SECURITIES AND EXCHANGE COMMISSION

FORM 10KSB40

Annual and transition reports of small business issuers [Section 13 or 15(d), S-B Item 405]

Filing Date: **1999-03-26** | Period of Report: **1998-12-31**
SEC Accession No. 0000950109-99-001048

(HTML Version on secdatabase.com)

FILER

AUBURN NATIONAL BANCORPORATION INC

CIK:**750574**| IRS No.: **630885779** | State of Incorp.:**DE** | Fiscal Year End: **1231**
Type: **10KSB40** | Act: **34** | File No.: **000-26486** | Film No.: **99573691**
SIC: **6022** State commercial banks

Mailing Address
100 NORTH GAY STREET
P O DRAWER 3110
AUBURN AL 36831

Business Address
100 N GAY ST
P O DRAWER 3110
AUBURN AL 36831-3110
3348219200

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB

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

For the Fiscal Year Ended December 31, 1998 Commission File No. 0-26486

Auburn National Bancorporation, Inc.
(Name of small business issuer in its charter)

Delaware	63-0885779
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

165 East Magnolia Avenue, Suite 203
Auburn, Alabama 36830
(334) 821-9200
(Address and telephone number of principal executive offices)

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

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

Securities registered pursuant to Section 12(g) of the Exchange Act:
Common Stock, Par Value, $.01 Per Share
(Title of class)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [x] No [ ]

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [x]

Issuer's revenues for its most recent fiscal year were $24,199,672.

The aggregate market value of the common stock held by non-affiliates of registrant as of February 26, 1999, computed by reference to the price at which the stock was sold as of such date, was $41,352,176.

As of February 26, 1999, there were issued and outstanding 3,924,573 shares of the registrant's $.01 par value common stock.

Transitional Small Business Disclosure Format: Yes [ ] No [x]

Documents Incorporated by Reference

Portions of the definitive proxy statement for the Annual Meeting of Shareholders to be held on May 11, 1999 are incorporated by reference into Part III.

PART I

SPECIAL CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

Certain of the matters discussed under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this Annual Report are forward-looking statements for purposes of the Securities Act of 1933, as amended (the "Securities Act") and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements to differ from those expressed or implied by such forward-looking statements. The Company's actual results may differ materially from the results anticipated in these forward-looking statements including those described under interest rate management, due to a variety of factors, including, without limitation: the effects of future economic conditions; governmental monetary and fiscal policies, as well as interest rate risks; the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

financial institutions operating in the Company's market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the Internet; and the failure of assumptions underlying the establishment of allowances for loan losses and estimations of values of collateral and various financial assets and liabilities. All forward-looking statements attributable to the Company are expressly qualified in their entirety by these Cautionary Statements.

ITEM 1. BUSINESS

Auburn National Bancorporation, Inc. ("the Company") is a bank holding company registered with the Board of Governors of the Federal Reserve System (the "Federal Reserve") under the Bank Holding Company Act of 1956, as amended (the "BHC Act"). The Company was incorporated in Delaware in 1990, and in 1994 it succeeded its Alabama predecessor as the bank holding company controlling AuburnBank, an Alabama state bank with its principal office in Auburn, Alabama (the "Bank"). The Company and its predecessor have controlled the Bank since 1984. As a bank holding company, the Company facilitates the Bank's ability to serve its customers' requirements for financial services. The holding company structure permits diversification by the Company into a broader range of financial services and other business activities than currently are permitted to the Bank under applicable law. The holding company structure also provides greater financial and operating flexibility than is presently permitted to the Bank.

The Bank has operated continuously since 1907 and conducts its business in East Alabama, including Lee County and surrounding areas. In April 1995, in order to gain flexibility and reduce certain regulatory burdens, the Bank converted from a national bank to an Alabama state bank that is a member of the Federal Reserve System (the "Charter Conversion"). Upon consummation of the Charter Conversion, the Bank's primary regulator changed from the Office of the Comptroller of the Currency (the "OCC") to the Federal Reserve and the Alabama Superintendent of Banks (the "Alabama Superintendent"). The Bank has been a member of the Federal Home Loan Bank of Atlanta (the "FHLB-Atlanta") since 1991.

General

The Company's business is conducted primarily through the Bank. The Bank's business consists of (i) accepting demand, savings, and time deposits; (ii) making loans to consumers, businesses, and other institutions; (iii) investments of money market instruments, U.S. government and agency obligations, and state, county, and

municipal bonds; and (iv) other financial services. Although it has no immediate plans to conduct any other business, the Company may engage directly or indirectly in a number of activities which the Federal Reserve has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

Services

The Bank offers checking, savings, negotiable order of withdrawal ("NOW") accounts, money market deposit accounts ("MMDAs") and certificates of deposit, and is an active residential mortgage lender in its primary service area ("PSA"). The Bank also offers commercial, financial, agricultural, real estate construction and consumer loan products. During 1995, the Bank sold its credit card portfolio and began providing credit cards, including MasterCard(R), MasterCard Gold, Visa(R), and Visa Gold through an agent bank arrangement with Columbus Bank & Trust Company in Columbus, Georgia. The Bank is one of the largest providers of automated teller services in East Alabama with 15 locations and was one of the nine original founders of Alabama Network, Inc. (Alert(R)), an Alabama ATM network that processes more than 18 million transactions annually. On January 1, 1997, Alert(R), Internet, Inc., and Southeast Switch, Inc. merged to become Honor Technologies, Inc. ("Honor"). Pursuant to such merger, the Company received an equity position in Honor equal to 0.3125% of combined total equity and a 30 month waiver of certain fees in Honor. The Bank's Tiger Teller ATM cards can be used internationally through the Cirrus(R) network. In 1998, the Bank began offering VISA Checkcards, which are debit cards with the VISA logo that work like checks but can be used anywhere VISA is accepted, including ATMs.

