AuburnBank

Since 1907
Your Partner, Your Neighbor,
Your Friend

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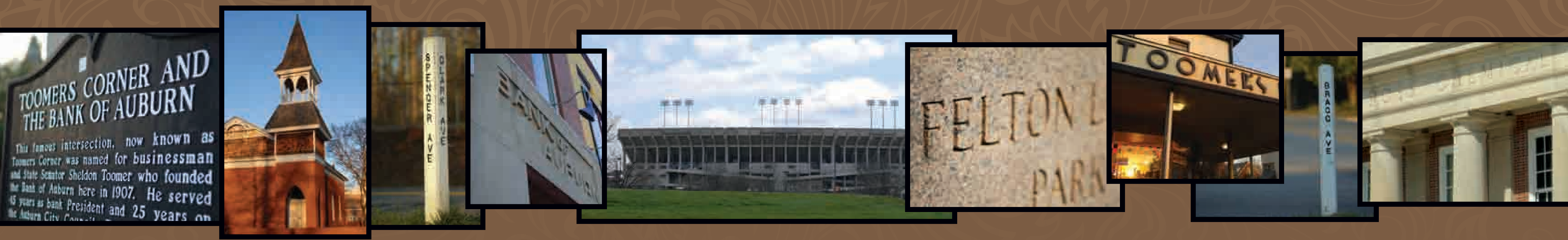
AuburnBank

2007 Annual Report

AuburnBank

2007
Annual Report

Our Reputation Is All Over Town



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 13, 2008
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 website 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.

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

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Your Partner, Your Neighbor, Your Friend

AUBURN NATIONAL BANCORPORATION, INC.

2007 ANNUAL REPORT

OUR REPUTATION IS ALL OVER TOWN

AUBURNBANK

SINCE 1907

YOUR PARTNER, YOUR NEIGHBOR, YOUR FRIEND

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 $689 million as of December 31, 2007. Since its inception, Auburn National Bancorporation has wholly owned AuburnBank.

Our centennial year, 2007, was not just a good year; it was a great year. This strong performance did not come from 2007 alone; it internally grew from the 100 years of serving as an integral part of the community at large. Rather than resting on the merits of our rich heritage, AuburnBank has abided by three strong values from the past that serve as guideposts for the future: the vision of committed men and women, the values they embrace, and their dedication to the customer.

Our vision is to remain a vital player in the communities we serve, providing the types of personal financial services that will fuel the economy and give impetus to the individual and collective goals of our customers.

Our values are integrity, a passion to serve, and an inherent conservatism that guides us in the best business practices, thus strengthening our ability to be a major contributor to the economic health of the communities we serve.

Our customer focus permeates every aspect of how we conduct business. Since we are the only truly local bank and fiercely independent, we are best positioned to have a relationship with each and every customer that enables us to personalize our service to individuals and businesses. The kind of connection we offer our customers is rare, and we accept that responsibility very seriously.

Community involvement is part of the heritage and culture of AuburnBank employees' lives. From a little league coach to a United Way volunteer, we try to find the best way to serve our home town. We weave our personal history into the history of the community, finding ways to be a partner, a neighbor, and a friend. Our employees find great satisfaction in giving back to the community in terms of service and support. You can see the evidence of AuburnBank's affiliation on many street corners and buildings, names of bank directors or employees who were more than bankers and who served the community with passion and pride.

Headquartered in Auburn, AL, 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 are 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 and Tiger Town Kroger supermarkets as well as Wal-Mart SuperCenter stores in Auburn, Opelika, and Phenix City, Alabama. Mortgage loan offices are also located in Phenix City, Valley, and Mountain Brook, Alabama. An extensive network of automated teller machines is operated throughout East Alabama. In addition, AuburnBank offers full financial consulting through a partnership with Bert Harris and Investment Professionals, Inc. (IPI), specializing in retirement planning, college saving, and estate planning.

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

To Our Shareholders and Friends

Our centennial year was a banner year in terms of AuburnBank's earnings and performance. Just as certain street signs and buildings in our community reflect the names of our leadership in the past, the values of these leaders can point us to the future. Combining the principles of the past with a vision for the future, we look forward to serving our communities as we begin our second century.

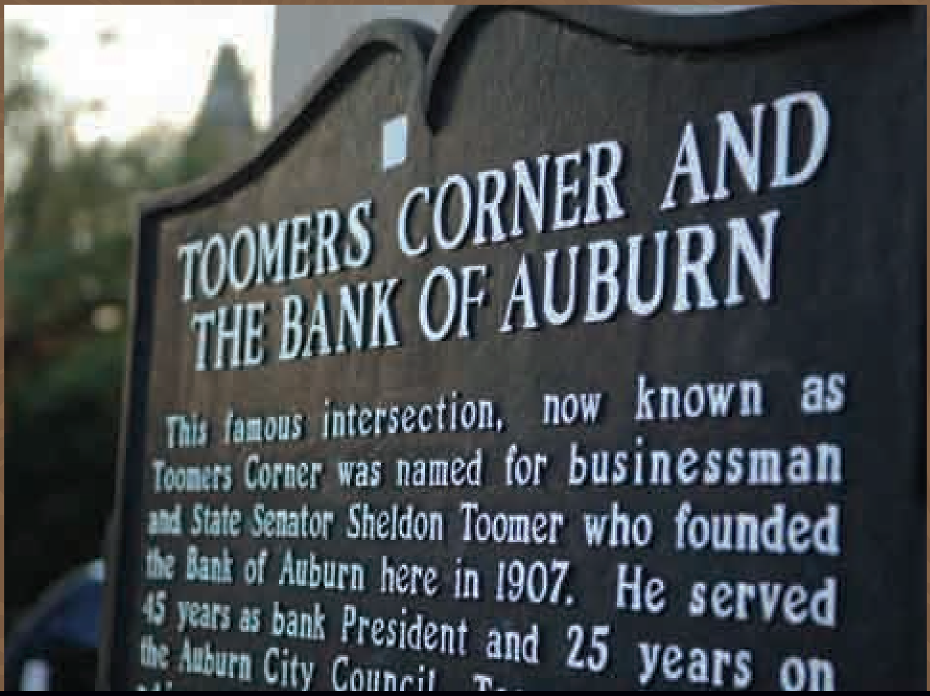
These signs point to strong economic performance. At year's end, our net earnings stood at $6.9 million, or $1.86 a share, compared to $6.6 million, or $1.74 a share, a year ago. In addition to robust earnings, we also had a solid year in terms of growth in our total loan portfolio, along with strong credit quality, and improvement in our net interest margin.

These values point to deep involvement in the community. With AuburnBank, it has always been more than dollars and cents. Our present day employees enjoy the legacy of connecting with our communities in supporting charities, schools, civic organizations, the arts, and a myriad of other deserving causes to show how much we appreciate being your partner, your neighbor, and your friend.

Finally, the ideals of the past point to a thriving future. As a community bank, we will continue to invest our money in our own home towns, providing local businesses and individuals with the means to grow. As a shareholder, you can rest assured that we will continue to follow the sound principles that will allow our bank to continue to be independent and provide outstanding customer service. We deeply appreciate your role as both an owner and a supporter of AuburnBank. We will continue to strive to be your bank of choice.

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

Pointing Us to the Future



Sheldon Toomer

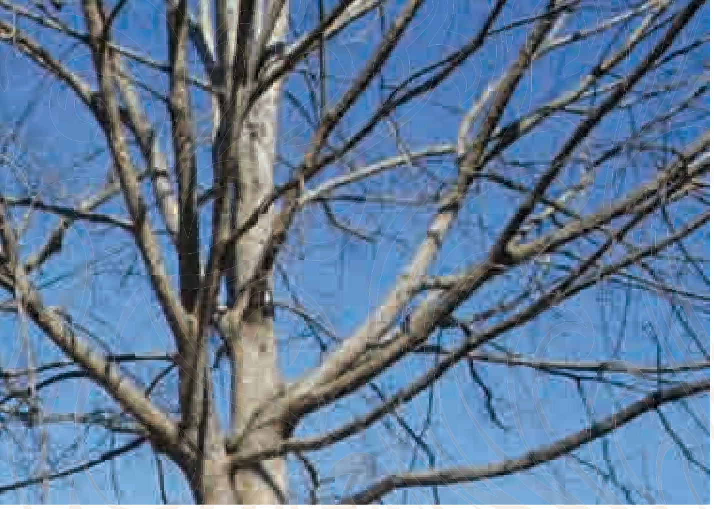
Bank of Auburn President and founding member Shel Toomer got his start with a $500 loan from a local black man affectionately known as "Old Drayman." The deliveryman's generosity allowed Toomer to buy into his stepfather's drugstore located in what's widely known as Toomer's Corner. The Opelika native envisioned an Auburn that could support a local bank to grow with the city and college it served. He garnered seven leading citizens to form the Bank of Auburn. The API graduate served for nearly twenty-five years on the Auburn City Council and also as chairman of the Auburn Board of Education. Toomer represented Lee County in the state legislature and served on the API board of trustees from 1941 to 1951.

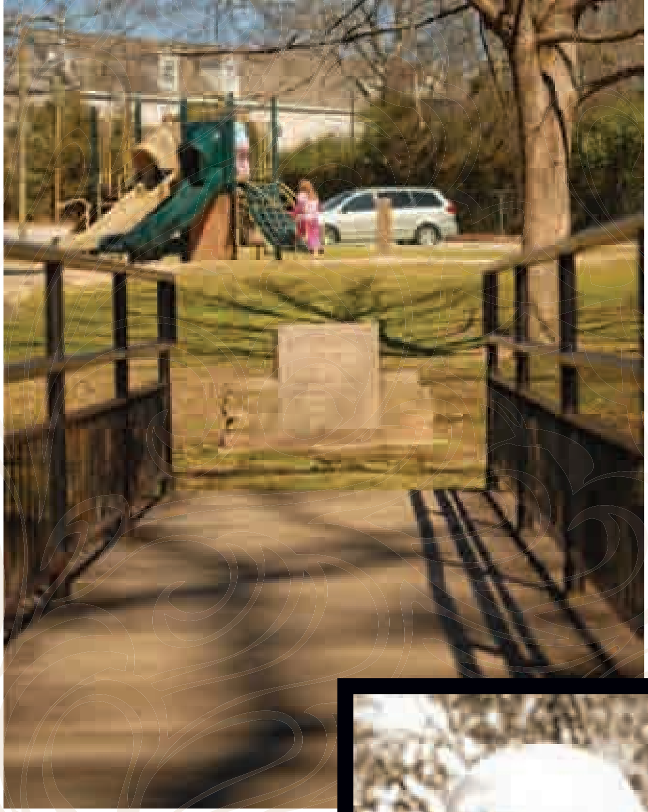
Bank of Auburn Director and founding member Thomas Bragg led the charge in state appropriated funding during the turbulent early 1900s. Described by former Alabama Polytechnic President Ralph Draughon as "one of the most devoted of all Auburn men," Bragg was instrumental in petitioning legislators against the repeal of a 1911 bill appropriating $200,000 to API. The Camden, Ala native also founded the *AU Alumni Quarterly*, a forerunner to today's Auburn Alumni Association magazine. He traveled the state with other alumnus in a broken down car to raise funds for a $50,000 new gym for API, which stood until 1969. Late to marry, the Alabama Power Company executive died on his honeymoon on Oct. 30, 1943.

Thomas Bragg

Bennett Battle Ross

Founding member Dr. Bennett Battle Ross played critical roles for both Alabama Polytechnic Institute and the state of Alabama. The Tuskegee native's work as state chemist and acting director of the Alabama Department of Agriculture's feed-and-fertilizer assay laboratory was directly tied to a state tax shared with API, resulting in a consistent flow of income to both the state and API. Having no funds to serve as state chemist, Ross would often use API's laboratory and would even travel the state at his own expense. A member of the Auburn City Council, Ross was named the first faculty chair of API athletics and later served as dean of API's agricultural sciences, chemistry and pharmacy departments.



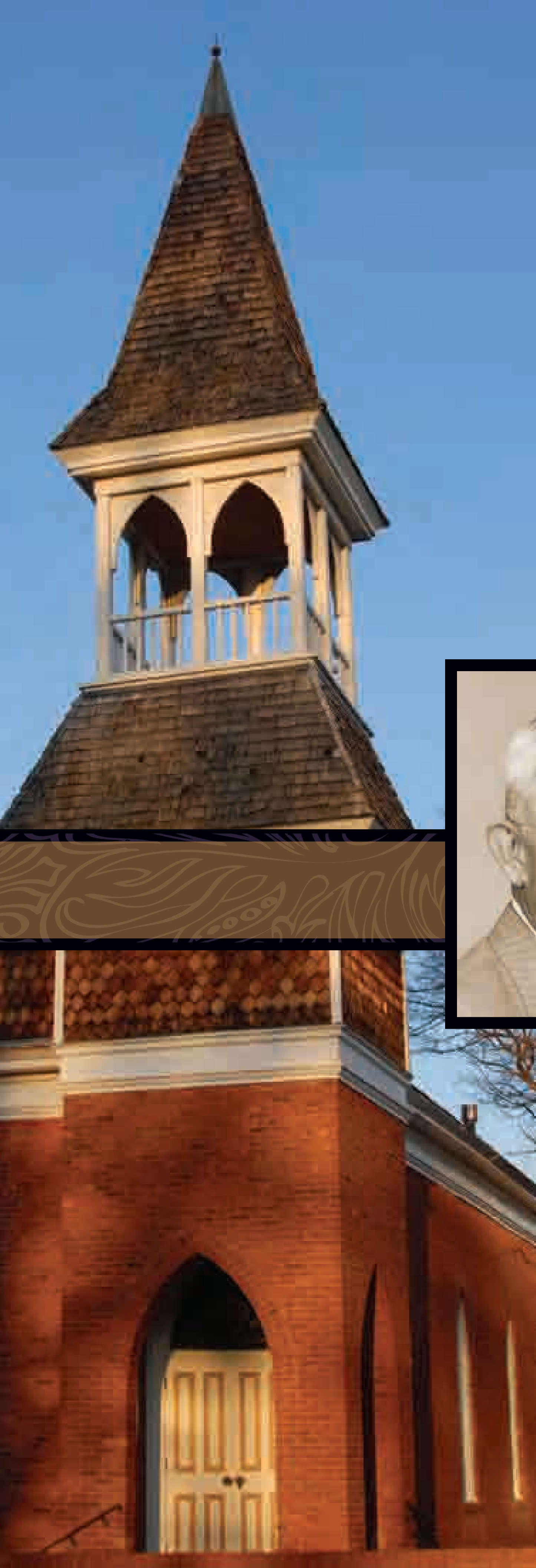


C. Felton Little came to the board of directors by way of the First National Bank of Auburn. For unknown personal reasons, the former president of First National quietly moved his business across the street to the Bank of Auburn. His demeanor was so reserved that one day an employee of the Bank of Auburn forgot he was in the vault and almost locked him up for the night. Having inherited large land holdings from his father, Little donated an area on East Glenn Ave. in Auburn to the city resulting in the first municipal park.

C. Felton Little

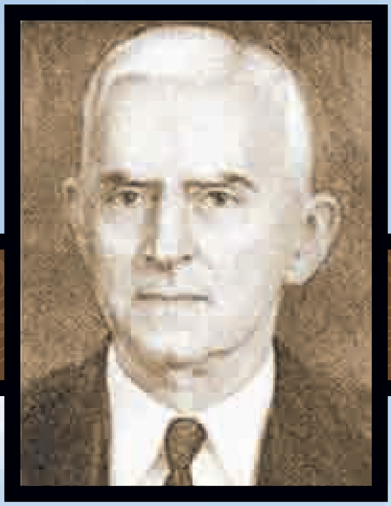
E.L. Spencer, Sr. joined the board in 1944 and was the first of three generations of his family to serve the bank. Spencer was awarded the Distinguished Service Cross and the Purple Heart for extraordinary heroism in the bloody Meuse-Argonne offensive in World War I. Soon after his time in the service, Spencer moved from North Carolina to East Alabama. After working in the timber business for several years, he relocated his wife and son to Auburn in 1932 and opened E.L. Spencer Lumber Company.

