty throughout the term of the contract. Previous contracts were issued by a securities broker-dealer and were entered into with the purpose of managing the Bank's interest rate exposure. Although none of the interest rate protection agreements were traded on any organized exchange, an active secondary market was available to the Company for such contracts.

The Bank's Asset Liability Management Policy states that establishing limits on interest rate swaps, caps and floors can be somewhat confusing or misleading since the notional amount by which these instruments are expressed is never exchanged between counterparties and therefore is not "at risk." Furthermore, since they represent tools used by ALCO to manage imbalances in the Bank's balance sheet in a prudent and cost effective manner, the appropriate volume of swaps for the Bank is not static; it changes with elements such as the economic environment, the capital position and the ability to efficiently replicate hedging actions in the cash markets. The Bank endeavors to limit outstanding notional value of cash contracts executed for purposes of managing net interest income to 25% of total assets as reported in the most recent quarterly call report. Notional value of cash contracts executed with one counterparty are limited to 10% of total assets as reported in the Bank's most recent quarterly call report.

As of December 31, 2005, the Company had a cash flow hedge with a notional amount of $10,000,000 for the purpose of converting the interest payments on floating rate money market accounts to a fixed rate. The Company started exchanging payments in March 2005 for this interest rate swap based on the three month Treasury bill investment rate. The Company recorded a liability for this swap of $8,000 for the year ended December 31, 2005. This interest rate swap was sold in August of 2006, before its scheduled maturity in July 2007. There was not any material hedge ineffectiveness from this cash flow hedge recognized in the income statement during the years ended December 31, 2006 and 2005, respectively. Additionally, the sale of the interest rate swap did not have a material effect on the Company's financial statements. As of December 31, 2006, the Company had no cash flow hedges. In addition, the Company had no fair value hedges at December 31, 2006 and 2005.

Effects of Inflation and Changing Prices

Inflation generally increases the costs of funds and operating overhead, and to the extent loans and other assets bear variable rates, the yields on such assets. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant effect on the performance of a financial institution than the effects of general levels of inflation. In addition, inflation affects financial institutions' cost of goods and services purchased, the cost of salaries and benefits, occupancy expense and similar items. Inflation and related increases in interest rates generally decrease the market value of investments and loans held and may adversely affect liquidity, earnings and stockholders' equity. Mortgage originations and refinancings tend to slow as interest rates increase, and such increases likely will reduce the Company's volume of such activities and the income from the sale of residential mortgage loans in the secondary market.

Pending Accounting Pronouncements

In December 2005, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2005), "Share-Based Payment" ("SFAS 123R"), which revised SFAS No. 123, "Accounting for Stock-Based Compensation." This statement supercedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). SFAS 123R addresses the accounting for share-based payment transactions with employees and other third parties, eliminates the ability to account for share-based compensation transactions using APB 25 and requires that the compensation costs relating to such transactions be recognized in the consolidated statement of earnings. The Company adopted SFAS 123R effective January 1, 2006, which did not have a material effect on the consolidated balance sheets or statements of earnings for the Company as all options outstanding were fully vested at that date.