Competition

The banking business in Alabama, including Lee County, is highly competitive with respect to loans, deposits, and other services, and the area is dominated by a number of major banks and bank holding companies which have numerous offices and affiliates operating over wide geographic areas. The Bank competes for deposits, loans, and other business with these banks, as well as with credit unions, mortgage companies, insurance companies, and other local and

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

nonlocal financial institutions, including services offered through the mail, by telephone and over the Internet. Among the advantages that certain of these institutions have vis-a-vis the Bank are their ability to finance extensive advertising campaigns and to allocate and diversify their assets among loans and securities of the highest yield and in locations with the greatest demand.

Many of the major commercial banks operating in the Bank's service area, or their affiliates, offer services, such as international banking and investment services, which are not presently offered directly by the Bank. Such competitors, because of their greater capitalization, also have substantially higher lending limits than the Bank.

The Bank faces further competition for loans and deposits from a wide variety of local and nonlocal financial institutions. As more and different kinds of businesses enter the market for financial services, competition from nonbank financial intermediaries such as thrifts, credit unions, mortgage companies, insurance companies, and other financial institution intermediaries may be expected to intensify further. Community banks also have experienced significant competition for deposits from mutual funds, insurance companies, and other investment companies, and money center banks' offerings of high-yield investments and deposits. Certain of these competitors are not subject to the same regulatory restrictions as the Bank. In addition, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Interstate Banking Act"), effective on September 29, 1995, repealed the prior statutory restrictions on interstate acquisition of banks by bank holding companies, such that any bank holding company located outside Alabama may presently acquire any bank based in Alabama or any other state, regardless of state law to the contrary, subject to certain deposit-percentage, aging requirements, and other restrictions. Alabama has also opted in to the provisions of the Interstate Banking Act which now permit national and state-chartered banks to branch interstate through acquisitions of banks in other states. See "SUPERVISION AND REGULATION."

Selected Economic Data

The Bank's primary service area ("PSA") includes the cities of Auburn and Opelika, Alabama and nearby surrounding areas in East Alabama, primarily in Lee County. Lee County's population is approximately 98,000, which ranks it 11th in the state. The 1996 per capita income in Lee County was $17,236, which ranked it 32nd in the state. Unemployment has been relatively low in Lee County, and during 1998, the County had average unemployment of 2.2%, which is the 3rd lowest unemployment rate in Alabama.

Approximately 71% of the land in Lee County is devoted to agriculture, with 91% comprised of forests. An estimated 10% is urban or developed. Timber and timber products, greenhouses and horticulture, beef cattle, and cotton are the major agricultural products. Principal manufactured products in the Company's PSA include magnetic recording tapes, tires, textiles, small gasoline engines, and hardware. The largest employers in the area are Auburn University, East Alabama Medical Center, Quantegy Corporation, Uniroyal-Goodrich, West Point Stevens, and Briggs & Straton.

Loans and Loan Concentrations

The Bank makes loans for commercial, financial, and agricultural purposes, as well as for real estate mortgage, real estate construction, and consumer purposes. While there are certain risks unique to each type of lending, management believes that there is more risk associated with commercial, real estate construction, agricultural, and consumer lending than with real estate mortgage loans. To help manage these risks, the Bank has established underwriting standards, which are substantially similar for each type of loan, used in evaluating each extension of credit on an individual basis. These standards include a review of the economic conditions affecting the borrower, the borrower's financial strength and capacity to repay the debt, the underlying collateral, and the borrower's past credit performance. These standards are used to determine the creditworthiness of the borrower at the time a loan is made and are monitored periodically throughout the life of the loan.

The Bank has loans outstanding to borrowers in all industries within its PSA. Any adverse economic or other conditions affecting these industries would also likely have an adverse effect on the local workforce, other local businesses, and individuals in the community that have entered into loans with the Bank. However, management believes that due to the diversified mix of industries located within the Bank's PSA, adverse changes in one industry may not necessarily affect other area industries to the same degree or within the same time frame. Management realizes that the Bank's PSA is also subject to both local and national economic fluctuations.

Employees

At December 31, 1998, the Company had 2 full-time equivalent employees, both of which are officers, and the Bank had 106 full-time equivalent employees,

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

including 22 officers.

SUPERVISION AND REGULATION

Bank holding companies and banks are extensively regulated under federal and state law. This discussion is qualified in its entirety by reference to the particular statutory and regulatory provisions referred to below and is not intended to be an exhaustive description of the status or regulations applicable to the Company's and the Bank's business. Supervision, regulation, and examination of the Company and the Bank and their respective subsidiary by the bank regulatory agencies are intended primarily for the protection of depositors rather than holders of Company capital stock. Any change in applicable law or regulation may have a material effect on the Company's business.

Bank Holding Company Regulation

The Company, as a bank holding company, is subject to supervision and regulation by the Board of Governors of the Federal Reserve System ("Federal Reserve") under the BHC Act. The Company is required to file with the Federal Reserve periodic reports and such other information as the Federal Reserve may request. The Federal Reserve examines the Company, and may examine the Company's Subsidiary. The State of Alabama does not regulate bank holding companies.

The BHC Act requires prior Federal Reserve approval for, among other things, the acquisition by a bank holding company of direct or indirect ownership or control of more than 5% of the voting shares or substantially all the assets of any bank, or for a merger or consolidation of a bank holding company with another bank holding company. With certain exceptions, the BHC Act prohibits a bank holding company from acquiring direct or indirect ownership or control of voting shares of any company which is not a bank or bank holding company and from engaging directly or indirectly in any activity other than banking or managing or controlling banks or performing services for its authorized subsidiary. A bank holding company, may, however, engage in or acquire an interest in a company that engages in activities which the Federal Reserve has determined by regulation or order to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

The Company is a legal entity separate and distinct from the Bank and its other subsidiary. Various legal limitations restrict the Bank from lending or otherwise supplying funds to the Company or its non-bank subsidiary. The Company and the Bank are subject to Section 23A of the Federal Reserve Act. Section 23A defines "covered transactions", which include extensions of credit, and limits a bank's covered transactions with any affiliate to 10% of such bank's capital and surplus. All covered and exempt transactions between a bank and its affiliates must be on terms and conditions consistent with safe and sound banking practices, and banks and their subsidiary are prohibited from purchasing low-quality assets from the bank's affiliates. Finally, Section 23A requires that all of a bank's extensions of credit to an affiliate be appropriately secured by acceptable collateral, generally United States government or agency securities. The Company and the Bank also are subject to Section 23B of the Federal Reserve Act, which generally limits covered and other transactions among affiliates to terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to the bank or its subsidiary as prevailing at the time for transactions with unaffiliated companies.