The Spencer family has always promoted local interests and been actively involved in supporting the community and landmarks, including the Auburn University Chapel — the oldest public structure in the town of Auburn. After the building had fallen into disrepair, E.L. Spencer, Jr. donated the funds in honor of his family for the Chapel to be totally renovated thereby saving the original craftsmanship and structure from destruction.



E.L. Spencer

Clifford L. Hare was the second new director added to the original seven founding members of the Bank of Auburn. The chemist played on Auburn's first football team and was the longtime chairman of the faculty athletic committee. As dean of chemistry at API, Hare was the state chemist, studying analyses of foods and vital organs in cases of food poisoning. Under Hare's direction, the state chemist's office evolved into one of the nation's first crime laboratory systems, the Alabama Department of Toxicology. The department, subsequently named Alabama's Department of Forensic Sciences, is still headquartered in Auburn.



Clifford L. Hare

AuburnBank Board of Directors

2007 Board of Directors

Seated left to right: William F. Ham, Jr , E L. Spencer, Jr.,
Anne M. May, J.E. Evans, Robert W. Dumas.

Standing left to right: C. Wayne Alderman, Terry W. Andrus, Dr. Emil F. Wright, Jr.,
Edward Lee Spencer, III, David E. Housel.

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 Audit

Shannon O'Donnell
Senior Vice President,
Credit Administration

Jerry Siegel
Senior Vice President, IT/IS
Chief Technology Officer

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

Bob R. Adkins
Vice President,
Commercial/Consumer Loans

Patty Allen
Vice President,
Commercial/Consumer Loans

Scottie Arnold
Vice President,
Retail Internet/
Operations Officer

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

David Hedges
Vice President, Controller
and CFO

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

Robert Smith
Vice President,
Commercial/Consumer Loans

Barbara Wilcox
Vice President,
Security and Bank Secrecy Act Officer

Suzanne Gibson
Assistant Vice President,
Portfolio Management Officer

Julie Ambrose
Mortgage Loan Officer

Adicia Coulter
Customer Relations Officer

Charlotte Lang
Assistant Bank Secrecy Act Officer
and Operations Officer

Woody Odom
Information Systems Officer

Marcia Otwell
Shareholder Relations and
Administrative Officer

Jeff Stewart
Consumer Loan Officer

Christy A. Young
Loan Review Officer

Sam S. Rainer
Marketing Officer

Opelika Branch Advisory Board

2007 Opelika Branch Advisory Board

Seated left to right: C. Eddie Smith, Michael James,
William G. Dyas, William H. Brown.

Standing left to right: Sherrie M. Stanyard, R. Kraig Smith, M.D.,
William P. Johnston, J. Tutt Barrett, Doug M. Horn.

Not pictured: Hugh Dean Fuller,
John W. Mitchell, M.D., Robert G. Young.

J. Tutt Barrett
Attorney, Dean and Barrett

William H. Brown
President, 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,				
	2007	**2006**	**2005**	**2004**	**2003**
Earnings					
Net Interest Income	$16,785	$15,980	$15,994	$15,626	$14,636
Provision for Loan Losses	23	330	485	600	675
Net Earnings	6,918	6,585	6,470	6,510	5,419
Per Share:					
Net Earnings	1.86	1.74	1.69	1.68	1.39
Cash Dividends	0.70	0.64	0.58	0.50	0.48
Book Value	14.40	12.93	11.58	11.57	10.38
Shares Issued	3,957,135	3,957,135	3,957,135	3,957,135	3,957,135
Weighted Average Shares Outstanding	3,716,427	3,777,721	3,830,002	3,870,198	3,894,969
Financial Condition					
Total Assets	$688,659	$635,126	$608,154	$591,161	$590,115
Loans, Net of Unearned Income	322,411	281,983	282,059	251,129	244,652
Investment Securities	318,373	301,937	274,961	282,199	285,319
Total Deposits	492,585	469,648	454,995	429,339	434,042
Long Term Debt	115,386	90,404	105,422	105,441	105,589
Shareholder's Equity	53,018	48,418	43,954	44,504	40,408
Selected Ratios					
Return on Average Total Assets	1.06%	1.06%	1.08%	1.10%	1.05%
Return on Average Total Equity	13.50%	14.66%	14.26%	15.69%	13.47%
Average Stockholders' Equity to Average Assets	7.88%	7.20%	7.56%	7.03%	7.78%
Allowance for Loan Losses as a % of Loans	1.27%	1.43%	1.36%	1.38%	1.76%
Loans to Total Deposits	65.45%	60.04%	61.99%	58.49%	56.37%

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

AuburnBank

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Your Friend

Financial Section

Auburn National Bancorporation, Inc. 2007 Annual Report

The following is a discussion of our financial condition at December 31, 2007 and 2006 and our results of operations for the years ended December 31, 2007, 2006, and 2005. The purpose of this discussion is to focus on information about our financial condition and results of operations which is not otherwise apparent from the consolidated financial statements. The following discussion and analysis should be read along with our consolidated financial statements and the related notes included elsewhere herein. In addition, this discussion and analysis contains forward-looking statements. Please refer to our 2007 Annual Report on Form 10-K for a discussion of various factors that could cause our actual results to differ materially from those expressed in such forward-looking statements.

Certain amounts reported in prior periods have been reclassified to conform to the current-period presentation. These reclassifications had no effect on the Company's previously reported stockholders' equity or net earnings during the periods involved.

OVERVIEW

Auburn National Bancorporation, Inc. is a bank holding company established in 1984, and incorporated in 1990 under the laws of the State of Delaware. AuburnBank, the Company's principal subsidiary, is an Alabama state-chartered bank that is a member of the Federal Reserve System and has operated continuously since 1907. Both the Company and the Bank are headquartered in Auburn, Alabama. The Bank conducts its business in East Alabama, including Lee County and surrounding areas. The Bank operates full-service branches in Auburn, Opelika, Hurtsboro and Notasulga, Alabama. In-store branches are located in the Auburn and Opelika Kroger stores, as well as Wal-Mart SuperCenter stores in Auburn, Opelika and Phenix City, Alabama. Mortgage loan offices are located in Phenix City, Valley, and Mountain Brook, Alabama.

Summary of Results of Operations

	Years ended December 31		
(Dollars in thousands, except per share amounts)	**2007**	**2006**	**2005**
Net interest income (GAAP)	**$ 16,875**	15,980	15,993
Tax-equivalent adjustment	**1,123**	1,033	956
Net interest income (a)	**17,998**	17,013	16,949
Noninterest income	**4,666**	4,448	4,319
Total revenue (a)	**22,664**	21,461	21,268
Provision for loan losses	**23**	330	485
Noninterest expense	**12,360**	11,201	11,148
Income tax expense	**2,240**	2,312	2,209
Tax-equivalent adjustment	**1,123**	1,033	956
Net earnings	**6,918**	6,585	6,470
Basic and diluted earnings per share	**$ 1.86**	1.74	1.69

(a) Tax-equivalent. See "Table 1 - Explanation of Non-GAAP Financial Measures".

Financial Summary

The Company's net earnings were $6.9 million for the 2007 compared to $6.6 million in 2006. Basic and diluted earnings per share were up 7% to $1.86 per share.

Total tax-equivalent revenue increased 6% to $22.7 million for 2007 compared to $21.5 million for 2006. The increase in total revenue was driven by an increase in tax-equivalent net interest income of 6% for 2007, reflecting loan growth from 2006.

Credit quality continued to be very strong. As of December 31, 2007, nonperforming assets were 0.17% of total loans. Provision for loan losses decreased $307 thousand in 2007 from 2006 due to continued strength in credit quality trends and a decrease in net charge-offs.

Average loans and loans held for sale increased 6% in 2007 from 2006 to $304.4 million. Average total deposits increased 5% in 2007 from 2006 to $491.6 million.

Noninterest income increased 5% in 2007 from 2006. This increase was driven by the Company's decision to sell $21.1 million in securities available-for-sale, generating gross gains of $227 thousand.

Noninterest expense increased 10% in 2007 from 2006. This increase was primarily impacted by the Company's decision to prepay $10.0 million of higher cost Federal Home Loan Bank ("FHLB") advances and increases in salaries and benefits and professional fees expense. The prepayment of the FHLB advances resulted in a charge of $313 thousand.

In 2007, the Company paid cash dividends of $2.6 million, or $0.70 per share and the dividend payout ratio was 37.63%. The Company's balance sheet remains strong and well capitalized under regulatory guidelines with a Tier 1 capital ratio of 14.74% and a leverage ratio of 9.02% at December 31, 2007.

CRITICAL ACCOUNTING POLICIES

The accounting and financial reporting policies of the Company conform with U.S. generally accepted accounting principles and with general practices within the banking industry. In connection with the application of those principles, we have made judgments and estimates which, in the case of the determination of our allowance for loan losses, was critical to the determination of our financial position and results of operations. Other policies also require subjective judgment and assumptions and may accordingly impact our financial position and results of operations.

Our management assesses the adequacy of the allowance prior to the end of each calendar quarter. This assessment includes procedures to estimate the allowance and test the adequacy and appropriateness of the resulting balance. The level of the allowance is based upon management's evaluation of the loan portfolios, past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan quality indications and other pertinent factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Loan losses are charged off when management believes that the full collectability of the loan is unlikely. A loan may be partially charged-off after a "confirming event" has occurred which serves to validate that full repayment pursuant to the terms of the loan is unlikely. Allocation of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, is deemed to be uncollectible.

Larger balance commercial and commercial real estate loans are impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Collection of all amounts due according to the contractual terms means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement.

An impairment allowance is recognized if the present value of expected future cash flows from the loan is less than the recorded investment in the loan (recorded investment in the loan is the principal balance plus any accrued interest, net deferred loan fees or costs and unamortized premium or discount, and does not reflect any direct write-down of the loan). The impairment is recognized through the allowance. Loans that are impaired are recorded at the present value of expected future cash flows discounted at the loan's effective interest rate, or if the loan is collateral dependent, impairment measurement is based on the fair value of the collateral, less estimated disposal costs. Income is recognized on impaired loans on a cash basis.

The level of allowance maintained is believed by management to be adequate to absorb probable losses in the portfolio at the balance sheet date. The allowance is increased by provisions charged to expense and decreased by charge-offs, net of recoveries of amounts previously charged-off.

In assessing the adequacy of the allowance, we also consider the results of our ongoing independent loan review process. We undertake this process both to ascertain whether there are loans in the portfolio whose credit quality has weakened over time and to assist in our overall evaluation of the risk characteristics of the entire loan portfolio. Our loan review process includes the judgment of management, the input from our independent loan reviewer, and reviews that may have been conducted by bank regulatory agencies as part of their usual examination process. We incorporate loan review results in the determination of whether or not it is probable that we will be able to collect all amounts due according to the contractual terms of a loan.

In addition, regulatory agencies, as an integral part of their examination process, will periodically review the Company's allowance for loan losses, and may require the Company to record adjustments to the allowance based on their judgment about information available to them at the time of their examinations.

Average Balance Sheet and Interest Rates

	Years ended December 31					
	2007		2006		2005	
(Dollars in thousands)	Average Balance	Yield/ Rate	Average Balance	Yield/ Rate	Average Balance	Yield/ Rate
Loans and loans held for sale	**$ 304,389**	**7.98%**	$ 286,613	7.78%	$ 275,912	7.13%
Securities—taxable	**242,826**	**4.96%**	241,298	4.51%	234,577	4.04%
Securities—tax-exempt	**51,995**	**6.36%**	47,748	6.37%	44,862	6.27%
Total securities	**294,821**	**5.21%**	289,046	4.82%	279,439	4.40%
Federal funds sold	**5,539**	**4.98%**	7,321	4.99%	8,254	3.16%
Interest bearing bank deposits	**693**	**4.62%**	1,264	5.06%	1,276	2.98%
Total interest-earning assets	**605,442**	**6.60%**	584,244	6.27%	564,881	5.71%
Deposits:						
NOW	**57,532**	**2.26%**	65,029	2.45%	66,472	1.81%
Savings and money market	**143,587**	**3.65%**	142,610	3.67%	121,961	2.43%
Certificates of deposits less than $100,000	**85,831**	**5.33%**	84,227	4.55%	86,670	3.80%
Certificates of deposits and other time deposits of $100,000 or more	**133,466**	**4.45%**	104,446	3.87%	100,213	3.05%
Total interest-bearing deposits	**420,416**	**4.06%**	396,312	3.71%	375,316	2.80%
Short-term borrowings	**12,727**	**4.72%**	7,502	5.48%	2,675	3.40%
Long-term debt	**93,278**	**4.60%**	102,848	4.40%	105,431	4.47%
Total interest-bearing liabilities	**526,421**	**4.17%**	506,662	3.88%	483,422	3.17%
Net interest income and margin (a)	**$ 17,998**	**2.97%**	$ 17,013	2.91%	$ 16,949	3.00%

(a) Tax-equivalent. See "Table 1 - Explanation of Non-GAAP Financial Measures".

RESULTS OF OPERATIONS

Net Interest Income and Margin

2007 vs. 2006 comparison

Tax-equivalent net interest income increased 6% in 2007 from 2006 due to growth in the loan portfolio. Net interest margin increased 6 basis points to 2.97%.

The tax-equivalent yield on total interest earning assets increased 33 basis points in 2007 from 2006 to 6.60%. This increase was comprised of a 20 basis point increase in the yield on loans and loans held for sale to 7.98% and a 39 basis point increase in the tax-equivalent yield on total securities to 5.21%.

The cost of total interest-bearing liabilities increased 29 basis points in 2007 from 2006, to 4.17%. This increase was comprised of a 35 basis point increase in the cost of total interest-bearing deposits to 4.06%, a 76 basis point decrease in the cost of short-term borrowings to 4.72% and a 20 basis point increase in the cost of long-term debt to 4.60%.

2006 vs. 2005 comparison

Tax-equivalent net interest income increased slightly to $17.0 million in 2006 from $16.9 million in 2005, despite net interest margin compression from an inverted yield curve. Net interest margin decreased 9 basis points to 2.91%.

The tax-equivalent yield on total interest earning assets increased 56 basis points in 2006 from 2005 to 6.27%. This increase was comprised of a 65 basis point increase in the yield on loans and loans held for sale to 7.78% and a 42 basis point increase in the tax-equivalent yield on total securities to 4.82%.

The cost of total interest-bearing liabilities increased 71 basis points in 2006 from 2005, to 3.88%. This increase was comprised of a 91 basis point increase in the cost of total interest-bearing deposits to 3.71%, a 208 basis point increase in the cost of short-term borrowings to 5.48%. The cost of long-term debt in 2006 decreased 7 basis points to 4.40% due to the Company's decision to restructure several FHLB advances in the third quarter of 2005.

Noninterest Income

	Years ended December 31		
(Dollars in thousands)	**2007**	**2006**	**2005**
Service charges on deposit accounts	**$ 1,302**	1,387	$ 1,497
Servicing fees	**339**	375	389
Gain on sale of loans held for sale	**626**	649	669
Bank-owned life insurance	**547**	452	459
Securities gains, net	**253**	10	11
Other	**1,599**	1,575	1,294
Total noninterest income	**$ 4,666**	4,448	4,319

The major components of noninterest income are service charges on deposit accounts, servicing fees, gain on sale of loans held for sale, income from bank-owned life insurance, securities gains, net, and other noninterest income.

2007 vs. 2006 comparison

Noninterest income increased 5% or $218 thousand in 2007 compared to 2006. This increase was driven by the Company's decision to sell $21.1 million in securities available-for-sale, generating gross gains of $227 thousand. Other changes in the components of noninterest income include an increase of $95 thousand in income from bank-owned life insurance, offset by a decrease of $85 thousand in service charges on deposit accounts.

2006 vs. 2005 comparison

Noninterest income increased 3% or $129 thousand in 2006 compared to 2005. This increase was driven by an increase in other noninterest income of $281 thousand, offset by a decrease in service charges on deposit accounts of $110 thousand.