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments." SFAS 155 is an amendment of SFAS 133 and SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities." SFAS 155 permits companies to elect, on a deal-by-deal basis, to apply a fair-value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. The Company will be required to apply the provisions of SFAS 155 to all financial instruments acquired or issued after January 1, 2007. The Company does not expect the adoption of SFAS 155 will have a material effect on the consolidated financial statements of the Company.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets – an amendment of FASB Statement 140." SFAS 156 amends SFAS No. 140 with respect to the accounting for separately recognized servicing assets and liabilities. SFAS 156 addresses the recognition and measurement of separately recognized servicing assets and liabilities and provides an approach to simplify efforts to obtain hedge-like accounting. SFAS 156 is effective as of the beginning of the first fiscal year that begins after September 15, 2006. The Company does not expect the adoption of SFAS 156 will have a material effect on the consolidated financial statements of the Company.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109." This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken, or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of FIN 48 will have a material effect on the consolidated financial statements of the Company.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosure about fair value measurements. The statement does not require any new fair value measurements, however, does clarify the proper measurement of fair value as the hypothetical price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or receive the assumed liability (an entry price) at the measurement date. The Company will be required to adopt this standard beginning January 1, 2008. The Company does not expect the adoption of SFAS 157 will have a material effect on the consolidated financial statements of the Company.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 ("SAB 108"), "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB 108 requires the use of both an income statement approach and a balance sheet approach when evaluating whether an error is material to an entity's financial statements, based on all relevant quantitative and qualitative factors. The SEC issued SAB 108 to address what the SEC identified as diversity in practice whereby entities were using either an income statement approach or a balance sheet approach, but not both. SAB 108 became effective December 31, 2006, and any material adjustments arising from the adoption of SAB 108 were required to be recorded as a cumulative effect adjustment to beginning retained earnings. The Company completed its analysis in accordance with SAB 108 using both the income statement approach and the balance sheet approach and concluded the Company had no prior year misstatements that were material to its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, "An Amendment to Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." SFAS 158 requires the recognition on the balance sheet of the overfunded or underfunded status of a defined benefit postretirement obligation measured as the difference between the fair value of plan assets and the benefit obligation. Recognition of "delayed" items should be considered in other comprehensive income. This statement is effective for fiscal years ending after December 15, 2006. Adoption of SFAS No. 158 did not have a material impact on the consolidated financial statements of the Company.

In February 2007, the FASB issued SFAS No.159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115." SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the Board's long-term measurement objectives for accounting for financial instruments. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007, with early adoption permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157, Fair Value Measurements. Management is currently evaluating this statement and its effect on the consolidated financial statements of the Company.

Results of Operations

Net Earnings

Net earnings increased $115,000, or 1.8%, to $6,585,000 during 2006 from $6,470,000 for the year ended December 31, 2005. Basic and diluted earnings per share was $1.74 and $1.69 for 2006 and 2005, respectively, an increase of 3.0%. Comparatively, net earnings during 2005 decreased $40,000, or 0.6%, to $6,470,000 from the 2004 total of $6,510,000, while basic and diluted earnings per share increased $0.01 per share to $1.69 for 2005 from $1.68 in 2004.

The increase in net earnings for 2006 is primarily attributable to a decrease in provision for loan losses compared to 2005. The decrease in net earnings for 2005 is attributable to a decrease in noninterest income compared to 2004. This is offset by an increase in net interest income and a decrease in noninterest expense and provision for loan losses.

Net Interest Income

Net interest income is the difference between the interest the Company earns on its loans, investment securities and other earning assets and the interest cost of its deposits, borrowed funds and other interest-bearing liabilities. This is the primary component of the Company's earnings. Net interest income was $15,980,000 for the year ended December 31, 2006. This slight decrease of $14,000, or 0.1%, over 2005 is due to a decrease in the net yield on total interest earning assets of 9 basis points to 2.91%.

Net interest income was $15,994,000 for the year ended December 31, 2005. This increase of $368,000, or 2.4%, over 2004 is due to an increase in average interest earning assets and an increase in the net yield on total interest earning assets of 7 basis points to 3.00%.

The Company may use interest rate protection contracts, primarily interest rate swaps, caps and floors, to protect the yields on earning assets and the rates paid on interest-bearing liabilities. Such contracts act as hedges against unfavorable rate changes. The income and expense associated with interest rate swaps, caps and floors are ultimately reflected as adjustments to the net interest income or expense of the underlying assets or liabilities. The effect of such interest rate protection contracts resulted in a net increase in net interest income of $36,000 for 2006, a net decrease in net interest income of $73,000 for 2005 and a net increase in net interest income of $65,000 for 2004. As of December 31, 2006, the Company had no interest rate swaps outstanding. At December 31, 2005, the Company had one interest rate swap that was accounted for as a cash flow hedge. This interest rate swap was sold during the third quarter of 2006. It is the intention of the Company to continue to utilize interest rate protection contracts to manage exposure to certain future changes in interest rate environments to the extent management deems advisable. However, there can be no assurance that such transactions will positively affect earnings. See "--INTEREST RATE SENSITIVITY MANAGEMENT," the "CONSOLIDATED AVERAGE BALANCES, INTEREST INCOME/EXPENSE AND YIELDS/RATES" table appearing elsewhere herein and the "RATE/VOLUME VARIANCE ANALYSIS" tables immediately following.