The BHC Act, as amended by the Interstate Banking Act, repealed the prior statutory restrictions on interstate acquisitions of banks by bank holding companies, such that the Company and any other bank holding company located in Alabama may now acquire a bank located in any other state, and any bank holding company located outside Alabama may lawfully acquire any bank based in another state, regardless of state law to the contrary, in either case subject to certain deposit-percentage, age of bank charter requirements, and other restrictions. The Interstate Banking Act also generally provides that, after June 1, 1997, national and state-chartered banks may branch interstate through acquisitions of banks in other states. By adopting legislation prior to that date, a state has the ability to either "opt in" and accelerate the date after which interstate branching is permissible or "opt out" and prohibit interstate branching altogether. Alabama has adopted legislation opting into interstate branching, effective May 31, 1997. Alabama has also adopted legislation, which became effective on September 29, 1995, that allows Alabama banks to establish a branch in any other state, territory, or country in accordance with federal law or the law of such other state, territory, or country and upon prior approval of the Alabama Superintendent.

Federal Reserve policy requires a bank holding company to act as a source of financial strength and to take measures to preserve and protect bank subsidiary in situations where additional investments in a troubled bank may not otherwise be warranted. In addition, under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), where a bank holding company has more than one bank or thrift subsidiary, each of the bank holding company's subsidiary depository institutions are responsible for any losses to the Federal

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Corporation ("FDIC") as a result of an affiliated depository institution's failure. As a result, a bank holding company may be required to loan money to its subsidiary in the form of capital notes or other instruments which qualify as capital under regulatory rules. However, any loans from the holding company to such subsidiary banks likely will be unsecured and subordinated to such bank's depositors and perhaps to other creditors of the bank.

The Federal Reserve has amended its Regulation Y to implement certain provisions of The Economic Growth and Regulatory Paperwork Reduction Act of 1996 ("EGRPRA"). Among other things, these amendments to Federal Reserve Regulation Y reduced the notice and application requirements applicable to bank and nonbank acquisitions and de novo expansion by well-capitalized and well-managed bank holding companies; expanded the list of nonbanking activities permitted under Regulation Y; reduced certain limitations on previously permitted activities; and amended Federal Reserve anti-tying restrictions to allow banks greater flexibility to package products and services with their affiliates.

Bank and Bank Subsidiary Regulation Generally

The Bank is subject to supervision, regulation, and examination by the Federal Reserve and the Alabama Superintendent which monitors all areas of the operations of the Bank, including reserves, loans, mortgages, issuances of securities, payment of dividends, establishment of branches, capital adequacy, and compliance with laws. The Bank is a member of the FDIC and, as such, its deposits are insured by the FDIC to the maximum extent provided by law. See "FDIC Insurance Assessments".

The powers of Alabama chartered banks include certain provisions designed to provide such banks with competitive equality to the powers of national banks regulated by the Office of the Comptroller of the Currency ("OCC").

In December 1996, the Federal Reserve adopted the Federal Financial Institutions Examination Council's ("FFIEC") updated statement of policy entitled "Uniform Financial Institutions Rating System" ("UFIRS"), effective January 1, 1997. UFIRS is an internal rating system used by the federal and state regulators for assessing the soundness of financial institutions on a uniform basis and for identifying those institutions requiring special supervisory attention. Under the previous UFIRS, each financial institution was assigned a confidential composite rating based on an evaluation and rating of five essential components of an institution's financial condition and operations including Capital adequacy, Asset quality, Management, Earnings, and Liquidity. The major changes include an increased emphasis on the quality of risk management practices and the addition of a sixth component for Sensitivity to market risk. For most institutions, the FFIEC has indicated that market risk primarily reflects exposures to changes in interest rates. When regulators evaluate this component, consideration is expected to be given to: management's ability to identify, measure, monitor, and control market risk; the institution's size; the nature and complexity of its activities and its risk profile, and the adequacy of its capital and earnings in relation to its level of market risk exposure. Market risk is rated based upon, but not limited to, an assessment of the sensitivity of the financial institution's earnings or the economic value of its capital to adverse changes in interest rates, foreign exchange rates, commodity prices, or equity prices; management's ability to identify, measure, monitor and control exposure to market risk; and the nature and complexity of interest rate risk exposure arising from nontrading positions.

Community Reinvestment Act

The Company and the Bank are subject to the provisions of the Community Reinvestment Act of 1977, as amended (the "CRA"), and the federal banking agencies' regulations thereunder. Under the CRA, all banks and thrifts have a continuing and affirmative obligation, consistent with their safe and sound operation to help meet the credit needs for their entire communities, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions, nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community,

consistent with the CRA. The CRA requires a depository institution's primary federal regulator, in connection with its examination of the institution, to assess the institution's record of assessing and meeting the credit needs of the community served by that institution, including low- and moderate-income neighborhoods. The regulatory agency's assessment of the institution's record is made available to the public. Further, such assessment is required of any institution which has applied to: (i) charter a national bank; (ii) obtain deposit insurance coverage for a newly-chartered institution; (iii) establish a new branch office that accepts deposits; (iv) relocate an office; or (v) merge

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

or consolidate with, or acquire the assets or assume the liabilities of, a federally regulated financial institution. In the case of a bank holding company applying for approval to acquire a bank or other bank holding company, the Federal Reserve will assess the records of each subsidiary depository institution of the applicant bank holding company, and such records may be the basis for denying the application. A less than satisfactory CRA rating will slow, if not preclude expansion of banking activities.

Current CRA regulations rate institutions based on their actual performance in meeting community credit needs. CRA performance is evaluated by the Federal Reserve, the Bank's primary federal regulator using a lending test, an investment test, and a service test. The Federal Reserve also will consider: (i) demographic data about the community; (ii) the institution's capacity and constraints; (iii) the institution's product offerings and business strategy; and (iv) data on the prior performance of the institution and similarly-situated lenders.