Noninterest Expense

(Dollars in thousands)	Years ended December 31		
	2007	**2006**	**2005**
Salaries and benefits	**$ 7,110**	6,714	6,658
Net occupancy and equipment	**1,267**	1,159	1,182
Professional fees	**621**	476	491
Loss on prepayment of FHLB advances	**313**	—	—
Other	**3,049**	2,852	2,817
Total noninterest expense	**$ 12,360**	11,201	11,148

The major components of noninterest expense are salaries and benefits, net occupancy and equipment, professional fees, loss on prepayment of FHLB advances, and other noninterest expense.

2007 vs. 2006 comparison

Noninterest expense increased 10% or $1.2 million in 2007 compared to 2006. This increase was primarily impacted by the Company's decision to prepay $10.0 million of higher cost Federal Home Loan Bank ("FHLB") advances and increases in salaries and benefits and professional fees expense. The prepayment of the FHLB advances resulted in a charge of $313 thousand. Salaries and benefits increased $396 thousand during 2007, due to normal increases in salaries and benefits costs, increases in commissions related to mortgage origination activity, and the hiring of additional mortgage originators in our loan production offices. Professional fees increased $145 thousand during 2007 due to increased legal fees and costs associated with regulatory compliance.

2006 vs. 2005 comparison

Noninterest expense increased by $53 thousand to $11.2 million in 2006 compared to 2005. This increase was primarily impacted by increases in salaries and benefits expense of $56 thousand.

Income Tax Expense

2007 vs. 2006 comparison

Income tax expense was $2.2 million in 2007, compared to $2.3 million in 2006. Although the decrease in income tax expense was not significant, the Company's effective tax rate decreased to 24.46% in 2007 compared to 25.99% in 2006. The decrease in the Company's effective tax rate was primarily driven by the recognition of previously unrecognized tax benefits upon settlement of an uncertain tax position related to state income tax matters. For additional information, see "Note 10 to the Consolidated Financial Statements."

2006 vs. 2005 comparison

Income tax expense was $2.3 million in 2006 compared to $2.2 million in 2005. The increase is primarily due to an increase in earnings before income taxes. The Company's effective tax rate was 25.99% in 2006 compared to 25.45% in 2005.

BALANCE SHEET ANALYSIS

Securities

At December 31, 2007 all securities were classified as available-for-sale. During the fourth quarter of 2007, the Company decided to transfer the remaining securities in the held-to-maturity classification into the available-for-sale classification. The carrying value of the securities transferred to the available-for-sale classification were adjusted to market as prescribed in Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. This transfer consisted of two securities with a total carrying value of $424 thousand and resulted in the recording of net unrealized losses of approximately $4 thousand.

Securities available-for-sale were $318.4 million and $301.4 million as of December 31, 2007 and December 31, 2006, respectively. The increase from December 31, 2006 was primarily due to a leverage strategy executed in December of 2007. Approximately $20.0 million in securities were purchased with proceeds from fixed-rate funding sources, including approximately $10.0 million in FHLB advances and $10.0 million in structured securities sold under agreements to repurchase. Unrealized net losses on securities available-for-sale were $0.7 million and $3.9 million as of December 31, 2007 and December 31, 2006, respectively. The unrealized net losses on securities available-for-sale were primarily attributable to interest rates. The decrease in unrealized net losses of $3.2 million from December 31, 2006 was due to changes in interest rates.

The average yield earned on total securities was 5.21% in 2007 and 4.82% in 2006. Information concerning the maturity distribution and the weighted average yields for investments in the securities portfolio as of and for the year ended December 31, 2007 and 2006 is included in "Note 2 to the Consolidated Financial Statements."

Loans

	December 31				
(Dollars in thousands)	**2007**	**2006**	**2005**	**2004**	**2003**
Commercial, financial and agricultural	**$ 62,478**	52,923	51,784	50,075	55,239
Leases - commercial	**486**	761	1,488	5,397	6,630
Real estate - construction:					
Commercial	**7,901**	4,684	2,039	945	2,099
Residential	**11,370**	9,912	8,832	5,426	4,866
Real estate - mortgage:					
Commercial	**161,703**	142,092	148,118	136,037	122,397
Residential	**67,246**	62,596	59,757	42,545	41,988
Consumer installment	**11,539**	9,349	10,334	11,021	11,673
Total loans	**322,723**	282,317	282,352	251,446	244,892
Less: unearned income	**(312)**	(334)	(293)	(317)	(240)
Loans, net of unearned income	**$ 322,411**	281,983	282,059	251,129	244,652

Total loans, net of unearned income were $322.4 million as of December 31, 2007, an increase of $40.4 million or 14% from $282.0 million at December 31, 2006. Growth in commercial, financial, and agricultural loans and commercial real estate mortgage loans were the primary drivers of the increase. As of December 31, 2007, commercial, financial, and agricultural loans and commercial real estate mortgage loans increased $9.6 million and $19.6 million, respectively from December 31, 2006.

Three loan categories represented the majority of the loan portfolio as of December 31, 2007. Commercial real estate mortgage loans represented 50%, residential real estate mortgage loans represented 21% and commercial, financial and agricultural loans represented 19% of the Bank's total loans at December 31, 2007. The average yield earned on loans and loans held for sale was 7.98% in 2007 and 7.78% in 2006. See "Table 7 – Loan Maturities and Sensitivities to Changes in Interest Rates" for additional information.

Allowance for Loan Losses

The Company maintains the allowance for loan losses at a level that management deems appropriate to adequately cover the probable losses in the loan portfolio. As of December 31, 2007 and December 31, 2006, the allowance for loan losses was $4.1 million and $4.0 million, respectively, which management deemed to be adequate at each of the respective dates. The judgments and estimates associated with the determination of the allowance for loan losses are described under "CRITICAL ACCOUNTING POLICIES" above.

We periodically analyze our loan portfolio with respect to our commercial borrowers' industries to determine if a concentration of credit risk exists to any one or more industries. We have moderate credit exposures arising from loans outstanding to residential and commercial builders, lessors of residential and commercial properties, and religious and professional organizations. We evaluate these exposures to ensure the adequacy of our allowance for loan losses.

A summary of changes in the allowance for loan losses for each of the years in the five year period ended December 31, 2007, is presented below.

	Years ended December 31				
(Dollars in thousands)	**2007**	**2006**	**2005**	**2004**	**2003**
Allowance for loan losses:					
Balance at beginning of period	**$4,044**	3,843	3,456	4,313	5,104
Charge-offs:					
Commercial, financial and agricultural	**(62)**	(37)	(39)	(215)	(416)
Real estate	**(143)**	(106)	(124)	(1,507)	(1,036)
Consumer	**(45)**	(46)	(193)	(44)	(125)
Total charge-offs	**(250)**	(189)	(356)	(1,766)	(1,577)
Recoveries:					
Commercial, financial and agricultural	**14**	13	89	219	52
Real estate	**267**	11	100	11	8
Consumer	**7**	36	69	79	51
Total recoveries	**288**	60	258	309	111
Net (charge-offs) recoveries	**38**	(129)	(98)	(1,457)	(1,466)
Provision for loan losses	**23**	330	485	600	675
Ending balance	**$4,105**	4,044	3,843	3,456	4,313

As noted in our critical accounting policies, management assesses the adequacy of the allowance prior to the end of each calendar quarter. This assessment includes procedures to estimate the allowance and test the adequacy and appropriateness of the resulting balance. The level of the allowance is based upon management's evaluation of the loan portfolios, past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan quality indications and other pertinent factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Although the allowance increased by $61 thousand between December 31, 2007 and December 31, 2006, the ratio of our allowance for loan losses to total loans outstanding decreased to 1.27% at December 31, 2007 compared to 1.43% at December 31, 2006. The reduction in the ratio between the two dates is primarily attributable to continued improvements in the overall credit quality of the loan portfolio. In the future, the allowance to total loans outstanding ratio will increase or decrease to the extent the factors that influence our quarterly allowance assessment in their entirety either improve or weaken.

Provision for Loan Losses

The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management's evaluation, should be adequate to provide coverage for the probable losses on outstanding loans. The provision for loan losses amounted to $23 thousand, $330 thousand, and $485 thousand for the years ended December 31, 2007, 2006 and 2005, respectively.

Based upon its evaluation of the loan portfolio, management believes the allowance for loan losses to be adequate to absorb our estimate of probable losses existing in the loan portfolio at December 31, 2007. Continued strength in credit quality trends and a net recovery in 2007 were the primary reasons for the decreased provision expense in 2007 when compared to 2006. The decrease in total charge-offs was the primary reason for the decreased provision expense in 2006 when compared to 2005.

Based upon its assessment of the loan portfolio, management adjusts the allowance for loan losses to an amount deemed appropriate to adequately cover probable losses in the loan portfolio. While our policies and procedures used to estimate the allowance for loan losses, as well as the resultant provision for loan losses charged to operations, are considered adequate by management and are reviewed from time to time by regulators, they are necessarily approximate. There exist factors beyond our control, such as general economic conditions both locally and nationally, which may negatively impact, materially, the adequacy of our allowance for loan losses and, thus, the resulting provision for loan losses.

Nonperforming Assets

The specific economic and credit risks associated with our loan portfolio include, but are not limited to, a general downturn in the economy which could affect employment rates in our market areas, general real estate market deterioration, interest rate fluctuations, deteriorated or non-existent collateral, title defects, inaccurate appraisals, financial deterioration of borrowers, fraud, and any violation of laws and regulations.

The Company discontinues the accrual of interest income when (1) there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or (2) the principal or interest is more than 90 days past due, unless the loan is both well-secured and in the process of collection. At December 31, 2007, the Company had $447 thousand in loans on nonaccrual compared to $72 thousand at December 31, 2006.

At December 31, 2007, the Company owned $98 thousand in residential real estate which we had acquired from borrowers.

At December 31, 2007, the Company had $4 thousand in loans 90 days past due and still accruing interest at December 31, 2007 compared to none at December 31, 2006. At December 31, 2007 and at December 31, 2006, no loans were deemed to be restructured loans.

The table below provides information concerning nonperforming assets and certain asset quality ratios.

	December 31				
(In thousands)	**2007**	**2006**	**2005**	**2004**	**2003**
Nonperforming assets:					
Nonaccrual loans	**$ 447**	72	108	711	1,704
Other nonperforming assets (primarily other real estate owned)	**98**	—	—	—	—
Accruing loans 90 days or more past due	**4**	—	—	105	—
Total nonperforming assets	**$ 549**	72	108	816	1,704
as a % of loans	**0.17%**	0.03	0.04	0.32	0.70

Potential problem assets, which are not included in nonperforming assets, amounted to $9.2 million, or 2.8% of total loans outstanding, net of unearned income at December 31, 2007, compared to $5.2 million, or 1.8% of total loans outstanding, net of unearned income at December 31, 2006. Potential problem assets represent those assets with a well-defined weakness and where information about possible credit problems of borrowers has caused management to have serious doubts about the borrower's ability to comply with present repayment terms.

Deposits

Total deposits were $492.6 million and $469.6 million at December 31, 2007 and December 31, 2006, respectively. The increase of $23.0 million in total deposits from December 31, 2006 was largely due to increases in certificates of deposit ("CDs") and other time deposits of $38.2 million, offset by decreases in transaction accounts of $15.2 million. Transaction accounts, which include non-interest bearing demand, NOW, money market, and savings accounts, decreased as customers exhibited a strong preference for CDs that offered more attractive returns. Of the $38.2 million increase in CDs and other time deposits, only $5.8 million of the increase related to brokered CDs, a wholesale funding source.

The average rate paid on total interest-bearing deposits was 4.06% in 2007 and 3.71% in 2006.

Noninterest bearing deposits were 14% and 17% of total deposits as of December 31, 2007 and December 31, 2006, respectively.

Other Borrowings

Other borrowings consist of short-term borrowings and long-term debt. Short-term borrowings consist of federal funds purchased, securities sold under agreements to repurchase, and other short-term borrowings. The Bank had available federal fund lines totaling $44.0 million with $8.7 million outstanding at December 31, 2007, compared to $34.3 million and $7.7 million outstanding at December 31, 2006. Securities sold under agreements to repurchase totaled $15.5 million at December 31, 2007, compared to $6.7 million at December 31, 2006.

Other short-term borrowings included FHLB advances with an original maturity of one year or less. In February of 2007, short-term FHLB advances of $10.0 million were repaid. The Company replaced the short-term FHLB advances with brokered CDs, an alternative source of cost-effective funding.

The average rate paid on short-term borrowings was 4.72% in 2007 and 5.48% in 2006. Information concerning the average balances, weighted average rates, and maximum amounts outstanding for short-term borrowings during the three-year period ended December 31, 2007 is included in "Note 7 to the Consolidated Financial Statements."

Long-term debt included FHLB advances with an original maturity greater than one year, structured securities sold under agreements to repurchase and subordinated debentures related to trust preferred securities. The Bank had $83.2 million in long-term FHLB advances and $7.2 million in subordinated debentures at December 31, 2007 and December 31, 2006. At December 31, 2007, the Bank had $25.0 million in structure securities sold under agreements to repurchase.

The average rate paid on long-term debt was 4.60% in 2007 and 4.40% in the 2006.

CAPITAL ADEQUACY

The Company's consolidated stockholders' equity was $53.0 million and $48.4 million as of December 31, 2007 and December 31, 2006, respectively. The increase from December 31, 2006 was primarily a result of net earnings of $6.9 million. This increase was offset by cash dividends of $2.6 million or $0.70 per share and $1.6 million in stock repurchases.

The Company's Tier 1 leverage ratio was 9.02%, Tier 1 risk-based capital ratio was 14.74% and Total risk-based capital ratio was 15.74% at December 31, 2007. These ratios exceed the minimum regulatory capital percentages of 4.0% for Tier 1 leverage ratio, 4.0% for Tier 1 risk-based capital ratio and 8.0% for Total risk-based capital ratio. Based on current regulatory standards, the Company is classified as "well capitalized."

MARKET AND LIQUIDITY RISK MANAGEMENT

Management's objective is to manage assets and liabilities to provide a satisfactory, consistent level of profitability within the framework of established liquidity, loan, investment, borrowing, and capital policies. The Bank's Asset Liability Management Committee ("ALCO") is charged with the responsibility of monitoring these policies, which are designed to ensure acceptable composition of asset/liability mix. Two critical areas of focus for ALCO are interest rate sensitivity and liquidity risk management.

Interest Rate Sensitivity Management

In the normal course of business, the Company is exposed to market risk arising from fluctuations in interest rates. ALCO measures and evaluates the interest rate risk so that we can meet customer demands for various types of loans and deposits. ALCO determines the most appropriate amounts of on-balance sheet and off-balance sheet items.

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, 2007, the Bank's net interest income would increase approximately 2.63% in a falling rate environment and would decrease approximately 4.04% in a rising rate environment. Interest rate scenario models are prepared using software created and licensed by a third party.

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.

The interest sensitive assets at December 31, 2007 that reprice or mature within 12 months were $290.9 million while the interest sensitive liabilities that reprice or mature within the same time frame were $356.4 million. At December 31, 2007, the 12 month cumulative GAP position was a negative $65.5 million resulting in a GAP ratio of interest sensitive assets to interest sensitive liabilities of 82%. This negative GAP indicates that the Company has more interest-bearing liabilities than interest-earning assets that reprice within the GAP period. For additional information, see "Table 10 – Sensitivities to Changes in Interest Rates." 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 Company may also use derivative financial instruments to improve the balance between interest-sensitive assets and interest-sensitive liabilities and as one tool to manage interest rate sensitivity while continuing to meet the credit and deposit needs of our customers. Beginning in 2006, the Company entered into interest rate swaps ("swaps") to facilitate customer transactions and meet their financing needs. These swaps qualify as derivatives, but are not designated as hedging instruments. At December 31, 2007 and 2006, the Company had not entered into any derivative contracts to assist in managing our interest rate sensitivity.