Rate/Volume Variance Analysis

Taxable-Equivalent Basis (1)(2) Years Ended December 31, 2006 Compared to 2005			**Change Due to**		
		Net Change	Rate	Volume	Rate/ Volume
			(In thousands)		
Earning Assets:					
Loans	$	2,622	1,794	759	69
Investment securities:					
Taxable		1,407	1,104	271	32
Tax-exempt		229	47	179	3
Total investment securities		1,636	1,151	450	35
Federal funds sold		104	151	(30)	(17)
Interest earning deposits with other banks		26	26	0	0
Total earning assets	$	4,388	3,122	1,179	87
Interest bearing liabilities:					
Deposits:					
NOWs	$	394	429	(26)	(9)
Savings and money market		2,276	1,518	501	257
Certificates of deposit less than $100,000		540	651	(93)	(18)
Certificates of deposit and other time deposits of $100,000 or more		976	813	129	34
Total interest bearing deposits		4,186	3,411	511	264
Federal funds purchased and securities sold under agreements to repurchase		234	37	140	57
Other borrowed funds		(97)	(12)	(85)	0
Total interest bearing liabilities	$	4,323	3,436	566	321

(1) For analytical purposes, income for tax-exempt assets, primarily securities issued by state and local governments or authorities, is adjusted by an increment which equates tax-exempt income to interest from taxable assets (assuming a 34% effective federal income tax rate).

(2) The change in interest due to rate is calculated by multiplying the previous volume by the rate change and the change in interest due to volume is calculated by multiplying the change in volume by the previous rate. Changes attributable to both changes in rate and volume are calculated by multiplying the change in volume by the change in rate, in proportion to the relationship of the absolute dollar amounts of the change in each.

Rate/Volume Variance Analysis

Taxable-Equivalent Basis (1)(2) Years Ended December 31, 2005 Compared to 2004		Net Change	Change Due to Rate	Change Due to Volume	Rate/ Volume
			(In thousands)		
Earning Assets:					
Loans	$	2,919	1,980	840	99
Investment securities:					
Taxable		(347)	376	(696)	(27)
Tax-exempt		666	(60)	747	(21)
Total investment securities		319	316	51	(48)
Federal funds sold		143	161	(8)	(10)
Interest earning deposits with other banks		25	16	4	5
Total earning assets	$	3,071	2,200	839	32
Interest bearing liabilities:					
Deposits:					
NOWs	$	337	515	(111)	(67)
Savings and money market		1,239	1,148	55	36
Certificates of deposit less than $100,000		359	394	(31)	(4)
Certificates of deposit and other time deposits of $100,000 or more		460	271	171	18
Total interest bearing deposits		2,395	2,328	84	(17)
Federal funds purchased and securities sold under agreements to repurchase		59	57	1	1
Other borrowed funds		359	266	88	5
Total interest bearing liabilities	$	2,813	2,651	173	(11)

(1) For analytical purposes, income for tax-exempt assets, primarily securities issued by state and local governments or authorities, is adjusted by an increment which equates tax-exempt income to interest from taxable assets (assuming a 34% effective federal income tax rate).

(2) The change in interest due to rate is calculated by multiplying the previous volume by the rate change and the change in interest due to volume is calculated by multiplying the change in volume by the previous rate. Changes attributable to both changes in rate and volume are calculated by multiplying the change in volume by the change in rate, in proportion to the relationship of the absolute dollar amounts of the change in each.