The Bank is also subject to, among other things, the provisions of the Equal Credit Opportunity Act (the "ECOA") and the Fair Housing Act (the "FHA"), both of which prohibit discrimination based on race or color, religion, national origin, sex, and familial status in any aspect of a consumer or commercial credit or residential real estate transaction. The Department of Housing and Urban Development, the Department of Justice (the "DJ"), and the federal banking agencies in April 1994 issued an Interagency Policy Statement on Discrimination in Lending in order to provide guidance to financial institutions in determining whether discrimination exists, how the agencies will respond to lending discrimination, and what steps lenders might take to prevent discriminatory lending practices. The DJ has also increased its efforts to prosecute what it regards as violations of the ECOA and FHA.

Payment of Dividends

The Company is a legal entity separate and distinct from its subsidiary. The prior approval of the Federal Reserve and/or the Alabama Superintendent is required if the total of all dividends declared by a state member bank (such as the Bank) in any calendar year will exceed the sum of such bank's net profits for the year and its retained net profits for the preceding two calendar years, less any required transfers to surplus. Federal law also prohibits any state member from paying dividends that would be greater than such bank's undivided profits after deducting statutory bad debt in excess of such bank's allowance for loan losses. During 1998, the Bank paid cash dividends of $385,000 to the Company.

In addition, the Company and the Bank are subject to various general regulatory policies and requirements relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The appropriate federal regulatory and state authorities are authorized to determine, under certain circumstances relating to the financial condition of a state member bank or a bank holding company, that the payment of dividends would be an unsafe or unsound practice and to prohibit payment thereof. The Federal Reserve and the Alabama Superintendent have indicated that paying dividends that deplete a state member bank's capital base to an inadequate level would be an unsound and unsafe banking practice. The Federal Reserve and the Alabama Superintendent have indicated that financial depository institutions should generally pay dividends only out of current operating earnings.

Capital

The Federal Reserve has risk-based capital guidelines for bank holding companies and state member banks, respectively. These guidelines require a minimum ratio of capital to risk-weighted assets (including certain off-

balance-sheet activities, such as standby letters of credit) of 8%. At least half of the total capital must consist of common equity, retained earnings and a limited amount of qualifying preferred stock, less goodwill and certain core deposit intangibles ("Tier 1 capital"). The remainder may consist of non-qualifying preferred stock, qualifying subordinated, perpetual, and/or mandatory convertible debt, term subordinated debt and intermediate term preferred stock, up to 45% of pretax unrealized holding gains on available for sale equity securities with readily determinable market values that are prudently valued, and a limited amount of any loan loss allowance ("Tier 2 capital" and, together with Tier 1 capital, "Total Capital").

In addition, the federal regulatory agencies have established minimum leverage ratio guidelines for bank holding companies and state member banks, which provide for a minimum leverage ratio of Tier 1 capital to adjusted average quarterly assets ("leverage ratio") equal to 3%, plus an additional cushion of 1.0% - 2.0%, if the institution has less than the highest regulatory rating. The guidelines also provide that institutions experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

assets. Higher capital may be required in individual cases, and depending upon a bank holding company's risk profile. All bank holding companies and banks are expected to hold capital commensurate with the level and nature of their risks including the volume and severity of their problem loans. Lastly, the Federal Reserve's guidelines indicate that the Federal Reserve will continue to consider a "tangible Tier 1 leverage ratio" (deducting all intangibles) in evaluating proposals for expansion or new activity. The Federal Reserve has not advised the Company or the Bank of any specific minimum leverage ratio or tangible Tier 1 leverage ratio applicable to them.

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), among other things, requires the federal banking agencies to take "prompt corrective action" regarding depository institutions that do not meet minimum capital requirements. FDICIA establishes five capital tiers: "well capitalized", "adequately capitalized", "undercapitalized", "significantly undercapitalized", and "critically undercapitalized". A depository institution's capital tier will depend upon how its capital levels compare to various relevant capital measures and certain other factors, as established by regulation.

All of the federal banking agencies have adopted regulations establishing relevant capital measures and relevant capital levels. The relevant capital measures are the Total Capital ratio, Tier 1 capital ratio, and the leverage ratio. Under the regulations, a state member bank will be (i) well capitalized if it has a Total Capital ratio of 10% or greater, a Tier 1 capital ratio of 6% or greater, and is not subject to any written agreement, order, capital directive, or prompt corrective action directive by a federal bank regulatory agency to meet and maintain a specific capital level for any capital measure, (ii) adequately capitalized if it has a Total Capital ratio of 8% or greater, a Tier 1 capital ratio of 4% or greater, and a leverage ratio of 4% or greater (3% in certain circumstances), (iii) undercapitalized if it has a Total Capital ratio of less than 8%, a Tier 1 capital ratio of less than 4% (3% in certain circumstances), or (iv) critically undercapitalized if its tangible equity is equal to or less than 2% of average quarterly tangible assets.

As of December 31, 1998, the consolidated capital ratios of the Company and the Bank were as follows:

	Regulatory Minimum	Company	Bank
Tier 1 risk-based capital ratio	4.0%	13.33%	12.33%
Total risk-based capital ratio	8.0%	14.58%	13.58%
Tier 1 leverage ratio	3.0-5.0%	9.29%	8.57%

FDICIA generally prohibits a depository institution from making any capital distribution (including payment of a dividend) or paying any management fee to its holding company if the depository institution would

thereafter be undercapitalized. Undercapitalized depository institutions are subject to growth limitations and are required to submit a capital restoration plan for approval. For a capital restoration plan to be acceptable, the depository institution's parent holding company must guarantee that the institution comply with such capital restoration plan. The aggregate liability of the parent holding company is limited to the lesser of 5% of the depository institution's total assets at the time it became undercapitalized and the amount necessary to bring the institution into compliance with applicable capital standards. If a depository institution fails to submit an acceptable plan, it is treated as if it is significantly undercapitalized. If the controlling holding company fails to fulfill its obligations under FDICIA and files (or has filed against it) a petition under the federal Bankruptcy Code, the claim would be entitled to a priority in such bankruptcy proceeding over third party creditors of the bank holding company. Significantly undercapitalized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. Critically undercapitalized institutions are subject to the appointment of a receiver or conservator. Because the Company and the Bank exceed applicable capital requirements, the respective managements of the Company and the Bank do not believe that the provisions of FDICIA have had any material impact on the Company and the Bank or their respective operations.