The Company manages the relationship of interest sensitive assets to interest sensitive liabilities and the resulting effect on net interest income. The Company utilizes a simulation model to analyze net interest income sensitivity to movements in interest rates. The simulation model projects net interest income based on both a rise and fall in interest rates of 200 basis points over a 12-month period. The model is based on actual repricing dates of interest sensitive assets and interest sensitive liabilities. The model incorporates assumptions regarding the impact of changing interest rates on the prepayment rates of certain assets. The assumptions are based on nationally published prepayment speeds on given assets when interest rates increase or decrease by 200 basis points or more.

Interest rate risk represents the sensitivity of earnings to changes in interest rates. As interest rates change, the interest income and expense associated with the Company's interest sensitive assets and liabilities also change, thereby impacting net interest income, the primary component of the Company's earnings. ALCO utilizes the results of the simulation model and the Economic Value of Equity report to quantify the estimated exposure of net interest income to a sustained change in interest rates.

Currently, the Company's income exposure to changes in interest rates is relatively low. The Company measures this exposure based on a gradual increase or decrease in interest rates of 200 basis points. Given this scenario, the Company had, at year-end, a slight exposure to rising rates, but would benefit from declining interest rates as interest-bearing liabilities would reprice faster than interest-earning assets.

The following chart reflects the Company's sensitivity to changes in interest rates as of December 31, 2007. Numbers are based on the December balance sheet and assume paydowns and maturities of both assets and liabilities are reinvested based on growth assumptions provided by the Company. The same growth and interest rate assumptions are used in the base, up 200 basis points, and down 200 basis points scenarios.

INTEREST RATE RISK
Income Sensitivity Summary
Interest Rate Scenario
(Dollars in thousands)

	-200 BP	Base	+200 BP
Year 1 Net Interest Income	$ 16,929	$ 16,495	$ 15,829
$ Change Net Interest Income	$ 434	—	$ (666)
% Change Net Interest Income	2.63%	—	(4.04)%

Policy Limit: 10% for +/- 200 Basis Points (BP) over 12 months.

The preceding sensitivity analysis is a modeling analysis, which changes quarterly and consists of hypothetical estimates based upon numerous assumptions, including the interest rate levels, shape of the yield curve, prepayments on loans and securities, rates on loans and deposits, reinvestments of paydowns and maturities of loans, investments and deposits, and others. While assumptions are developed based on the current economic and market conditions, management cannot make any assurances as to the predictive nature of these assumptions, including how customer preferences or competitor influences might change.

As market conditions vary from those assumed in the sensitivity analysis, actual results will differ. Also, the sensitivity analysis does not reflect actions that ALCO might take in responding to or anticipating changes in interest rates. See "Table 10 – Sensitivities to Changes in Interest Rates." Based on our interest rate risk profile as of December 31, 2007, we expect net interest income to benefit from decreases in interest rates in the first quarter of 2008.

Liquidity Risk Management

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 obligations. Without proper management of its liquidity, 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.

Liquidity is managed at two levels. The first is the liquidity of the Company. The second is the liquidity of the Bank. The management of liquidity at both levels is essential, because the Company and the Bank have different funding needs and sources, and each are subject to regulatory guidelines and requirements.

The primary source of funding and the primary source of liquidity for the Company includes dividends received from the Bank and proceeds from the issuance of common stock or other securities. Primary uses of funds for the Company include dividends paid to shareholders, stock repurchases, and interest payments on junior subordinated debentures issued by the Company in connection with trust preferred securities. The junior subordinated debentures are presented as long-term debt in the Consolidated Balance Sheets and the related trust preferred securities are includible in Tier 1 Capital for regulatory capital purposes.

Primary sources of funding for the Bank include customer deposits, other borrowings, repayment and maturity of securities, and sale and repayment of loans. The Bank has access to federal funds lines from various banks and borrowings from the Federal Reserve discount window. In addition to these sources, 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. As of December 31, 2007, the Bank had an available line of credit with the FHLB totaling $205.2 million with $83.2 million outstanding. As of December 31, 2007, the Bank also had $44.0 million of federal funds lines with $8.7 million outstanding. Primary uses of funds include repayment of maturing obligations and growing the loan portfolio.

The following table presents additional information about our contractual obligations as of December 31, 2007, which by their terms have contractual maturity and termination dates subsequent to December 31, 2007:

	Payments due by period				
(Dollars in thousands)	**Total**	**1 year or less**	**1 to 3 years**	**3 to 5 years**	**More than 5 years**
Contractual obligations:					
Deposit maturities (1)	**$ 492,585**	421,093	66,866	4,626	—
Long-term debt	**115,386**	10,018	10,036	30,018	65,314
Operating lease obligations	**586**	221	247	118	—
Total	**$ 608,557**	431,332	77,149	34,762	65,314

(1) Deposits with no stated maturity (demand, NOW, money market, and savings deposits) are presented in the less than one year category.

Management believes the Company's and the Bank's sources of liquidity are adequate to meet loan demand, operating needs, and deposit withdrawal requirements.

Off-Balance Sheet Arrangements

At December 31, 2007, the Bank had outstanding standby letters of credit of $10.1 million and unfunded loan commitments outstanding of $54.5 million. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, the Bank has the ability to liquidate federal funds sold or securities available-for-sale, or on a short-term basis to borrow and purchase federal funds from other financial institutions.

Effects of Inflation and Changing Prices

The consolidated financial statements and related consolidated financial data presented herein have been prepared in accordance with U.S. generally accepted accounting principles and practices within the banking industry which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157, which defines fair value, establishes a framework for measuring fair value in U.S. generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 applies only to fair-value measurements that are already required or permitted by other accounting standards and is expected to increase the consistency of those measurements. The definition of fair value focuses on the exit price, i.e., the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, not the entry price, i.e., the price that would be paid to acquire the asset or received to assume the liability at the measurement date. The statement emphasizes that fair value is a market-based measurement; not an entity-specific measurement. Therefore, the fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. The effective date for SFAS No. 157 is for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not believe SFAS No. 157 will have a significant impact on the consolidated financial statements of the Company.

In February of 2007, the FASB issued Statement of Financial Accounting Standard No. 159 ("SFAS 159"), "The Fair Value Option for Financial Assets and Financial Liabilities", which gives entities the option to measure eligible financial assets, and financial liabilities at fair value on an instrument by instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting standards. The election to use the fair value option is available when an entity first recognizes a financial asset or financial liability. Subsequent changes in fair value must be recorded in earnings. This statement is effective as of the beginning of a company's first fiscal year after November 15, 2007. We do not believe SFAS No. 159 will have a significant impact on our consolidated financial statements of the Company.

In November 2007, the SEC issued SAB 109, "Written Loan Commitments Recorded at Fair Value Through Earnings." SAB 109 rescinds SAB 105's prohibition on inclusion of expected net future cash flows related to loan servicing activities in the fair value measurement of a written loan commitment. SAB 109 also applies to any loan commitments for which fair value accounting is elected under SFAS 159. SAB 109 is effective prospectively for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. We do not believe SAB 109 will have a significant impact on the consolidated financial statements of the Company.

In December 2007, the SEC issued SAB 110, "Share-Based Payment." SAB 110 allows eligible public companies to continue to use a simplified method for estimating the expense of stock options if their own historical experience isn't sufficient to provide a reasonable basis. Under SAB 107, "Share-Based Payment," the simplified method was scheduled to expire for all grants made after December 31, 2007. The SAB describes disclosures that should be provided if a company is using the simplified method for all or a portion of its stock option grants beyond December 31, 2007. The provisions of this bulletin are effective on January 1, 2008. At December 31, 2007, the Company had no stock options outstanding. As a result, we do not believe SAB 110 will have a significant impact on the consolidated financial statements of the Company.

In December 2007, the FASB issued SFAS 141R, "Business Combinations." SFAS 141R clarifies the definitions of both a business combination and a business. All business combinations will be accounted for under the acquisition method (previously referred to as the purchase method). This standard defines the acquisition date as the only relevant date for recognition and measurement of the fair value of consideration paid. SFAS 141R requires the acquirer to expense all acquisition related costs. SFAS 141R will also require acquired loans to be recorded net of the allowance for loan losses on the date of acquisition. SFAS 141R defines the measurement period as the time after the acquisition date during which the acquirer may make adjustments to the "provisional" amounts recognized at the acquisition date. This period cannot exceed one year, and any subsequent adjustments made to provisional amounts are done retrospectively and restate prior period data. The provisions of this statement are effective for business combinations during fiscal years beginning after December 15, 2008. The Company has not determined the impact that SFAS 141R will have on its financial position and results of operations and believes that such determination will not be meaningful until the Company enters into a business combination.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in consolidated financial statements — An Amendment of ARB No. 51.” SFAS No. 160 requires noncontrolling interests to be treated as a separate component of equity, not as a liability or other item outside of equity. Disclosure requirements include net income and comprehensive income to be displayed for both the controlling and noncontrolling interests and a separate schedule that shows the effects of any transactions with the noncontrolling interests on the equity attributable to the controlling interest. The provisions of this statement are effective for fiscal years beginning after December 15, 2008. This statement should be applied prospectively except for the presentation and disclosure requirements which shall be applied retrospectively for all periods presented. Management is currently evaluating this Statement and its effect on the consolidated financial statements of the Company.

Table 1—Explanation of Non-GAAP Financial Measures

In addition to results presented in accordance with U.S. generally accepted accounting principles (GAAP), this annual report includes certain designated net interest income amounts presented on a tax-equivalent basis, a non-GAAP financial measure, including the presentation of total revenue and the calculation of the efficiency ratio.

The Company believes the presentation of net interest income on a tax-equivalent basis provides comparability of net interest income from both taxable and tax-exempt sources and facilitates comparability within the industry. Although the Company believes this non-GAAP financial measure enhances investors' understanding of its business and performance, this non-GAAP financial measure should not be considered an alternative to GAAP. The reconciliation of this non-GAAP financial measure from GAAP to non-GAAP is presented below.

	Years ended December 31		
(Dollars in thousands)	**2007**	**2006**	**2005**
Net interest income (GAAP)	**$ 16,875**	15,980	15,993
Tax-equivalent adjustment	**1,123**	1,033	956
Net interest income (Tax-equivalent)	**$ 17,998**	17,013	16,949

Table 2—Selected Financial Data

(Dollars in thousands, except per share amounts)	2007	2006	2005	2004	2003
	Years ended December 31				
Income statement					
Tax-equivalent interest income	**$ 39,940**	36,658	32,270	28,864	26,219
Total interest expense	**21,942**	19,645	15,321	12,508	11,422
Tax equivalent net interest income	**17,998**	17,013	16,949	16,356	14,797
Provision for loan losses	**23**	330	485	600	675
Total noninterest income	**4,666**	4,448	4,319	6,907	6,958
Total noninterest expense	**12,360**	11,201	11,148	13,069	13,212
Net earnings before income taxes and tax-equivalent adjustment	**10,281**	9,930	9,635	9,594	7,868
Tax-equivalent adjustment	**1,123**	1,033	956	735	166
Income tax expense	**2,240**	2,312	2,209	2,349	2,283
Net earnings	**$ 6,918**	6,585	6,470	6,510	5,419
Per share data:					
Basic and diluted net earnings	**$ 1.86**	1.74	1.69	1.68	1.39
Cash dividends declared	**$ 0.70**	0.64	0.58	0.50	0.48
Weighted average shares outstanding					
Basic	**3,716,427**	3,777,721	3,830,002	3,870,198	3,894,969
Diluted	**3,716,427**	3,778,055	3,830,794	3,871,273	3,895,728
Shares outstanding	**3,681,809**	3,743,787	3,795,016	3,846,861	3,892,568
Book value	**$ 14.40**	12.93	11.58	11.57	10.38
Common stock price					
High	**$ 30.00**	28.89	24.50	22.00	21.50
Low	**21.30**	21.50	20.00	18.60	12.90
Period-end	**$ 21.95**	28.89	22.14	20.68	19.67
To earnings ratio	**11.80 x**	16.60	13.10	12.31	14.15
To book value	**152%**	223	191	179	189
Performance ratios:					
Return on average equity	**13.50%**	14.66	14.26	15.69	13.47
Return on average assets	**1.06**	1.06	1.08	1.10	1.05
Dividend payout ratio	**37.63**	36.78	34.32	29.76	34.53
Average equity to average assets	**7.88**	7.20	7.56	7.03	7.78
Asset Quality:					
Allowance for loan losses as a % of:					
Loans	**1.27%**	1.43	1.36	1.38	1.76
Nonperforming assets	**748**	3,184	3,558	424	253
Net charge-offs (recoveries) as a % of average loans	**(0.01)**	0.05	0.13	0.58	0.59
Nonperforming assets as a % of loans	**0.17**	0.03	0.04	0.32	0.70
Capital Adequacy:					
Tier 1 capital ratio	**14.74%**	15.59	15.88	16.09	15.27
Total capital ratio	**15.74**	16.68	16.99	17.15	16.53
Leverage ratio	**9.02**	9.22	9.11	8.86	8.85
Other financial data:					
Net interest margin	**2.91%**	2.97	3.00	2.93	3.04
Effective income tax rate	**24.46**	25.99	25.45	26.52	29.64
Efficiency ratio (a)	**54.54**	52.19	52.42	56.18	60.73
Selected period end balances:					
Securities	**$ 318,373**	301,937	274,961	282,199	285,319
Loans, net of unearned income	**322,411**	281,983	282,059	251,129	244,652
Allowance for loan losses	**4,105**	4,044	3,843	3,456	4,313
Total assets	**688,659**	635,126	608,154	591,161	590,115
Total deposits	**492,585**	469,648	454,995	429,339	434,042
Long-term debt	**115,386**	90,404	105,422	105,441	105,589
Total stockholders' equity	**53,018**	48,418	43,954	44,504	40,408

(a) Tax-equivalent. See "Table 1 - Explanation of Non-GAAP Financial Measures".