Interest Income

Interest income is a function of the volume of interest-earning assets and their related yields. Interest income was $35,625,000, $31,315,000 and $28,134,000 for the years ended December 31, 2006, 2005, and 2004, respectively. The increase in interest income during 2006 resulted primarily from an increase in the average volume outstanding of loans and investment securities and an increase in yields for all components of interest earning assets. Average interest-earning assets increased $19,273,000 or 3.4% during 2006, compared to an increase of $6,608,000 or 1.2% during 2005, while the fully taxable equivalent yields on average earning assets increased 56 basis points and 54 basis points in 2006 and 2005, respectively. The combination of these factors resulted in an increase in interest income of $4,310,000, or 13.8%, for 2006 and an increase of $3,181,000, or 11.3%, during 2005. See "--CONSOLIDATED AVERAGE BALANCES, INTEREST INCOME/EXPENSE AND YIELDS/RATES" and THE "RATE/VOLUME VARIANCE ANALYSIS" tables.

Loans are the main component of the Bank's earning assets. Interest and fees on loans were $22,304,000, $19,682,000 and $16,763,000 for the years ended December 31, 2006, 2005 and 2004, respectively. These levels reflected an increase of $2,622,000 or 13.3% during 2006, and an increase of $2,919,000 or 17.4% during 2005. The increase in 2006 and 2005, respectively is due to an increase in the yield on loans and an increase in the average volume outstanding on loans. The level of average balances increased to $286,613,000 in 2006 from $275,972,000 in 2005 and $262,800,000 for 2004. The yield on loans increased 65 basis points to 7.78% in 2006 and increased 75 basis points to 7.13% in 2005 from the 2004 average yield of 6.38%.

Interest income on investment securities increased $1,558,000 or 13.7% to $12,891,000 in 2006, following an increase of $93,000 or 0.8% to $11,333,000 in 2005 from $11,240,000 in 2004. The 2006 increase was due to an increase in the fully taxable equivalent yield of 42 basis points and a $9,577,000 increase in average volume outstanding compared to 2005 levels. The 2005 increase was due to an increase in the fully taxable equivalent yield of 21 basis points offset by a $6,320,000 decrease in average volume outstanding compared to 2004 levels. The fully taxable equivalent yields on investment securities were 4.82% in 2006, 4.40% in 2005 and 4.19% in 2004. See "FINANCIAL CONDITION--INVESTMENT SECURITIES."

Interest Expense

Total interest expense was $19,645,000, $15,321,000 and $12,508,000 for the years ended December 31, 2006, 2005 and 2004 respectively, representing an increase of $4,324,000 or 28.2% during 2006 and an increase of $2,813,000 or 22.5% during 2005. Total average balances outstanding of interest-bearing liabilities have continued an upward trend over the last three years to $506,662,000 in 2006 from $483,422,000 in 2005 and $482,121,000 in 2004. The rates paid on these liabilities increased 71 basis points in 2006 to 3.88% after increasing 58 basis points to 3.17% during 2005 from 2.59% in 2004.

Interest on deposits, the primary component of total interest expense, increased $4,186,000 to $14,706,000, or 39.8%, during 2006 from $10,520,000 in 2005, which in turn represented a $2,395,000 or 29.5% increase from the 2004 level of $8,125,000. The average balance outstanding of interest-bearing deposits has increased to the 2006 level of $396,312,000 as compared to $375,316,000 in 2005 and $376,144,000 in 2004. The average rates paid on interest-bearing deposits were 3.71%, 2.80% and 2.16% for 2006, 2005 and 2004, respectively.

Interest expense on borrowed funds was $4,613,000, $4,710,000 and $4,352,000 for the year ended December 31, 2006, 2005 and 2004, respectively. These levels represent a decrease of $97,000 or 2.1% during 2006 and an increase of $358,000 or 8.2% during 2005. The 2006 decrease was due to repayments on FHLB advances during 2006. The 2005 increase was due to an increase in interest rates on FHLB advances.

Provision for Loan Losses

During 2006, the Company recorded a total provision for loan losses of $330,000 based on management's reviews and assessments of the risks in the loan portfolio, the amount of the loan portfolio and historical loan loss trends, and an evaluation of certain significant problem loans. During 2005 and 2004, the Company made total provisions for loan losses of $485,000 and $600,000, respectively. The decrease in 2006 and 2005 are due to improved performance in the loan portfolio. Provision for loan losses also decreased in 2006 due to the decrease in charge-offs compared to 2005. See "FINANCIAL CONDITION -- ALLOWANCE FOR LOAN LOSSES AND RISK ELEMENTS."