FDICIA

FDICIA directs that each federal banking regulatory agency prescribe standards for depository institutions and depository institution holding companies relating to internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth compensation, a maximum ratio of classified assets to capital, minimum earnings sufficient to absorb losses, a minimum ratio of market value to book value for publicly traded shares, and such other standards as the federal regulatory agencies deem appropriate.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

FDICIA also contains a variety of other provisions that may affect the operations of the Company and the Bank, including new reporting requirements, regulatory standards for real estate lending, "truth in savings" provisions, the requirement that a depository institution give 90 days prior notice to customers and regulatory authorities before closing any branch, and a prohibition on the acceptance or renewal of brokered deposits by depository institutions that are not well capitalized or are adequately capitalized and have not received a waiver from the FDIC.

Enforcement Policies and Actions

The Federal Reserve and the FDIC monitor compliance with laws and regulations. Violations of laws and regulations, or other unsafe and unsound practices, may result in these agencies imposing fines or penalties, cease and desist orders, or taking other enforcement actions. Under certain circumstances, these agencies may enforce these remedies directly against officers, directors, employees and others participating in the affairs of a bank or bank holding company.

Depositor Preference

The Omnibus Budget Reconciliation Act of 1993 provides that deposits and certain claims for administrative expenses and employee compensation against an insured depository institution would be afforded a priority over other general unsecured claims against such an institution in the "liquidation or other resolution" of such an institution by any receiver.

Fiscal and Monetary Policy

Banking is a business which depends on interest rate differentials. In general, the difference between the interest paid by a bank on its deposits and its other borrowings, and the interest received by a bank on its loans and

securities holdings, constitutes the major portion of a bank's earnings. Thus, the earnings and growth of the Company and the Bank are subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve. The Federal Reserve regulates the supply of money through various means, including open market dealings in United States government securities, the discount rate at which banks may borrow from the Federal Reserve, and the reserve requirements on deposits. The nature and timing of any changes in such policies and their effect on the Company and the Bank cannot be predicted.

FDIC Insurance Assessments

The Bank is subject to FDIC deposit insurance assessments. The Bank's deposits are insured by the FDIC's Bank Insurance Fund ("BIF"), and it has no deposit insured by the Savings Association Insurance Fund ("SAIF"). Prior to January 1, 1996, the annual premiums ranged from $.04 to $.31 for every $100 of BIF deposits. In 1996, the FDIC adopted a new risk-based premium schedule which decreased the assessment rates for BIF depository institutions. Under this schedule, which took effect for assessment periods beginning January 1, 1996, the annual premiums range from zero to $.27 for every $100 of deposits. In addition, the FDIC Board eliminated the $2,000 minimum annual assessment previously imposed on all insured institutions. The Deposit Insurance Funds Act of 1996 (the "Funds Act") authorized FICO to levy assessments on BIF-assessable deposits at a rate equal to one-fifth of the FICO assessment rate that is applied to deposits assessable by SAIF. The actual FICO 1998 annual assessment rates on deposits were approximately 1.2 basis points for BIF-assessable deposits.

Each financial institution is assigned to one of three capital groups - well capitalized, adequately capitalized or undercapitalized - and further assigned to one of three subgroups within a capital group, on the basis of supervisory evaluations by the institution's primary federal and, if applicable, state regulators and other information relevant to the institution's financial condition and the risk posed to the applicable insurance fund. For the years 1996 and before the actual assessment rate applicable to a particular institution will, therefore, depend in part upon the risk assessment classification so assigned to the institution by the FDIC. During the years ended December 31, 1998, 1997 and 1996 the Bank paid $0, $0 and $2,000, respectively, in BIF deposit insurance premiums, and paid approximately $27,000 and $26,000 in FICO assessments during 1998 and 1997, respectively.

Legislative and Regulatory Changes

Various changes have been proposed with respect to restructuring and changing the regulation of the financial services industry. FIRREA required a study of the deposit insurance system. On February 5, 1991, the Department of

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

the Treasury released "Modernizing the Financial System; Recommendations for Safer, More Competitive Banks". Among other matters, this study analyzed and made recommendations regarding reduced bank competitiveness and financial strength, overextension of deposit insurance, the fragmented regulatory system and the under- capitalized deposit insurance fund. It proposed restoring competitiveness by allowing banking organizations to participate in a full range of financial services outside of insured commercial banks. Deposit insurance coverage would be narrowed to promote market discipline.

The Interstate Banking Act also directed the Secretary of the Treasury to take a broad look at the strengths and weaknesses of the United States' financial services system. In June 1997, the Treasury Department proposed legislation to eliminate what it deemed outmoded barriers to competition among financial services providers. On November 17, 1997, the United States Department of the Treasury released its study "American Finance for the 21st Century" which considered changes in the financial services industry during the next 10 years and beyond and reviewed the adequacy of existing statutes and legislation.

Other legislative and regulatory proposals regarding changes in banking, and the regulation of banks, thrifts and other financial institutions and bank and bank holding company powers are being considered by the

executive branch of the Federal government, Congress and various state governments. Among other items under consideration are the possible combination of the BIF and SAIF, changes in or repeal of the Glass-Steagall Act which separates commercial banking from investment banking, and changes in the BHC Act to broaden the powers of "financial services" companies to own and control depository institutions and engage in activities not closely related to banking. The FDIC is considering possibly adding risk measures in determining deposit insurance assessments. Certain of these proposals, if adopted, could significantly change the regulation of banks and the financial services industry. It cannot be predicted whether any of these proposals will be adopted, and, if adopted, how these proposals will affect the Company and the Bank.