Table 3—Selected Quarterly Financial Data

(Dollars in thousands, except per share amounts)	2007 Fourth	2007 Third	2007 Second	2007 First	2006 Fourth	2006 Third	2006 Second	2006 First
Income statement								
Tax-equivalent interest income	**$ 10,138**	**10,234**	**9,993**	**9,575**	9,307	9,441	9,272	8,638
Total interest expense	**5,549**	**5,624**	**5,417**	**5,352**	5,229	5,067	4,903	4,446
Tax equivalent net interest income	**4,589**	**4,610**	**4,576**	**4,223**	4,078	4,374	4,369	4,192
Provision for loan losses	**—**	**—**	**20**	**3**	35	85	105	105
Total noninterest income	**1,252**	**1,088**	**1,138**	**1,188**	1,090	1,090	1,092	1,176
Total noninterest expense	**3,253**	**3,074**	**3,130**	**2,903**	2,772	2,849	2,759	2,821
Net earnings before income taxes and tax-equivalent adjustment	**2,588**	**2,624**	**2,564**	**2,505**	2,361	2,530	2,597	2,442
Tax-equivalent adjustment	**291**	**286**	**278**	**268**	251	248	269	265
Income tax expense	**517**	**589**	**575**	**559**	563	621	595	533
Net earnings	**$ 1,780**	**1,749**	**1,711**	**1,678**	1,547	1,661	1,733	1,644
Per share data:								
Basic and diluted net earnings	**$ 0.48**	**0.47**	**0.46**	**0.45**	0.41	0.44	0.46	0.43
Cash dividends declared	**$ 0.175**	**0.175**	**0.175**	**0.175**	0.16	0.16	0.16	0.16
Weighted average shares outstanding								
Basic	**3,688,780**	**3,708,097**	**3,729,681**	**3,739,803**	3,765,27	3,775,64	3,783,97	3,786,25
Diluted	**3,688,780**	**3,708,097**	**3,729,68**	**3,739,80**	3,765,27	3,776,02	3,784,44	3,786,74
Shares outstanding	**3,681,809**	**3,691,26**	**3,727,260**	**3,735,70**	3,743,78	3,771,56	3,782,86	3,784,53
Book value	**$ 14.40**	**13.68**	**12.69**	**13.41**	12.93	12.47	11.67	11.77
Common stock price								
High	**$ 25.56**	**27.88**	**29.00**	**30.00**	28.89	27.01	24.29	23.83
Low	**21.30**	**23.25**	**26.03**	**26.48**	26.39	23.00	23.13	21.50
Period-end	**$ 21.95**	**24.77**	**26.31**	**28.01**	28.89	27.01	23.78	23.00
To earnings ratio	**11.80 x**	**13.84**	**14.95**	**15.91**	16.60	15.09	13.44	13.45
To book value	**152%**	**181**	**207**	**209**	223	217	204	195
Performance ratios:								
Return on average equity	**13.51%**	**14.41**	**13.03**	**13.25**	12.96	14.84	15.37	14.73
Return on average assets	**1.06**	**1.07**	**1.07**	**1.06**	0.99	1.06	1.10	1.08
Dividend payout ratio	**36.46**	**37.23**	**38.04**	**38.89**	39.02	36.36	34.78	37.21
Average equity to average assets	**7.85**	**7.43**	**8.19**	**7.98**	7.60	7.14	7.15	7.33
Asset Quality:								
Allowance for loan losses as a % of:								
Loans	**1.27%**	**1.29**	**1.35**	**1.46**	1.43	1.42	1.35	1.40
Nonperforming assets	**748**	**911**	**58,629**	**1,793**	5,617	23,753	2,066	1,564
Net charge-offs (recoveries) as a % of average loans	**(0.04)**	**0.04**	**0.05**	**(0.11)**	0.04	0.05	0.06	0.03
Nonperforming assets as a % of loans	**0.17**	**0.14**	**0.00**	**0.08**	0.03	0.01	0.07	0.09
Capital Adequacy:								
Tier 1 capital ratio	**14.74%**	**14.85**	**15.46**	**15.72**	15.59	15.42	14.91	15.22
Total capital ratio	**15.74**	**15.86**	**16.50**	**16.82**	16.68	16.49	15.96	16.29
Leverage ratio	**9.02**	**9.13**	**9.51**	**9.72**	9.22	9.20	9.00	9.19
Other financial data:								
Net interest margin	**2.91%**	**3.02**	**3.07**	**2.90**	2.76	2.96	2.96	2.97
Effective income tax rate	**22.51**	**25.19**	**25.15**	**24.99**	26.68	27.21	25.56	24.48
Efficiency ratio (a)	**55.71**	**53.95**	**54.78**	**53.65**	53.64	52.14	50.52	52.55
Selected period end balances:								
Securities	**$ 318,373**	**288,459**	**292,618**	**297,323**	301,937	287,703	291,518	292,947
Loans	**322,411**	**316,795**	**303,281**	**282,837**	281,983	283,746	294,320	281,334
Allowance for loan losses	**4,105**	**4,074**	**4,104**	**4,123**	4,044	4,038	3,988	3,925
Total assets	**688,659**	**661,780**	**651,822**	**643,515**	635,126	635,987	650,278	627,523
Total deposits	**492,585**	**510,078**	**490,478**	**493,218**	469,648	479,269	490,265	471,349
Long-term debt	**115,386**	**90,390**	**90,395**	**90,399**	90,404	100,409	105,413	105,418
Total stockholders' equity	**53,018**	**50,503**	**47,305**	**50,089**	48,418	47,025	44,128	44,527

(a) Tax-equivalent. See "Table 1 - Explanation of Non-GAAP Financial Measures".

Table 4—Average Balance and Net Interest Income Analysis

(Dollars in thousands)	2007 Average Balance	2007 Interest Income/ Expense	2007 Yield/ Rate	2006 Average Balance	2006 Interest Income/ Expense	2006 Yield/ Rate	2005 Average Balance	2005 Interest Income/ Expense	2005 Yield/ Rate
	Years ended December 31								
Interest-earning assets:									
Loans and loans held for sale (1)	**$304,389**	**$ 24,286**	**7.98%**	$ 286,613	$ 22,304	7.78%	$ 275,912	$ 19,682	7.13%
Securities—taxable	**242,826**	**12,038**	**4.96%**	241,298	10,882	4.51%	234,577	9,475	4.04%
Securities—tax-exempt (2)	**51,995**	**3,308**	**6.36%**	47,748	3,043	6.37%	44,862	2,814	6.27%
Total securities	**294,821**	**15,346**	**5.21%**	289,046	13,925	4.82%	279,439	12,289	4.40%
Federal funds sold	**5,539**	**276**	**4.98%**	7,321	365	4.99%	8,254	261	3.16%
Interest bearing bank deposits	**693**	**32**	**4.62%**	1,264	64	5.06%	1,276	38	2.98%
Total interest-earning assets	**605,442**	**$ 39,940**	**6.60%**	584,244	$ 36,658	6.27%	564,881	$ 32,270	5.71%
Cash and due from banks	**13,063**			13,142			11,985		
Other assets	**31,903**			26,541			23,081		
Total assets	**$650,408**			$ 623,927			$ 599,947		
Interest-bearing liabilities:									
Deposits:									
NOW	**$ 57,532**	**$ 1,301**	**2.26%**	$ 65,029	$ 1,595	2.45%	$ 66,472	$ 1,201	1.81%
Savings and money market	**143,587**	**5,243**	**3.65%**	142,610	5,238	3.67%	121,961	2,962	2.43%
Certificates of deposits less than $100,000	**85,831**	**4,575**	**5.33%**	84,227	3,836	4.55%	86,670	3,296	3.80%
Certificates of deposits and other time deposits of $100,000 or more	**133,466**	**5,933**	**4.45%**	104,446	4,037	3.87%	100,213	3,061	3.05%
Total interest-bearing deposits	**420,416**	**17,052**	**4.06%**	396,312	14,706	3.71%	375,316	10,520	2.80%
Short-term borrowings	**12,727**	**601**	**4.72%**	7,502	411	5.48%	2,675	91	3.40%
Long-term debt	**93,278**	**4,289**	**4.60%**	102,848	4,528	4.40%	105,431	4,710	4.47%
Total interest-bearing liabilities	**526,421**	**$ 21,942**	**4.17%**	506,662	$ 19,645	3.88%	483,422	$ 15,321	3.17%
Noninterest-bearing deposits	**71,201**			70,240			68,408		
Other liabilities	**1,544**			2,120			2,758		
Stockholders' equity	**51,242**			44,905			45,359		
Total liabilities and stockholders' equity	**$650,408**			$ 623,927			$ 599,947		
Net interest income and margin		**$ 17,998**	**2.97%**		$ 17,013	2.91%		$ 16,949	3.00%

(1) Average loan balances are shown net of unearned income and 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%.

Table 5 - Volume and Rate Variance Analysis

(Dollars in thousands)	Years ended December 31, 2007 vs. 2006 Net Change	Due to change in Rate (2)	Due to change in Volume (2)	Years ended December 31, 2006 vs. 2005 Net Change	Due to change in Rate (2)	Due to change in Volume (2)
Interest Income:						
Loans and loans held for sale	**$ 1,982**	**574**	**1,408**	2,622	1,838	784
Securities - taxable	**1,156**	**1,087**	**69**	1,407	1,130	277
Securities - tax-exempt (1)	**265**	**(5)**	**270**	229	46	183
Total securities	**1,421**	**1,082**	**339**	1,636	1,176	460
Federal funds sold	**(89)**	**—**	**(89)**	104	130	(26)
Interest bearing bank deposits	**(32)**	**(5)**	**(27)**	26	26	—
Total interest income	**$ 3,282**	**1,651**	**1,631**	4,388	3,170	1,218
Interest expense:						
Deposits:						
NOW	**$ (294)**	**(118)**	**(176)**	394	419	(25)
Savings and money market	**5**	**(31)**	**36**	2,276	1,711	565
Certificates of deposits less than $100,000	**739**	**665**	**74**	540	630	(90)
Certificates of deposits and other time deposits of $100,000 or more	**1,896**	**665**	**1,231**	976	842	134
Total interest-bearing deposits	**2,346**	**1,181**	**1,165**	4,186	3,602	584
Short-term borrowings	**190**	**(47)**	**237**	320	81	239
Long-term debt	**(239)**	**218**	**(457)**	(182)	(68)	(114)
Total interest expense	**2,297**	**1,352**	**945**	4,324	3,615	709
Net interest income	**$ 985**	**299**	**686**	64	(445)	509

(1) Yields on tax-exempt securities have been computed on a tax-equivalent basis using an income tax rate of 34%.
(2) Changes attributable to rate/volume are allocated to both rate and volume on an equal basis.

Table 6—Loan Portfolio Composition

(Dollars in thousands)	**December 31** 2007	2006	2005	2004	2003
Commercial, financial and agricultural	**$ 62,478**	52,923	51,784	50,075	55,239
Leases—commercial	**486**	761	1,488	5,397	6,630
Real estate—construction:					
Commercial	**7,901**	4,684	2,039	945	2,099
Residential	**11,370**	9,912	8,832	5,426	4,866
Real estate—mortgage:					
Commercial	**161,703**	142,092	148,118	136,037	122,397
Residential	**67,246**	62,596	59,757	42,545	41,988
Consumer installment	**11,539**	9,349	10,334	11,021	11,673
Total loans	**322,723**	282,317	282,352	251,446	244,892
Less: unearned income	**(312)**	(334)	(293)	(317)	(240)
Loans, net of unearned income	**322,411**	281,983	282,059	251,129	244,652
Less: Allowance for Loan Losses	**(4,105)**	(4,044)	(3,843)	(3,456)	(4,312)
Loans, net	**$318,306**	277,939	278,216	247,673	240,340

Table 7—Loan Maturities and Sensitivities to Changes in Interest Rates

(Dollars in thousands)	December 31, 2007						
	1 year or less	1 to 5 years	After 5 years	Total	Adjustable Rate	Fixed Rate	Total
Commercial, financial and agricultural	$ 33,916	26,008	2,554	62,478	25,735	36,743	62,478
Leases—commercial	49	437	—	486	—	486	486
Real estate—construction:	11,951	5,614	1,706	19,271	—	19,271	19,271
Real estate—mortgage:	49,939	98,452	80,558	228,949	120,461	108,488	228,949
Consumer installment	6,305	4,893	341	11,539	927	10,612	11,539
Total loans	$102,160	135,404	85,159	322,723	147,123	175,600	322,723

Table 8—Allowance for Loan Losses and Nonperforming Assets

	Years ended December 31				
(Dollars in thousands)	2007	2006	2005	2004	2003
Allowance for loan losses:					
Balance at beginning of period	**$ 4,044**	3,843	3,456	4,313	5,104
Charge-offs:					
Commercial, financial and agricultural	**(62)**	(37)	(39)	(215)	(416)
Real estate	**(143)**	(106)	(124)	(1,507)	(1,036)
Consumer	**(45)**	(46)	(193)	(44)	(125)
Total charge-offs	**(250)**	(189)	(356)	(1,766)	(1,577)
Recoveries:					
Commercial, financial and agricultural	**14**	13	89	219	52
Real estate	**267**	11	100	11	8
Consumer	**7**	36	69	79	51
Total recoveries	**288**	60	258	309	111
Net (charge-offs) recoveries	**38**	(129)	(98)	(1,457)	(1,466)
Provision for loan losses	**23**	330	485	600	675
Ending balance	**$ 4,105**	4,044	3,843	3,456	4,313
as a % of loans	**1.27%**	1.43	1.36	1.38	1.76
as a % of nonperforming assets	**748**	3,184	3,558	424	253
Net charge-offs as a % of average loans	**(0.01)**	0.05	0.13	0.58	0.59
Nonperforming assets:					
Nonaccrual loans	**$ 447**	72	108	711	1,704
Other nonperforming assets (primarily other real estate owned)	**98**	—	—	—	—
Accruing loans 90 days or more past due	**4**	—	—	105	—
Total nonperforming assets	**$ 549**	72	108	816	1,704
as a % of loans	**0.17%**	0.03	0.04	0.32	0.70

Table 9—CDs and Other Time Deposits of $100,000 or More

(Dollars in thousands)	December 31, 2007
Maturity of:	
3 months or less	$ 11,306
Over 3 months through 6 months	11,353
Over 6 months through 12 months	60,157
Over 12 months	59,535
Total CDs and other time deposits of $100,000 or more	$ 142,351

Table 10—Sensitivities to Changes in Interest Rates

	December 31, 2007					
(Dollars in thousands)	Immediate	1 to 3 months	4 to 12 months	1 to 5 years	(1) Thereafter	Total
Interest-earning assets:						
Loans, net of unearned income (2)	$ —	130,469	74,361	112,698	7,861	325,389
Securities—taxable	—	45,855	39,301	109,272	65,697	260,125
Securities—tax-exempt	—	—	735	16,563	40,950	58,248
Federal funds sold	50	—	—	—	—	50
Interest bearing bank deposits	136	—	—	—	—	136
Total earning assets	186	176,324	114,397	238,533	114,508	643,948
Interest-bearing liabilities:						
Deposits:						
NOW	—	23,957	4,685	24,915	—	53,557
Savings and money market	—	120,092	2,745	14,632	—	137,469
Certificates of deposits less than $100,000	1,917	12,513	43,882	30,655	—	88,967
Certificates of deposits and other time deposits of $100,000 or more	4,153	14,669	86,317	37,212	—	142,351
Total interest-bearing deposits	6,070	171,231	137,629	107,414	—	422,344
Short-term borrowings	24,247	—	—	—	—	24,247
Long-term debt	—	7,217	10,011	45,067	53,091	115,386
Total interest-bearing liabilities	30,317	178,448	147,640	152,481	53,091	561,977
Interest sensitivity gap	(30,131)	(2,124)	(33,243)	86,052	61,417	81,971
Cumulative interest sensitivity gap	$ (30,131)	(32,255)	(65,498)	20,554	81,971	—

(1) includes non-rate sensitive items
(2) includes loans held for sale

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, 2007 and 2006, 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, 2007. 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, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007 in conformity U.S. generally accepted accounting principles.

As discussed in note 1 to the consolidated financial statements, effective January 1, 2007, the Company changed its method of accounting for uncertainties in income taxes.