Noninterest Income

Noninterest income decreased $1,744,000, or 27.3%, to $4,649,000 for the year ended December 31, 2006, from the 2005 total of $6,393,000, which in turn represented a decrease of $646,000, or 9.2%, from the total of $7,039,000 for 2004.

Service charges on deposit accounts decreased $110,000, or 7.3%, during 2006 to $1,387,000 and increased $7,000, or 0.5%, in 2005 to $1,497,000 from $1,490,000 in 2004. Service charge income remained fairly stable in 2006, 2005 and 2004.

Net gains from investment securities decreased $1,000 or 9.1% to $10,000 for the year ended December 31, 2006, from $11,000 in 2005. Net gains from investment securities decreased $722,000, or 98.5%, to $11,000 for the year ended December 31, 2005. This decrease was primarily due to a gain of $566,000 in 2004, net of applicable income tax effects, upon the sale of a private equity investment.

Other noninterest income decreased $1,632,000 or 33.4% to $3,252,000 in 2006 from $4,884,000 in 2005. Comparatively, the 2005 total represented an increase of $68,000 or 1.4% from $4,816,000 in 2004. The decrease in 2006 was primarily due to a $1,849,000 decrease in MasterCard/VISA discounts and fees as a result of the Company moving its MasterCard/VISA merchant processing to a third party in mid 2005. The net effect of the decrease in other noninterest income related to MasterCard/Visa discounts and fees and in other noninterest expense related to MasterCard/Visa processing expense, discussed below, was a benefit of $83,000 for the year ended December 31, 2006 as compared to December 31, 2005. The increase in 2005 noninterest income was primarily due to a $321,000 increase in the gain on sale of mortgage loans. This was offset by a $293,000 decrease in MasterCard/VISA discounts and fees.

Noninterest Expense

Total noninterest expense was $11,402,000, $13,223,000 and $13,205,000 for the years ended December 31, 2006, 2005 and 2004, respectively, representing a decrease of $1,821,000, or 13.8% during 2006 and an increase of $18,000, or 0.1%, during 2005. The decrease in noninterest expense during 2006 was primarily due to a decrease in other noninterest expense.

Salaries and benefits increased $55,000, or 0.8%, to $6,714,000 for the year ended December 31, 2006, and increased $365,000, or 5.8%, to $6,659,000 for the year ended December 31, 2005, from $6,294,000 for 2004. At December 31, 2006, the Company had 137 full-time equivalent employees, a number which has remained stable compared to 133 and 135 for 2005 and 2004, respectively. The increase in salary and benefit expenses for 2006 and 2005 was primarily due to merit raises and the cost of benefits associated with such increases.

Net occupancy expense was $1,058,000, $1,079,000 and $1,234,000 for 2006, 2005 and 2004, respectively, representing a decrease of $21,000, or 1.9%, in 2006 and a decrease of $155,000, or 12.6%, in 2005 over the previous year's levels. 2006 net occupancy expense was consistent with 2005 results. The decrease in 2005 was primarily due to a decrease in technology lease payments.