ITEM 2. DESCRIPTION OF PROPERTY

The Bank conducts its business from its main office and four branches. The main office is located in the center of Auburn, Alabama, in a 16,150 square foot building that is owned by the Bank. The original building was constructed in 1964, and an addition was completed in 1981. Portions of the building have been renovated within the last five years in order to accommodate growth and changes in the Bank's operational structure and to adapt to technological changes. The main office building is surrounded on two sides by paved areas that provide parking for 84 vehicles, including four handicapped spaces.

The Bank's Kroger branch is located in the Kroger supermarket in the Corner Village Shopping Center in Auburn, Alabama. On September 15, 1987, the Bank entered into a 15-year lease agreement for approximately 300 square feet of space in the supermarket. This branch offers the full line of the Bank's services, with the exception of loans and safe deposit boxes.

The Opelika branch is located in Opelika, Alabama, in a 4,000 square foot building. This branch is owned by the Bank and was built in 1991. This branch offers the full line of the Bank's services and has drive-through windows and an ATM. This branch offers parking for approximately 36 vehicles, including two handicapped spaces.

The Bank's Winn-Dixie branch opened April 3, 1997, at the Winn Dixie supermarket in the Tiger Crossing Shopping Center on the south side of Auburn, Alabama. The Bank has a five year lease agreement for approximately 350 square feet of space in the supermarket. This branch offers the full line of the Bank's deposit and other services, except loans and safe deposit boxes.

The Bank's Wal-Mart branch was opened August 19, 1998 in the Wal-Mart shopping center in Phenix City, Alabama, about 20 miles south of Auburn, Alabama. The Bank has a five year lease agreement for approximately 600 square feet of space in the Wal-Mart. This branch offers the full line of the Bank's deposit and other services, except loans and safe deposit boxes.

The Bank owns a drive-in facility located directly across the street from its main office. This drive-in facility was constructed in 1979 and has five drive-through lanes and a walk-up window.

In addition, the Bank leases from the Company approximately 8,300 square feet of space in the AuburnBank Center (the "Center"), which is located next to the main office. This building, which has approximately 18,000 square feet of space, is also leased to outside third parties. Leases between the Bank and the Company are based on the same terms and conditions as leases to outside third parties leasing space in the same building. The Bank's data processing activities, as well as other operations, are located in this leased space. The parking lot provides parking for approximately 120 vehicles, including handicapped parking.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Directly behind the Center is an older home that is also owned by the Company. This building is rented as housing to university students. The rear portion of this property is used as a parking area for approximately 20 vehicles of Bank employees.

The Bank also owns a two-story building located directly behind the main office. The first floor of this building is leased to unaffiliated third parties.

The Company owns a commercial office building (the "Hudson Building") located across the street from the main office in downtown Auburn. The Hudson Building has two floors and a basement which contain approximately 14,395 square feet of leasable space. Approximately 73.2% of this building is available for rent by third-party tenants. The Bank occupies approximately 3,900 square feet, which includes a portion of the basement level used for storage and office space used to house certain bank functions. The Bank pays rent to the Company based on current market rates for such space.

In 1994, the Bank acquired a piece of commercial real estate located in Auburn on U.S. Highway 29. This property, which was acquired in satisfaction of debt previously contracted, was formerly used by a floor covering business and contained approximately 6,045 square feet of office, showroom, and warehouse space. The Bank subsequently removed an underground storage tank ("UST") containing petroleum products from the site. In March 1995, the Alabama Department of Environmental Management ("ADEM") requested that the Bank submit a Secondary Investigation Plan ("Secondary Investigation") as a result of underground soil and water contamination of petroleum-based hydrocarbon products. The Secondary Investigation was completed and submitted to ADEM by Roy R. Weston, Inc. ("Weston"), an independent consultant hired by the Bank. The Secondary Investigation indicated low concentrations of soil contamination on site and elevated concentrations of gasoline constituents both on-site and off-site. The Secondary Investigation indicated a low risk to human receptors, and Weston recommended to ADEM initiation of a quarterly ground water monitoring program for one year, at which time the program would be reassessed. In response to ADEM's Letter of Requirement dated January 18, 1996, Weston prepared and submitted, on behalf of the Bank, a Monitoring Only Corrective Action Plan on February 20, 1996. Quarterly groundwater monitoring will continue in 1999 as required by ADEM. Samples from the eight (8) existing monitoring wells will be collected and analyzed by Roy F. Weston, Inc. The monitoring data will be submitted by Weston to ADEM as required. It is estimated that the cost for monitoring and providing reporting data to ADEM for 1999 will be approximately $9,000 (unless the site is released by ADEM during the year). The extent and cost of any further testing and remediation, if any, cannot be predicted at this time.

ITEM 3. LEGAL PROCEEDINGS

In the normal course of its business, the Company and the Bank from time to time are involved in legal proceedings. The Company and Bank management believe there are no pending or threatened legal proceedings which upon resolution are expected to have a material adverse effect upon the Company's or the Bank's financial condition.

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

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 1998.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock is listed on the Nasdaq SmallCap Market, under the symbol AUBN. As of February 26, 1999, there were approximately 3,924,573 shares of the Company's Common Stock issued and outstanding, which were held by approximately 450 shareholders of record. The following table sets forth, for the indicated periods, the high and low closing sale prices for Company's Common Stock as reported on the Nasdaq SmallCap Market.

	Closing Price Per Share (1)(2)		Cash Dividends Declared (2)
	High	Low	
1998			
First Quarter	$ 19.67	$ 12.77	$ 0.04

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Second Quarter	24.00	18.17	0.05
Third Quarter	29.25	17.94	0.05
Fourth Quarter	17.50	15.88	0.05
1997			
First Quarter	9.17	7.83	0.04
Second Quarter	8.67	7.67	0.04
Third Quarter	9.83	7.83	0.04
Fourth Quarter	13.83	11.33	0.04

----

(1) The price information represents actual transactions.

(2) The price information for 1997 and the first quarter of 1998 is restated to reflect the Company's three for one stock split in the form of a dividend in June 1998.

On May 12, 1998, the Company's Board of Directors approved a three for one stock split effected in the form of a dividend payable on June 25, 1998 to shareholders of record on June 10, 1998. All share and per share information in the accompanying financial statements has been restated to reflect the effect of the additional shares outstanding resulting from the stock split. Common stock and surplus have been restated also to reflect the stock split retroactively.