KPMG LLP

Birmingham, Alabama
March 28, 2008

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

(Dollars in thousands, except share data)	December 31 2007	2006
Assets:		
Cash and due from banks	**$ 13,312**	16,875
Federal funds sold	**50**	—
Interest bearing bank deposits	**136**	151
Cash and cash equivalents	**13,498**	17,026
Securities held-to-maturity (fair value of $514 for December 31, 2006)	**—**	513
Securities available-for-sale	**318,373**	301,424
Loans held for sale	**2,978**	3,109
Loans, net of unearned income	**322,411**	281,983
Allowance for loan losses	**(4,105)**	(4,044)
Loans, net	**318,306**	277,939
Premises and equipment, net	**6,423**	5,796
Bank-owned life insurance	**14,825**	14,278
Other assets	**14,256**	15,041
Total assets	**$ 688,659**	635,126
Liabilities:		
Deposits:		
Noninterest-bearing	**$ 70,241**	79,102
Interest-bearing	**422,344**	390,546
Total deposits	**492,585**	469,648
Federal funds purchased and securities sold under agreements to repurchase	**24,247**	14,401
Other short-term borrowings	**—**	10,000
Long-term debt	**115,386**	90,404
Accrued expenses and other liabilities	**3,423**	2,255
Total liabilities	**635,641**	586,708
Stockholders' equity:		
Preferred stock of $.01 par value; authorized 200,000 shares; issued shares—none	**—**	—
Common stock of $.01 par value; authorized 8,500,000 shares; issued 3,957,135 shares	**39**	39
Additional paid-in capital	**3,748**	3,748
Retained earnings	**55,362**	51,087
Accumulated other comprehensive loss, net	**(397)**	(2,335)
Less treasury stock, at cost—275,326 shares and 213,348 shares for December 31, 2007 and December 31, 2006, respectively	**(5,734)**	(4,121)
Total stockholders' equity	**53,018**	48,418
Total liabilities and stockholders' equity	**$ 688,659**	635,126

See accompanying notes to consolidated financial statements

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES
Consolidated Statements of Earnings

(Dollars in thousands, except share and per share data)	Years ended December 31 2007	2006	2005
Interest income:			
Loans, including fees	$ **24,286**	22,304	19,682
Securities	**14,223**	12,892	11,333
Federal funds sold and interest bearing bank deposits	**308**	429	299
Total interest income	**38,817**	35,625	31,314
Interest expense:			
Deposits	**17,052**	14,706	10,520
Short-term borrowings	**601**	411	91
Long-term debt	**4,289**	4,528	4,710
Total interest expense	**21,942**	19,645	15,321
Net interest income	**16,875**	15,980	15,993
Provision for loan losses	**23**	330	485
Net interest income after provision for loan losses	**16,852**	15,650	15,508
Noninterest income:			
Service charges on deposit accounts	**1,302**	1,387	1,497
Servicing fees	**339**	375	389
Gain on sale of loans held for sale	**626**	649	669
Bank-owned life insurance	**547**	452	459
Securities gains, net	**253**	10	11
Other	**1,599**	1,575	1,294
Total noninterest income	**4,666**	4,448	4,319
Noninterest expense:			
Salaries and benefits	**7,110**	6,714	6,658
Net occupancy and equipment	**1,267**	1,159	1,182
Professional fees	**621**	476	491
Loss on prepayment of FHLB advances	**313**	—	—
Other	**3,049**	2,852	2,817
Total noninterest expense	**12,360**	11,201	11,148
Earnings before income taxes	**9,158**	8,897	8,679
Income tax expense	**2,240**	2,312	2,209
Net earnings	$ **6,918**	6,585	6,470
Net earnings per share:			
Basic and diluted	$ **1.86**	1.74	1.69
Weighted average shares outstanding:			
Basic	**3,716,427**	3,777,721	3,830,002
Diluted	**3,716,427**	3,778,055	3,830,794

See accompanying notes to consolidated financial statements

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity and Comprehensive Income

(Dollars in thousands, except share and per share data)	Common Stock Shares	Common Stock Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Treasury stock	Total
Balance, December 31, 2004	3,957,135	$ 39	$ 3,723	$ 42,669	$ (361)	$ (1,566)	$ 44,504
Comprehensive income (loss):							
Net earnings	—	—	—	6,470	—	—	6,470
Other comprehensive income due to change in unrealized loss on securities available for sale and derivative, net	—	—	—	—	(3,621)	—	(3,621)
Total comprehensive income	—	—	—	6,470	(3,621)	—	2,849
Cash dividends paid ($0.58 per share)	—	—	—	(2,220)	—	—	(2,220)
Stock repurchases (53,745 shares)	—	—	—	—	—	(1,202)	(1,202)
Sale of treasury stock (1,900 shares)	—	—	11	—	—	12	23
Balance, December 31, 2005	3,957,135	$ 39	$ 3,734	$ 46,919	$ (3,982)	$ (2,756)	$ 43,954
Comprehensive income:							
Net earnings	—	—	—	6,585	—	—	6,585
Other comprehensive income due to change in unrealized loss on securities available for sale and derivative, net	—	—	—	—	1,647	—	1,647
Total comprehensive income	—	—	—	6,585	1,647	—	8,232
Cash dividends paid ($0.64 per share)	—	—	—	(2,417)	—	—	(2,417)
Stock repurchases (53,229 shares)	—	—	—	—	—	(1,378)	(1,378)
Sale of treasury stock (2,000 shares)	—	—	14	—	—	13	27
Balance, December 31, 2006	3,957,135	$ 39	$ 3,748	$ 51,087	$ (2,335)	$ (4,121)	$ 48,418
Comprehensive income:							
Net earnings	**—**	**—**	**—**	**6,918**	**—**	**—**	**6,918**
Other comprehensive income due to change in unrealized loss on securities available for sale, net	**—**	**—**	**—**	**—**	**1,938**	**—**	**1,938**
Total comprehensive income	**—**	**—**	**—**	**6,918**	**1,938**	**—**	**8,856**
Cash dividends paid ($0.70 per share)	**—**	**—**	**—**	**(2,643)**	**—**	**—**	**(2,643)**
Stock repurchases (61,978 shares)	**—**	**—**	**—**	**—**	**—**	**(1,613)**	**(1,613)**
Balance, December 31, 2007	**3,957,135**	**$ 39**	**$ 3,748**	**$ 55,362**	**$ (397)**	**$ (5,734)**	**$ 53,018**

See accompanying notes to consolidated financial statements

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows

(In thousands)	2007	2006	2005
	Years ended December 31		
Cash flows from operating activities:			
Net earnings	$ **6,918**	6,585	6,470
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Provision for loan losses	**23**	330	485
Depreciation and amortization	**387**	396	444
Premium amortization and discount accretion, net	**52**	470	994
Deferred tax expense (benefit)	**65**	(389)	(1,640)
Net loss (gain) on securities available for sale transactions	**360**	(10)	(11)
Net gain on sale of loans held for sale	**(626)**	(649)	(669)
Gain on sale of privately-held stock investments	**(613)**	—	—
Gain on sale of other real estate owned	**—**	(7)	(15)
Loans originated for sale	**(97,477)**	(80,803)	(86,401)
Proceeds from sale of loans	**98,234**	79,744	87,779
Loss on sale of premises and equipment	**—**	—	3
Increase in cash surrender value of bank owned life insurance	**(547)**	(452)	(459)
Loss on prepayment of FHLB advances	**313**	—	—
Net (increase) decrease in other assets	**(1,576)**	(6,350)	1,263
Net increase (decrease) in accrued expenses and other liabilities	**1,168**	601	(367)
Net cash provided by (used in) operating activities	**6,681**	(534)	7,876
Cash flows from investing activities:			
Proceeds from maturities of securities held-to-maturity	**89**	120	175
Proceeds from sales of securities available-for-sale	**50,207**	31,146	33,346
Proceeds from maturities of securities available-for-sale	**41,509**	33,769	38,880
Purchase of securities available-for-sale	**(105,423)**	(89,736)	(72,388)
Net increase in loans	**(40,528)**	(328)	(25,609)
Net purchases of premises and equipment	**(971)**	(2,502)	(75)
Proceeds from sale of other real estate	**40**	280	386
Decrease (increase) in FHLB stock	**526**	193	(4)
Proceeds from sale of privately-held stock investment	**1,146**	—	—
Net cash used in investing activities	**(53,405)**	(27,058)	(25,289)
Cash flows from financing activities:			
Net (decrease) increase in noninterest-bearing deposits	**(8,861)**	8,317	5,421
Net increase in interest-bearing deposits	**31,798**	6,335	20,236
Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	**9,846**	12,670	(5,882)
Net (decrease) increase in other short-term borrowings	**(10,000)**	10,000	—
Proceeds from issuance of long-term debt	**35,000**	—	28,000
Repayments or retirement of long-term debt	**(10,331)**	(15,018)	(28,018)
Stock repurchases	**(1,613)**	(1,378)	(1,202)
Proceeds from sale of treasury stock	**—**	27	23
Dividends paid	**(2,643)**	(2,417)	(2,220)
Net cash provided by financing activities	**43,196**	18,536	16,358
Net change in cash and cash equivalents	**(3,528)**	(9,056)	(1,055)
Cash and cash equivalents at beginning of period	**17,026**	26,082	27,137
Cash and cash equivalents at end of period	$ **13,498**	17,026	26,082
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Interest	$ **21,570**	19,195	15,086
Income taxes	**1,937**	4,320	3,292
Supplemental disclosure of non-cash transactions:			
Real estate acquired through foreclosure	**138**	276	286
Loans held for sale transferred to loan portfolio	**—**	—	5,767
Transfer of securities from held-to-maturity to available-for-sale	**424**	—	—

See accompanying notes to consolidated financial statements

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Auburn National Bancorporation, Inc. (the "Company") is a bank holding company whose primary business is conducted by its wholly-owned subsidiary, AuburnBank (the "Bank"). AuburnBank is a commercial bank located in Auburn, Alabama. The Bank provides a full range of banking services in its primary market area, Lee County, which includes the Auburn-Opelika Metropolitan Statistical Area.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, AuburnBank. Significant intercompany transactions are eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the balance sheet date and the reported amounts income and expense during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the determination of the allowance for loan losses.

Reclassifications

Certain amounts reported in prior periods have been reclassified to conform to the current-period presentation. These reclassifications had no effect on the Company's previously reported net earnings or total stockholders' equity.

Cash Equivalents

Cash on hand, cash items in process of collection, amounts due from banks, and federal funds sold are included in cash and cash equivalents.

Securities

Securities are classified based on management's intention at the date of purchase. At December 31, 2007, all of the Company's securities are classified as available-for-sale. Securities available-for-sale are used as part of the Company's interest rate risk management strategy, and they may be sold in response to changes in interest rates, changes in prepayment risks or other factors. All securities classified as available-for-sale are recorded at fair value with any unrealized gains and losses reported in accumulated other comprehensive loss, net of the deferred income tax effects. Interest and dividends on securities, including the amortization of premiums and accretion of discounts are calculated using a method that approximates the effective interest method over the anticipated life of the security, taking into consideration prepayment assumptions. Realized gains and losses from the sale of securities are determined using the specific identification method.

On a quarterly basis, the Company makes an assessment to determine whether there have been events or economic circumstances to indicate that a security on which there is an unrealized loss is other-than-temporarily impaired. The Company considers many factors including the severity and duration of the impairment; the intent and ability of the Company to hold the security for a period of time sufficient for a recovery in value; recent events specific to the issuer or industry; external credit ratings and recent downgrades. Securities on which there is an unrealized loss that is deemed to be other-than-temporary are written down to fair value with the write-down recorded as a realized loss in securities gains (losses).

Loans held for sale

Loans originated and intended for sale are carried at the lower of cost or estimated fair value as determined on a loan-by-loan basis. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Loans

Loans are reported at their outstanding principal balances, net of unearned income. Loan origination fees, net of certain loan origination costs, are deferred and recognized as an adjustment to the related loan yield using a method that approximates the interest method. Loan commitment fees are generally deferred and amortized on a straight-line basis over the commitment period.

The accrual of interest on loans is discontinued when there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or the principal or interest is more than 90 days past due, unless the loan is both well-collateralized and in the process of collection. Generally, all interest accrued but not collected for loans that are placed on nonaccrual status is reversed against current income. Interest income is subsequently recognized only to the extent cash payments are received.

A loan is considered impaired when it is probable the Company will be unable to collect all principal and interest payments due according to the contractual terms of the loan agreement. Individually identified impaired loans are measured based on the present value of expected payments using the loan’s original effective rate as the discount rate, the loan’s observable market price, or the fair value of the collateral if the loan is collateral dependent. If the recorded investment in the impaired loan exceeds the measure of fair value, a valuation allowance may be established as part of the allowance for loan losses. Changes to the valuation allowance are recorded as a component of the provision for loan losses.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level that management believes adequate to absorb probable losses in the loan portfolio. Loan losses are charged against the allowance when they are known. Subsequent recoveries are credited to the allowance. Management’s determination of the adequacy of the allowance is based on an evaluation of the portfolio, current economic conditions, growth, composition of the loan portfolio, homogeneous pools of loans, risk ratings of specific loans, historical loan loss factors, identified impaired loans and other factors related to the portfolio. This evaluation is performed quarterly and is inherently subjective, as it requires material estimates that are susceptible to significant change including the amounts and timing of future cash flows expected to be received on any impaired loans. In addition, regulatory agencies, as an integral part of their examination process, will periodically review the Company’s allowance for loan losses, and may require the Company to record adjustments to the allowance based on their judgment about information available to them at the time of their examinations.

Premises and Equipment

Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation and amortization computed on a straight-line method over the useful lives of the assets or the expected terms of the leases, if shorter. Expected terms include lease option periods to the extent that the exercise of such options is reasonably assured.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying value amount or fair value less cost to sell.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales (i.e. loan sales) when control over the assets have been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking that right) to pledge or exchange the transferred assets, and (3) the Company doe not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Derivative Instruments

In accordance with SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities,” as amended by SFAS No. 138 “Accounting for Certain Derivative Instruments and Hedging Activities, an Amendment of SFAS No. 133,” all derivative instruments are recorded on the consolidated balance sheet at their respective fair values.

The accounting for changes in fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and if so, on the reason for holding it. If the derivative instrument is not designated as a hedge, the gain or loss on the derivative instrument is recognized in earnings in the period of change. None of the derivatives utilized by the Company have been designated as a hedge.

Securities sold under agreements to repurchase

Securities sold under agreements to repurchase generally mature less than one year from the transaction date. Securities sold under agreements to repurchases are reflected as a secured borrowing in the accompanying consolidated balance sheets at the amount of cash received in connection with each transaction.

Income Taxes

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

The Company adopted FASB Interpretation 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”), as of January 1, 2007. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. The adoption had no material affect on the Company’s financial statements. It is the Company’s policy to recognize interest and penalties related to income tax matters in income tax expense. The Company and its wholly-owned subsidiary file a consolidated income tax return.

Earnings Per Share

Basic net earnings per share is computed by dividing net earnings by the weighted average common shares outstanding for the year. Diluted net earnings per share reflects the potential dilution that could occur if the Company’s potential common stock was issued. As of December 31, 2007 and 2006, the Company had no options issued or outstanding.

A reconciliation of the numerator and denominator of the basic earnings per share computation to the diluted earnings per share computation for the years ended December 31, 2007, 2006 and 2005, respectively, is presented on the following page.

(Dollars in thousands, except share and per share data)		**2007**	2006	2005
			Years ended December 31	
Basic:				
Net earnings	$	**6,918**	6,585	6,470
Average common shares outstanding		**3,716,427**	3,777,721	3,830,002
Earnings per share	$	**1.86**	1.74	1.69
Diluted:				
Net earnings	$	**6,918**	6,585	6,470
Average common shares outstanding		**3,716,427**	3,777,721	3,830,002
Dilutive effect of options issued		**—**	334	792
Average diluted shares outstanding		**3,716,427**	3,778,055	3,830,794
Earnings per share	$	**1.86**	1.74	1.69

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, 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.

(Dollars in thousands, except share and per share data)		**Year ended December 31, 2005**
Basic:		
Net earnings—as reported	$	6,470
Deduct:		
Total stock-based employee compensation expense determined under fair value based method for all options, net of related tax effects		(3)
Net earnings—pro forma	$	6,467
Earnings per share—as reported		
Basic	$	1.69
Diluted		1.69
Earnings per share—pro forma		
Basic	$	1.69
Diluted		1.69

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 at December 31, 2005. These options vested on the date of grant and expired on December 31, 2006. During 2006 and 2005, 2,000 and 800 options were exercised, respectively. At December 31, 2007 and 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. During 2005 1,100 options were exercised.

NOTE 2: SECURITIES

At December 31, 2007 all securities were classified as available-for-sale. During the fourth quarter of 2007, the Company decided to transfer the remaining securities in the held-to-maturity classification into the available-for-sale classification. The carrying value of the securities transferred to the available-for-sale classification were adjusted to market as prescribed in Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. This transfer consisted of two securities with a total carrying value of $424 thousand and resulted in the recording of net unrealized losses of approximately $4 thousand.

The fair value and amortized cost for securities available-for-sale at December 31, 2007, by contractual maturity are presented below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations without prepayment penalties.

	December 31, 2007							
						Gross Unrealized		
(Dollars in thousands)	1 year or less	1 to 5 years	5 to 10 years	After 10 years	Fair Value	Gains	Losses	Amortized cost
Available-for-sale:								
U.S. government agencies, excluding mortgage-backed securities	$ 6,475	20,100	27,314	54,372	108,261	951	54	107,364
State and political subdivisions	433	69	11,762	46,551	58,815	560	320	58,575
Corporate securities	—	2,528	1,011	9,320	12,859	56	118	12,921
Collateralized mortgage obligations	—	—	2,304	9,916	12,220	33	189	12,376
Mortgage-backed securities	—	12,942	20,588	92,688	126,218	189	1,770	127,799
Total available-for-sale	$ 6,908	35,639	62,979	212,847	318,373	1,789	2,451	319,035
Weighted average yield:								
U.S. government agencies, excluding mortgage-backed securities	3.74%	4.49%	5.26%	5.69%	5.24%			
State and political subdivisions	3.62%	7.64%	6.04%	6.10%	6.07%			
Corporate securities	—	6.75%	6.01%	6.72%	6.67%			
Collateralized mortgage obligations	—	—	4.04%	4.97%	4.79%			
Mortgage-backed securities	—	3.95%	3.67%	4.99%	4.67%			
Total available-for-sale	3.73%	4.46%	4.85%	5.49%	5.21%			

Securities with an aggregate fair value of $193.7 million and $190.8 million at December 31, 2007 and December 31, 2006, respectively, were pledged to secure public deposits, securities sold under agreements to repurchase, structured securities sold under agreements to repurchase, Federal Home Loan Bank ("FHLB") advances, and for other purposes required or permitted by law.