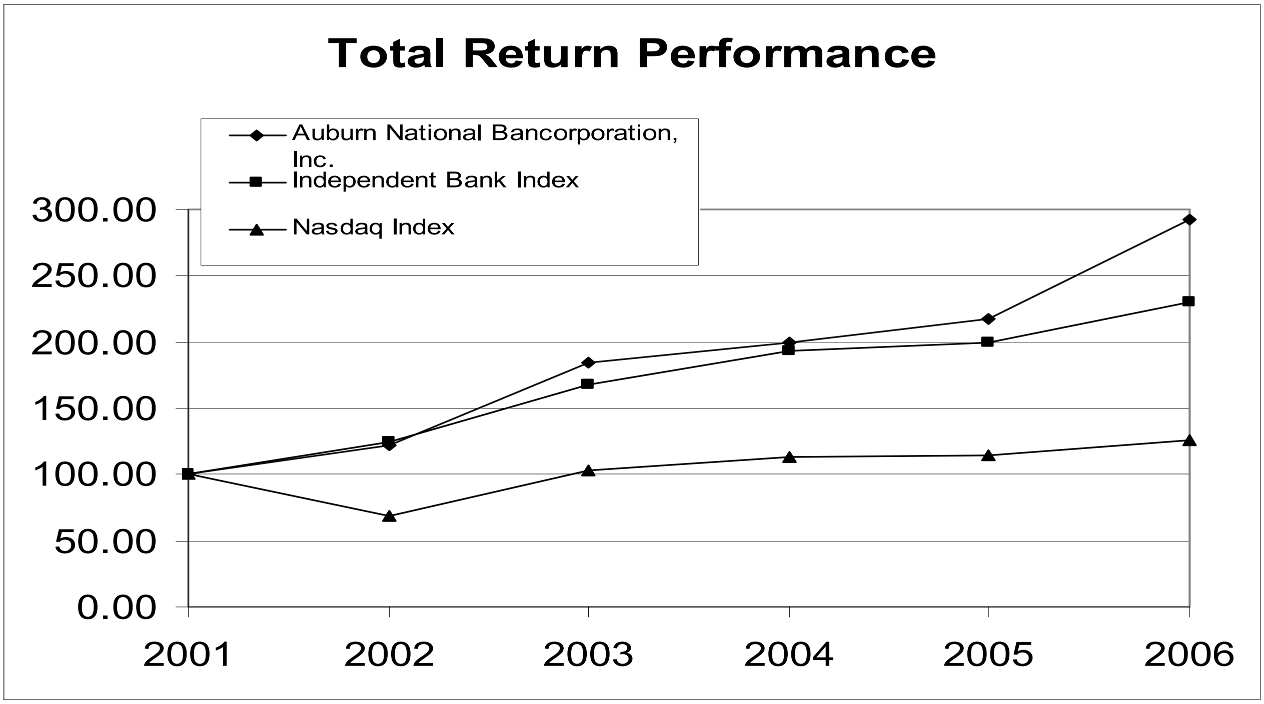
Other noninterest expense was $3,630,000 for 2006, $5,486,000 for 2005, and $5,677,000 for 2004. These levels represent a decrease of $1,856,000 or 33.8% in 2006 and a decrease of $191,000 or 3.4% in 2005 over the respective previous year. The 2006 decrease is due to a $1,932,000 decrease in MasterCard/VISA processing expense as a result of the Company moving its MasterCard/VISA processing to a third party in mid 2005, as mentioned above. The 2005 decrease is also due to a $263,000 decrease in MasterCard/VISA processing expense as a result of the Company moving its MasterCard/VISA processing to a third party in mid 2005.

Income Taxes

The Company's income tax expense was $2,312,000, $2,209,000 and $2,349,000 in 2006, 2005 and 2004, respectively. These levels represent an effective tax rate on pre-tax earnings of 26.0% for 2006, 25.5% for 2005, and 26.5% for 2004. The effective tax rate has remained consistent for the years ended December 31, 2006, 2005, and 2004. Details of the tax provision for income taxes are included in Note 12, "Income Tax Expense" in the Notes to the Consolidated Financial Statements included elsewhere herein.

PERFORMANCE GRAPH

The following line-graph compares the cumulative, total return on the Company's Class A Common Stock from December 31, 2001 to December 31, 2006, with that of the Nasdaq Index and Southeastern Bank Index (assuming a $100 investment on December 31, 2001). The Southeastern Bank Index is an independent bank index of Southern banks prepared by The Carson Medlin Company. Cumulative total return represents the change in stock price and the amount of dividends received over the indicated period, assuming the reinvestment of dividends.



Comparison of Five Year Cumulative Total Return

	2001	2002	2003	2004	2005	2006
Auburn National Bancorporation, Inc.	100	122	184	199	218	292
Southeastern Bank Index	100	124	168	193	199	230
Nasdaq Index	100	69	103	133	115	126