The Company has paid cash dividends on its capital stock since 1985. Prior to this time, the Bank paid cash dividends since its organization in 1907, except during the Depression years of 1932 and 1933. Holders of Common Stock are entitled to receive such dividends as may be declared by the Company's Board of Directors. The amount and frequency of cash dividends will be determined through the judgment of the Company's Board of Directors based upon a number of factors, including the Company's earnings, financial condition, capital requirements, and other relevant factors. Company management presently intends to continue its present dividend policies.

The amount of dividends payable by the Bank is limited by law and regulation. The need to maintain adequate capital in the Bank also limits dividends that may be paid to the Company. Although Federal Reserve policy could restrict future dividends on Common Stock, such policy places no current restrictions on such dividends. See "SUPERVISION AND REGULATION -- DIVIDENDS" and "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS -- CAPITAL RESOURCES."

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis is designed to provide a better understanding of various factors related to the Company's results of operations and financial condition. Such discussion and analysis should be read in conjunction with "BUSINESS" and "FINANCIAL STATEMENTS AND RELATED NOTES."

The purpose of this discussion is to focus on significant changes in the financial condition and results of the operations of the Company during the three years ended December 31, 1998, 1997 and 1996. This discussion and analysis is intended to supplement and highlight information contained in the accompanying consolidated financial statements and the selected financial data presented elsewhere herein.

Summary

Net earnings increased $359,000 (11.7%) to $3,439,000 during 1998 from $3,080,000 for the year ended December 31, 1997. Basic income per share was $0.88 and $0.79 for 1998 and 1997, respectively, an increase of 11.4%. Comparatively, net earnings during 1997 increased $327,000 (11.9%) from the 1996 total of $2,753,000, while basic income per share showed a similar increase of $0.09 per share for 1997 from a 1996 per share total of $0.70. The increase in net earnings for 1998 is attributable to higher net interest income and higher noninterest income offset by higher noninterest expense for the year. The increase in 1997 was due to higher levels of net interest income offset by lower noninterest income and higher noninterest expense compared to 1996. See "FINANCIAL CONDITION -- CAPITAL RESOURCES" and the "CONSOLIDATED AVERAGE BALANCES, INTEREST INCOME/EXPENSE AND YIELDS/RATES" tables.

Total assets at December 31, 1998 and 1997 were $307,874,000 and $264,029,000, reflecting growth of $43,845,000 (16.6%). The Company's growth during 1998 resulted primarily from the growth in loans. Deposits grew $9,527,000 (4.3%) from $223,978,000 at year-end 1997 to $233,505,000 at year-end 1998. See "FINANCIAL CONDITION-DEPOSITS AND LOANS and LIQUIDITY."

Financial Condition

Investment Securities

Investment securities held to maturity were $8,094,000 and $14,364,000 at

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

December 31, 1998 and 1997, respectively. This decline of $6,270,000 (43.7%) in 1998 resulted entirely from scheduled paydowns, calls and maturities. The securities available for sale portfolio was $63,586,000 and $40,446,000 at December 31, 1998 and 1997, respectively. This increase of $23,140,000 (57.2%) reflects purchases in the fourth quarter for approximately $10,000,000 to pre-refund callable U.S. government agency securities which the Bank expects will be called in the first quarter of 1999. In addition, proceeds from held-to-maturity securities that were called or matured during 1998 were shifted by management to available for sale securities to maintain flexibility in its liquidity planning. See "-- LIQUIDITY."

The composition of the Company's total investment securities portfolio reflects the Company's investment strategy to provide acceptable levels of interest income from portfolio yields while maintaining an appropriate level of liquidity to assist with controlling the Company's interest rate position. In recent years, the Company has invested primarily in taxable securities due to its inability to fully realize the benefits of the preferential treatment afforded tax-exempt securities under the tax laws. Because of their liquidity, credit quality and yield characteristics, the majority of the purchases of taxable securities have been in investment grade mortgage-backed securities ("MBS") and collateralized mortgage obligations ("CMOs"). The yields, values, and durations of such MBS and CMOs generally vary with interest rates, prepayment levels, and general economic conditions, and as a result, the values of such instruments may be more volatile than other instruments with similar maturities. Such MBS and CMOs also may have longer stated maturities than other securities, which may result in further price volatility.

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

<TABLE>
<CAPTION>

	Amortized Cost December 31,		
	1998	1997	1996
	(In thousands)		
Investment Securities Held to Maturity:			
U.S. government agency	$ --	3,216	2,028
State and political subdivisions	1,585	1,479	1,470
Mortgage-backed securities	6,509	9,470	13,663
Collateralized mortgage obligations	--	199	535
Other	--	--	207
Total investment securities held to maturity	$ 8,094	14,364	17,903

</TABLE>

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

<TABLE>
<CAPTION>

	Cost and Unrealized Gain December 31,		
	1998	1997	1996
	(In thousands)		
Investment Securities Available for Sale:			
U.S. Government agency	17,340	12,097	17,873
State and political subdivisions	883	498	490
Mortgage-backed securities	17,711	7,990	363
Collateralized mortgage obligations	27,652	19,861	24,854
Mutual funds	--	--	447
Total investment securities available for sale	$ 63,586	40,446	44,027

</TABLE>

At December 31, 1998, the Bank owned CMOs with a total amortized cost of $27,525,000. All of the CMOs are rated AAA. The CMOs are all backed by federal agency guaranteed mortgages, except for 2 issues in the amount of $427,000 which are privately issued mortgage pass-through certificates. Fair values for the private placement CMOs were estimated based on fair values for similar instruments.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The MBS portfolio's total amortized cost of $24,140,000 at December 31, 1998, is a mixture of fixed rate mortgages, adjustable rate mortgages ("ARMs"), and securities with balloon payments. At the time of purchase, the Bank looks at various prepayment speeds and makes the purchase based on the ability to accept the yield and average life based on both increasing and decreasing prepayment speeds.