Yields related to tax-exempt securities are stated on a fully tax-equivalent basis using an income tax rate of 34%.

Gross gains realized on the sale of securities were $247 thousand, $261 thousand and $123 thousand for the years ended, December 31, 2007, 2006 and 2005 respectively. Gross losses realized on the sale of securities were $607 thousand, $251 thousand and $112 thousand for the years ended December 31, 2007, 2006 and 2005, respectively. In addition, the Company sold a privately-held investment in 2007 for a gain of $613 thousand.

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

	December 31, 2006							
						Gross Unrealized		
(Dollars in thousands)	1 year or less	1 to 5 years	5 to 10 years	After 10 years	Amortized cost	Gains	Losses	Fair value
Held-to-maturity:								
State and political subdivisions	$ —	—	—	340	340	—	—	340
Mortgage-backed securities	10	59	27	77	173	1	—	174
Total held-to-maturity	$ 10	59	27	417	513	1	—	514
Weighted average yield:								
State and political subdivisions	—	—	—	3.69%	3.69%			
Mortgage-backed securities	7.86%	7.03%	7.19%	5.91%	6.60%			
Total held-to-maturity	7.86%	7.03%	7.19%	4.10%	4.67%			

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

	December 31, 2006							
						Gross Unrealized		
(Dollars in thousands)	1 year or less	1 to 5 years	5 to 10 years	After 10 years	Fair Value	Gains	Losses	Amortized cost
Available-for-sale:								
U.S. government agencies, excluding mortgage-backed securities	$ —	43,412	37,409	19,287	100,108	194	809	100,723
State and political subdivisions	—	511	3,362	45,645	49,518	655	69	48,932
Corporate securities	—	—	3,449	7,137	10,586	51	170	10,705
Collateralized mortgage obligations	—	—	1,518	13,195	14,713	34	300	14,979
Mortgage-backed securities	—	16,701	35,320	74,478	126,499	204	3,682	129,977
Total available-for-sale	$ —	60,624	81,058	159,742	301,424	1,138	5,030	305,316
Weighted average yield:								
U.S. government agencies, excluding mortgage-backed securities	—	3.98%	4.92%	7.19%	4.94%			
State and political subdivisions	—	—	4.19%	6.05%	6.04%			
Corporate securities	—	—	6.53%	7.15%	6.95%			
Collateralized mortgage obligations	—	—	3.88%	4.87%	4.77%			
Mortgage-backed securities	—	3.68%	3.66%	4.82%	4.34%			
Total available-for-sale	—	3.86%	4.39%	5.57%	4.93%			

On a quarterly basis, the Company makes an assessment to determine whether there have been events or economic circumstances to indicate that a security on which there is an unrealized loss is other-than-temporarily impaired. The Company considers many factors including the severity and duration of the impairment; the intent and ability of the Company to hold the security for a period of time sufficient for a recovery in value; recent events specific to the issuer or industry; external credit ratings and recent downgrades. Securities on which there is an unrealized loss that is deemed to be other-than-temporary are written down to fair value with the write-down recorded as a realized loss in securities gains (losses).

Gross unrealized losses on securities at December 31, 2007 were primarily attributable to interest rate changes. The Company has reviewed these securities and does not consider them other-than-temporarily impaired. The composition of securities with an unrealized loss position at December 31, 2007 and 2006 is shown below including the securities with an unrealized loss of less than twelve months and twelve months or longer.

	Less than 12 months		12 months or longer		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2007:						
U.S. government agencies, excluding mortgage- backed securities	$16,939	5	14,436	49	31,375	54
State and political subdivisions	11,737	221	5,098	99	16,835	320
Corporate securities	3,396	118	—	—	3,396	118
Collateralized mortgage obligations	—	—	8,311	189	8,311	189
Mortgage-backed securities	9,907	37	80,103	1,733	90,010	1,770
Total	$41,979	381	107,948	2,070	149,927	2,451

	Less than 12 months		12 months or longer		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2006:						
U.S. government agencies, excluding mortgage- backed securities	$24,378	38	48,749	771	73,127	809
State and political subdivisions	5,646	51	902	18	6,548	69
Corporate securities	5,107	143	981	27	6,088	170
Collateralized mortgage obligations	—	—	10,110	300	10,110	300
Mortgage-backed securities	—	—	108,082	3,682	108,082	3,682
Total	$35,131	232	168,824	4,798	203,955	5,030

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 $4.9 million and $5.4 million at December 31, 2007 and 2006, respectively.

NOTE 3: LOANS, NET OF UNEARNED INCOME

(Dollars in thousands)	December 31 2007	2006
Commercial, financial, and agricultural	**$ 62,478**	52,923
Leases—commercial	**486**	761
Real estate—construction:		
Commercial	**7,901**	4,684
Residential	**11,370**	9,912
Real estate—mortgage:		
Commercial	**161,703**	142,092
Residential	**67,246**	62,596
Consumer installment	**11,539**	9,349
Total loans	**322,723**	282,317
Less: Unearned income	**(312)**	(334)
Loans, net of unearned income	**$322,411**	281,983

During 2007 and 2006, 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, 2007 and 2006 amounted to $8.9 million and $7.1 million, respectively. The change from 2006 to 2007 reflects payments of $6.9 million and advances of $8.7 million. 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.

At December 31, 2007 and 2006, nonaccrual loans amounted to $447 thousand and $72 thousand, respectively. For the years ended December 31, 2007, 2006, and 2005, gross interest income of $15 thousand, $4 thousand, and $36 thousand, respectively, would have been recorded if all nonaccrual loans had been performing in accordance with their original terms and if they had been outstanding throughout the entire period, or since origination held for part of the period.

At December 31, 2007 and 2006, the Company had no impaired loans. For the years ended December 31, 2007 and 2006, there was no average recorded investment in impaired loans. For the year ended December 31, 2005, the average recorded investment in impaired loans was $86 thousand. The Company did not recognize any interest income on impaired loans for the years ended December 31, 2007, 2006, and 2005.

NOTE 4: ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses for the years ended December 31, 2007, 2006 and 2005, is presented below.

(Dollars in thousands)	Years ended December 31 2007	2006	2005
Balance at beginning of period	**$4,044**	3,843	3,456
Charge-offs	**(250)**	(189)	(356)
Recoveries	**288**	60	258
Net (charge-offs) recoveries	**38**	(129)	(98)
Provision for loan losses	**23**	330	485
Ending balance	**$4,105**	4,044	3,843

NOTE 5: PREMISES AND EQUIPMENT

Premises and equipment at December 31, 2007 and 2006 is presented below.

	December 31	
(Dollars in thousands)	**2007**	**2006**
Land	**$ 3,075**	2,605
Buildings	**6,109**	5,941
Furniture, fixtures, and equipment	**3,699**	3,401
Total premises and equipment	**12,883**	11,947
Less: Accumulated depreciation	**(6,460)**	(6,151)
Premises and Equipment, net	**$ 6,423**	5,796

NOTE 6: DEPOSITS

At December 31, 2007 and 2006, the composition of total deposits is presented below.

	December 31	
(Dollars in thousands)	**2007**	**2006**
Non-interest bearing demand	**$ 70,241**	79,102
NOW	**53,557**	58,942
Money market	**119,198**	119,370
Savings	**18,271**	19,157
Certificates of deposit under $100,0000	**88,967**	82,790
Certificates of deposit and other time deposits of $100,000 or more	**142,351**	110,287
Total deposits	**$492,585**	469,648

At December 31, 2007, the scheduled maturities of certificates of deposit and other time deposits of $100,000 or more is presented below.

(Dollars in thousands)	**December 31, 2007**
2008	$ 102,933
2009	35,331
2010	1,173
2011	1,745
2012	1,169
2013 and after	—
Total CDs and other time deposits of $100,000 or more	$ 142,351

During 2007 and 2006, 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 for these persons at December 31, 2007 and 2006 amounted to $16.9 million and $14.1 million, respectively.

NOTE 7: SHORT-TERM BORROWINGS

(Dollars in thousands)	2007 Amount	2007 Rate	2006 Amount	2006 Rate	2005 Amount	2005 Rate
Federal funds purchased and securities sold under agreements to repurchase:						
As of December 31	$24,247	3.76%	$14,401	5.28%	$ 1,731	3.91%
Average during the year	11,536	4.73	6,817	4.77	2,502	3.18
Maximum outstanding at any month-end	24,247		14,401		4,078	
Other short-term borrowings:						
As of December 31	$ —	— %	$10,000	5.52%	$ —	— %
Average during the year	1,096	5.44	1,534	5.58	—	—
Maximum outstanding at any month-end	10,000		10,000		—	

Federal funds purchased represent unsecured overnight borrowings from other financial institutions by the Bank. The Bank had available federal fund lines totaling $44.0 million with $8.7 million outstanding at December 31, 2007.

Securities sold under agreements to repurchase represent short-term borrowings with maturities less than one year collateralized by a portion of the Company's securities portfolio. Securities with an aggregate carrying value of $16.4 million and $11.9 million at December 31, 2007 and 2006, respectively, were pledged to secure securities sold under agreements to repurchase.

Other short-term borrowings include FHLB advances with an original maturity of one year or less. FHLB advances are collateralized by securities from the Company's securities portfolio and a blanket lien on certain qualifying single-family loans held in the Company's loan portfolio. At December 31, 2007 there were no other short-term borrowings outstanding.

NOTE 8: LONG-TERM DEBT

At December 31, 2007 and 2006, the composition of long-term debt is presented below.

(Dollars in thousands)	2007 Amount	2007 Weighted Avg. Rate	2006 Amount	2006 Weighted Avg. Rate
FHLB advances:				
Fixed Rate, due 2008 to 2017	**$ 169**	**6.64%**	$10,187	5.40%
Convertible—LIBOR based, due 2008 to 2015	**83,000**	**4.10**	73,000	4.10
Total FHLB advances	**83,169**	**4.11**	83,187	4.26
Structured securities sold under agreements to repurchase	**25,000**	**4.08**	—	—
Subordinated debentures	**7,217**	**7.88**	7,217	8.38
Total long-term debt	**$ 115,386**	**4.34%**	$90,404	4.59%

Long-term debt consists of FHLB advances with original maturities greater than one year, structured securities sold under agreements to repurchase, and subordinated debentures related to trust preferred securities. At December 31, 2007 and 2006, respectively, the Bank had $83.2 million of long-term FHLB advances.

At December 31, 2007, the Bank had long-term debt in the form of structured securities sold under agreements to repurchases with maturities exceeding one year of $25.0 million. The long-term structured securities sold under agreements to repurchase are callable by the issuer and therefore could mature earlier than the stated maturity date. According to the contractual terms, $20.0 million is callable in 2008 and $5.0 million is callable in 2009. Securities with an aggregate carrying value of $29.9 million at December 31, 2007 were pledged to secure structured securities sold under agreements to repurchase.

The Company formed Auburn National Bancorporation Capital Trust I ("Trust"), a wholly-owned statutory business trust, in 2003. The Trust issued $7.0 million of trust preferred securities that were sold to third parties. The proceeds from the sale of the trust preferred securities were used to purchase subordinated debentures of $7.2 million from the Company, which are presented as long-term debt in the consolidated balance sheets and qualify for inclusion in Tier 1 capital for regulatory capital purposes, subject to certain limitations. The debentures mature on December 31, 2033 and may not be redeemed, except under limited circumstances, until December 31, 2008.

The following is a schedule of annual maturities of long-term debt:

(Dollars in thousands)	2008	2009	2010	2011	2012	Thereafter	Total
FHLB advances	$10,018	18	10,018	18	20,000	43,097	83,169
Structured securities sold under agreements to repurchase	—	—	—	5,000	5,000	15,000	25,000
Subordinated debentures	—	—	—	—	—	7,217	7,217
Total long-term debt	$10,018	18	10,018	5,018	25,000	65,314	115,386

NOTE 9: OTHER COMPREHENSIVE INCOME (LOSS)

Comprehensive income is defined as the change in equity from all transactions other than those with shareholders, and it includes net earnings and other comprehensive income (loss). Other comprehensive income (loss) for the years ended December 31, 2007, 2006, and 2005, is presented below.

(In thousands)	Pre-tax amount	Tax (expense) benefit	Net of tax amount
2007:			
Unrealized net holding gain on securities	**$ 3,483**	**(1,393)**	**2,090**
Reclassification adjustment for realized (gains) losses on securities	**(253)**	**101**	**(152)**
Other comprehensive income	**$ 3,230**	**(1,292)**	**1,938**
2006:			
Unrealized net holding gain on securities	$ 2,746	(1,098)	1,648
Net gain on cash flow hedge derivative	8	(3)	5
Reclassification adjustment for realized (gains) losses on securities	(10)	4	(6)
Other comprehensive income	$ 2,744	(1,097)	1,647
2005:			
Unrealized net holding loss on securities	(6,231)	2,492	(3,739)
Net gain on cash flow hedge derivative	208	(83)	125
Reclassification adjustment for realized (gains) losses on securities	(11)	4	(7)
Other comprehensive loss	$ (6,034)	2,413	(3,621)

NOTE 10: INCOME TAXES

The aggregate amount of income tax expense (benefit) included in the consolidated statements of earnings and in the consolidated statements of stockholders' equity for the years ended December 31, 2007, 2006, and 2005 is presented below.

(Dollars in thousands)	Years ended December 31 2007	2006	2005
Earnings from continuing operations	**$ 2,240**	2,312	2,209
Stockholders' equity, for accumulated other comprehensive income (loss)	**1,292**	1,097	(2,413)
Total	**$ 3,532**	3,409	(204)

For the years ended December 31, 2007, 2006, and 2005 the components of income tax expense from continuing operations are presented below.

(Dollars in thousands)	Years ended December 31 2007	2006	2005
Current income taxes:			
Federal	**$ 2,078**	2,305	3,409
State	**97**	396	440
Total current income taxes	**2,175**	2,701	3,849
Deferred income taxes:			
Federal	**(82)**	(343)	(1,481)
State	**147**	(46)	(159)
Total deferred income taxes	**65**	(389)	(1,640)
Total income taxes	**$ 2,240**	2,312	2,209

Total income tax expense differs from the amounts computed by applying the statutory federal income tax rate of 34% to earnings before income taxes. A reconciliation of the differences for the years ended December 31, 2007, 2006, and 2005, is presented below.

	2007		2006		2005	
(Dollars in thousands)	Amount	Percent of pre-tax earnings	Amount	Percent of pre-tax earnings	Amount	Percent of pre-tax earnings
Earnings before income taxes	**$ 9,158**		8,897		8,679	
Income taxes at statutory rate	**3,114**	**34.0%**	3,025	34.0	2,951	34.0
Tax-exempt interest	**(625)**	**(6.8)**	(594)	(6.7)	(582)	(6.7)
State income taxes, net of federal tax effect	**161**	**1.8**	231	2.6	185	2.1
Low-income housing credit	**(228)**	**(2.5)**	(228)	(2.6)	(228)	(2.6)
Bank owned life insurance	**(186)**	**(2.0)**	(152)	(1.7)	(156)	(0.0)
Other	**4**	**—**	30	0.3	39	0.4
Total income tax expense	**$ 2,240**	**24.5%**	2,312	26.0	2,209	25.5

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2007 and 2006 are presented below:

	December 31	
(Dollars in thousands)	**2007**	**2006**
Deferred tax assets:		
Allowance for loan losses	**$ 1,515**	1,557
Principal amortization of leases	**2,905**	2,804
Unrealized loss on securities	**265**	1,557
Other	**9**	152
Total deferred tax assets	**4,694**	6,070
Deferred tax liabilities:		
Depreciation	**2,740**	2,824
Discount accretion	**534**	401
FHLB stock dividends	**25**	28
Prepaid expenses	**92**	106
Deferred loan fees	**57**	84
Other	**91**	115
Total deferred tax liabilities	**3,539**	3,558
Net deferred tax asset	**$ 1,155**	2,512

The change in the net deferred tax asset (liability) for the years ended December 31, 2007, 2006, and 2005, is presented below.

	Years ended December 31		
(Dollars in thousands)	**2007**	**2006**	**2005**
Net deferred tax asset (liability):			
Balance, beginning of year	**$ 2,512**	3,220	(833)
Deferred tax (expense) benefit related to continuing operations	**(65)**	389	1,640
Stockholders’ equity, for accumulated other comprehensive income	**(1,292)**	(1,097)	2,413
Balance, end of year	**$ 1,155**	2,512	3,220

In assessing the realization 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.

In June 2006, the FASB issued FIN 48, which clarifies the accounting for uncertain income tax positions by providing guidance on recognition, derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted FIN 48 on January 1, 2007, and determined there was no need to make an adjustment to retained earnings upon adoption of this Interpretation. As of January 1, 2007, the Company had $658 thousand of unrecognized tax benefits related to state income tax matters. During the fourth quarter of 2007, the Company recognized previously unrecognized tax benefits upon settlement of an uncertain tax position related to state income taxes. As of December 31, 2007, the Company had no unrecognized tax benefits related to federal or state income tax matters. The Company does not anticipate any material increase or decrease in unrecognized tax benefits during 2008 relative to any tax positions taken prior to December 31, 2007.

A reconciliation of the change in unrecognized tax benefits from January 1, 2007, to December 31, 2007, is as follows:

(Dollars in thousands)	**2007**
Balance at beginning of year	$ 658
Increases (decreases) for tax positions relating to current period	49
Increases (decreases) for tax positions relating to prior periods	(378)
Decreases related to settlements with taxing authorities	(329)
Reductions related to lapse of statute of limitations	—
Balance at end of year	$ —

As of December 31, 2007, the Company has accrued no interest and no penalties related to uncertain tax positions. It is the Company's policy to recognize interest and penalties related to income tax matters in income tax expense.

The Company and its subsidiaries file a consolidated U.S. federal income tax return. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ending December 31, 2004 through 2007. Except for the tax positions covered by the tax settlement described above, the Company is currently open to audit by the state of Alabama for the years ended December 31, 2003, through 2007.

NOTE 11: EMPLOYEE BENEFIT PLAN

The Company has a 401(k) Plan that covers substantially all employees. Participants may contribute up to 10% of eligible compensation subject to certain limits based on federal tax laws. The Company's matching contributions to the Plan are determined by the board of directors. Participants become 20% vested in their accounts after two years of service and 100% vested after six years of service. Company matching contributions to the Plan were $109 thousand, $107 thousand, and $120 thousand for the years ended December 31, 2007, 2006, and 2005, respectively, and are included in salaries and benefits expense.

NOTE 12: DERIVATIVE INSTRUMENTS

Financial derivatives are reported at fair value in other assets or other liabilities. The accounting for changes in the fair value of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as hedges, the gain or loss is recognized in current earnings. Beginning in 2006, the Company entered into interest rate swaps ("swaps") to facilitate customer transactions and meet their financing needs. Upon entering into these instruments to meet customer needs, the Company enters into offsetting positions in order to minimize the risk to the Company. These swaps qualify as derivatives, but are not designated as hedging instruments.

Interest rate swap contracts involve the risk of dealing with counterparties and their ability to meet contractual terms. When the fair value of a derivative instrument contract is positive, this generally indicates that the counter party or customer owes the Company, and results in credit risk to the Company. When the fair value of a derivative instrument contract is negative, the Company owes the customer or counterparty and therefore, has no credit risk.

A summary of the Company's interest rate swaps is presented below.

	December 31, 2007	
(Dollars in thousands)	Notional Amount	Estimated fair value
Interest rate swap agreements:		
Pay fixed / receive variable swaps	$ 7,000	(625)
Pay variable / receive fixed swaps	7,000	625
Total	$ 14,000	—

In prior periods, the Company accounted for its only interest rate swap as a hedge of the cash flows on variable-rate money market accounts. The interest rate swap was sold in August 2006, before its scheduled maturity in July 2007. There was not any material hedge ineffectiveness from this cash flow hedge recognized in the statements of earnings for 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 consolidated financial statements.

NOTE 13: COMMITMENTS AND CONTINGENT LIABILITIES

Credit-Related Financial Instruments

The Company is party to credit related 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 commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance sheet instruments.

At December 31, 2007 and 2006, the following financial instruments were outstanding whose contract amount represents credit risk:

	December 31	
(Dollars in thousands)	2007	2006
Commitments to extend credit	**$ 54,460**	51,666
Standby letters of credit	**10,055**	10,612

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. The commitments for lines of credit may expire without being drawn upon. Therefore, total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management's credit evaluation of the customer.

Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates 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 in the amount of $87 thousand and $104 thousand at December 31, 2007 and 2006, respectively.

Other Commitments

Minimum lease payments under leases classified as operating leases due in each of the five years subsequent to December 31, 2007, are as follows: 2008, $221 thousand; 2009, $137 thousand; 2010, $110 thousand; 2011, $80 thousand; 2012, $38 thousand.

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 proceeding will not have a material adverse affect upon the financial position or results of operations of the Company and Bank.

NOTE 14: 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:

Cash and cash equivalents

Due to their short-term nature, the carrying amounts reported in the balance sheet are assumed to approximate fair value for these assets. For purposes of disclosure, cash equivalents include federal funds sold and other short-term investments.

Securities

The fair values of securities are based primarily upon quoted market prices. In some instances, for securities that are not widely traded, market quotes for comparable securities were used.

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.

Deposits

The fair values disclosed for demand deposits, such as interest and noninterest checking, NOW accounts, savings and certain types of money market accounts, are by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using discounted cash flows. The discount rates used are based on estimated market rates for deposits of similar remaining maturities.

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.

Long–term debt

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 related estimated fair value of the Company's financial instruments at December 31, 2007 and 2006 are presented below.

	2007		**2006**	
(Dollars in thousands)	**Carrying amount**	**Estimated fair value**	**Carrying amount**	**Estimated fair value**
Financial Assets:				
Cash and cash equivalents	**$ 13,498**	**$ 13,498**	$ 17,026	$ 17,026
Securities	**318,373**	**318,373**	301,937	301,938
Loans, net of allowance for loan losses (1)	**321,284**	**322,739**	281,048	278,616
Financial Liabilities:				
Deposits	**$ 492,585**	**$ 491,423**	$ 469,648	$ 447,256
Short-term borrowings	**24,247**	**24,247**	24,401	24,401
Long-term debt	**115,386**	**114,236**	90,404	88,343

(1) includes loans held for sale

NOTE 15: REGULATORY RESTRICTIONS AND CAPITAL RATIOS

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, 2007, that the Company and Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2007, the Bank is "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, 2007 and 2006 are presented below.

(Dollars in thousands)	Actual		Minimum for capital adequacy purposes		Minimum to be well capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At December 31, 2007:						
Leverage						
Auburn National Bancorporation	**$ 60,521**	**9.02%**	**$ 26,872**	**4.00%**	**N/A**	**N/A**
AuburnBank	**55,570**	**8.34**	**26,655**	**4.00**	**$ 33,318**	**5.00%**
Tier 1 Capital						
Auburn National Bancorporation	**$ 60,521**	**14.74%**	**$ 16,422**	**4.00%**	**N/A**	**N/A**
AuburnBank	**55,570**	**13.69**	**16,240**	**4.00**	**$ 24,360**	**6.00%**
Total Risk-Based Capital						
Auburn National Bancorporation	**$ 64,627**	**15.74%**	**$ 32,844**	**8.00%**	**N/A**	**N/A**
AuburnBank	**59,676**	**14.70**	**32,480**	**8.00**	**$ 40,600**	**10.00%**
At December 31, 2006:						
Leverage						
Auburn National Bancorporation	$ 57,868	9.22%	$ 25,102	4.00%	N/A	N/A
AuburnBank	53,024	8.51	24,936	4.00	$ 31,170	5.00%
Tier 1 Capital						
Auburn National Bancorporation	$ 57,868	15.59%	$ 14,850	4.00%	N/A	N/A
AuburnBank	53,024	14.44	14,684	4.00	$ 22,026	6.00%
Total Risk-Based Capital						
Auburn National Bancorporation	$ 61,912	16.68%	$ 29,700	8.00%	N/A	N/A
AuburnBank	57,068	15.55	29,368	8.00	$ 36,710	10.00%

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, 2007, the Bank could have declared additional dividends of approximately $6.1 million without prior approval of regulatory authorities. As a result of this limitation, approximately $44.3 million of the Company’s investment in the Bank was restricted from transfer in the form of dividends.

NOTE 16: AUBURN NATIONAL BANCORPORATION (PARENT COMPANY)

The Parent Company's condensed balance sheet and related condensed statements of earnings and cash flows are as follows:

CONDENSED BALANCE SHEETS

	December 31	
(Dollars in thousands)	2007	2006
Assets:		
Cash and due from banks	**$ 1,271**	1,321
Investment in bank subsidiary	**55,389**	50,896
Premises and Equipment	**4,103**	3,614
Other assets	**347**	438
Total assets	**$ 61,110**	56,269
Liabilities:		
Accrued expenses and other liabilities	**$ 875**	634
Long-term debt	**7,217**	7,217
Total liabilities	**8,092**	7,851
Stockholders' equity	**53,018**	48,418
Total liabilities and stockholders' equity	**$ 61,110**	56,269

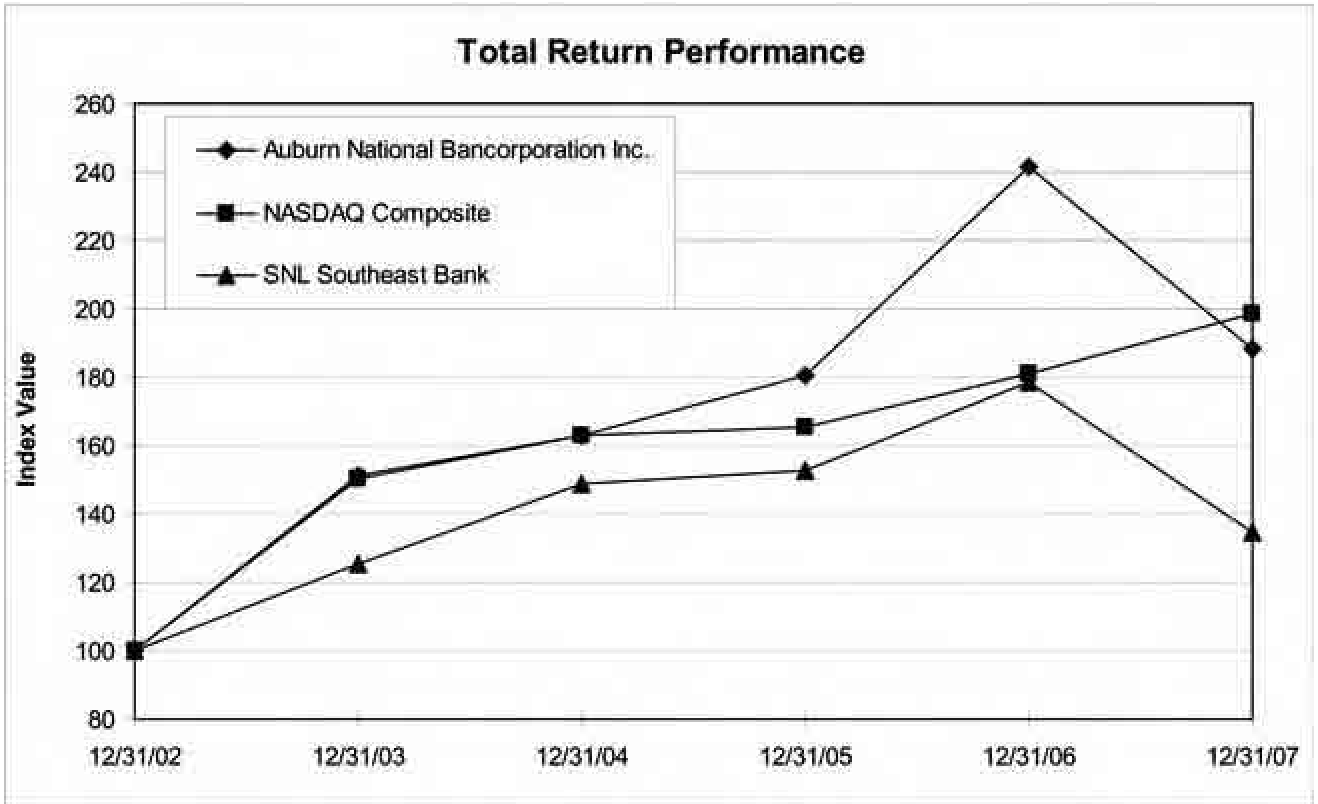
CONDENSED STATEMENTS OF EARNINGS

	Years ended December 31		
(Dollars in thousands)	2007	2006	2005
Income:			
Dividends from bank subsidiary	**$ 4,753**	6,934	3,199
Interest on bank deposits	**—**	—	9
Noninterest income	**463**	387	380
Total income	**5,216**	7,321	3,588
Expense:			
Interest	**583**	560	429
Non-interest	**494**	437	436
Total expense	**1,077**	997	865
Earnings before income tax benefit and equity in undistributed earnings of bank subsidiary	**4,139**	6,324	2,723
Income tax benefit	**(224)**	(234)	(182)
Earnings before equity in undistributed earnings bank subsidiary	**4,363**	6,558	2,905
Equity in undistributed earnings of bank subsidiary	**2,555**	27	3,565
Net Earnings	**$ 6,918**	6,585	6,470

CONDENSED STATEMENTS OF CASH FLOWS

(Dollars in thousands)	Years ended December 31 2007	2006	2005
Cash flows from operating activities:			
Net earnings	**$ 6,918**	6,585	6,470
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	**116**	114	109
Decrease (increase) in other assets	**91**	(8)	(204)
Increase in other liabilities	**241**	186	190
Equity in undistributed earnings of bank subsidiary	**(2,555)**	(27)	(3,565)
Net cash provided by operating activities	**4,811**	6,850	3,000
Cash flows from investing activities:			
Purchases of premises and equipment	**(605)**	(2,491)	(15)
Cash dividend to bank subsidiary	**—**	—	(1,000)
Net cash used by investing activities	**(605)**	(2,491)	(1,015)
Cash flows from financing activities:			
Stock repurchases	**(1,613)**	(1,378)	(1,202)
Proceeds from sale of treasury stock	**—**	27	23
Dividends paid	**(2,643)**	(2,417)	(2,220)
Net cash used in financing activities	**(4,256)**	(3,768)	(3,399)
Net change in cash and cash equivalents	**(50)**	591	(1,414)
Cash and cash equivalents at beginning of period	**1,321**	730	2,144
Cash and cash equivalents at end of period	**$ 1,271**	1,321	730

The following line-graph compares the cumulative, total return on the Company's Common Stock from December 31, 2002 to December 31, 2007, with that of the Nasdaq Composite Index and SNL Southeast Bank Index (assuming a $100 investment on December 31, 2002). Cumulative total return represents the change in stock price and the amount of dividends received over the indicated period, assuming the reinvestment of dividends.



	Period Ending					
Index	**12/31/02**	**12/31/03**	**12/31/04**	**12/31/05**	**12/31/06**	**12/31/07**
Auburn National Bancorporation Inc.	100.00	151.29	163.01	180.39	241.60	188.51
NASDAQ Composite	100.00	150.01	162.89	165.13	180.85	198.60
SNL Southeast Bank	100.00	125.58	148.92	152.44	178.75	134.65