The following tables present the maturities and weighted average yields of investment securities at December 31, 1998:

<TABLE>
<CAPTION>

Maturities of Held-to-Maturity Investment Securities Amortized Cost

<S>	Within one year <C>	After one through five years <C>	After five through 10 years <C>	After 10 years <C>
	(In thousands)			
State and political subdivision securities	$ 595	200	365	425
Mortgage-backed securities	21	184	4,780	1,524
Total investment securities held to maturity	$ 616	384	5,145	1,949

</TABLE>

<TABLE>
<CAPTION>

Weighted Average Yields of Held-to-Maturity Investment Securities

<S>	Within one year <C>	After one through five years <C>	After five through 10 years <C>	After 10 years <C>
State and political subdivision securities (1)	6.91%	5.91%	5.30%	7.25%
Mortgage-backed securities	9.33%	6.84%	6.39%	6.87%
Total weighted average yield	7.00%	6.35%	6.31%	6.96%

</TABLE>

(1) Weighted average yields have not been computed on a tax-equivalent basis.

<TABLE>
<CAPTION>

Maturities of Available for Sale Investment Securities Amortized Cost

<S>	After one through five years <C>	After five through 10 years <C>	After 10 years <C>
	(In thousands)		
U.S. government agencies, excluding mortgage-backed securities	$ 9,985	7,041	--
State and political subdivision securities	--	848	--
Mortgage-backed securities	145	2,646	14,839
Collateralized mortgage obligations	--	555	26,970
Total investment securities available for sale	$ 10,130	11,090	41,809

</TABLE>

<TABLE>
<CAPTION>

Weighted Average Yields of Available for Sale Investment Securities

After one through	After five through	After

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

	five years	10 years	10 years
U.S. government agencies, excluding mortgage-backed securities	6.34%	6.04%	--
State and political subdivision securities (1)	--	4.67%	--
Mortgage-backed securities	6.79%	6.11%	6.01%
Collateralized mortgage obligations	--	8.66%	6.24%
Total weighted average yield	6.35%	6.08%	6.16%

(1) Weighted average yields have not been computed on a tax-equivalent basis.

Loans

Total loans, net of unearned income, were $218,687,000 at December 31, 1998, an increase of $33,194,000 (17.9%), over total loans, net of unearned income, of $185,493,000 at December 31, 1997. The primary growth during 1998 occurred in the real estate mortgage and commercial, financial and agricultural loan areas. The commercial, financial and agricultural portfolio increased $14,746,000 (31.8%) to $61,075,000 at December 31, 1998 compared to $46,329,000 at December 31, 1997. The increase was due primarily to increased demand for commercial credits. Commercial, financial and agricultural loans represented 27.9% and 25.0% of the total loans at December 31, 1998 and 1997, respectively.

The real estate mortgage loan component of the loan portfolio increased $11,622,000 (10.2%) to $125,448,000 at December 31, 1998, over the 1997 balance of $113,826,000 and represented 57.3% of the total loan portfolio at December 31, 1998, as compared to 61.3% at December 31, 1997. This growth in real estate mortgage loans was attributable to the increase in commercial real estate mortgages of $9,399,000 (18.2%) combined with an increase in residential real estate mortgage loans of $2,223,000 (3.6%), reflecting lower rates to borrowers and strong demand in the Bank's market for those products.

The respective increases in commercial real estate mortgage loans and commercial, financial and agricultural loans also reflects management's focus on balancing the composition of its loan portfolio by increasing the volume of loans in these categories.

In addition to originating mortgage loans for its own portfolio, the Company also originates residential mortgage loans which are sold in the secondary market. In addition to selling real estate mortgage loans to the Federal National Mortgage Association ("FNMA") with the Bank retaining the servicing, the Bank has arranged with one mortgage servicing company to originate and sell, without recourse, residential first mortgage real estate loans, with servicing released. During 1998, the Bank sold mortgage loans totaling approximately $24,662,000, to FNMA, with the Bank retaining the servicing, and sold mortgage loans, totaling approximately $5,899,000, to the mortgage servicing company, with servicing released. At December 31, 1998, the Bank was servicing loans totaling approximately $65,661,000. The Bank collects monthly servicing fees of 0.25% to 0.375% annually of the outstanding balances of loans serviced for FNMA. See "- EFFECTS OF INFLATION AND CHANGING PRICES."

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

Loan Portfolio Composition
December 31,

	1998	1997	1996	1995	1994
			(In thousands)		
Commercial, financial and agricultural	$ 61,075	46,329	39,213	35,800	32,443
Real estate - construction:					
Commercial	8,112	3,172	3,572	945	1,076
Residential	4,544	3,583	3,068	2,323	1,657
Real estate - mortgage:					
Commercial	61,113	51,714	42,827	33,593	33,517
Residential	64,335	62,112	58,530	54,384	50,677
Consumer installment	19,523	18,620	14,600	13,583	21,168
Total loans	$ 218,702	185,530	161,810	140,628	140,538
Less:					
Unearned income	(15)	(37)	(91)	(157)	(210)
Allowance for loan losses	(2,808)	(2,125)	(2,094)	(2,012)	(2,100)

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Loans, net	$ 215,879	183,368	159,625	138,459	138,228

</TABLE>

The following table presents maturities by major loan classifications and the sensitivity of loans to changes in interest rates within each maturity category at December 31, 1998:

<TABLE>
<CAPTION>

	Loan Portfolio Maturing			
	Within one year	After one through five years	After five years	Total
	(In thousands)			
Commercial, financial and agricultural	$ 37,702	18,373	5,000	61,075
Real estate - construction	10,729	1,927	--	12,656
Real estate - mortgage	14,211	14,248	96,989	125,448
Consumer installment	8,916	10,053	554	19,523
Total loans	71,558	44,601	102,543	218,702
Variable-rate loans	28,117	8,314	76,270	112,701
Fixed-rate loans	43,441	36,287	26,273	106,001
Total loans	$ 71,558	44,601	102,543	218,702

</TABLE>

Allowance for Loan Losses and Risk Elements

Interest on loans is normally accrued from the date an advance is made. The performance of loans is evaluated primarily on the basis of a review of each customer relationship over a period of time and the judgment of lending officers as to the ability of borrowers to meet the repayment terms of loans. If there is reasonable doubt as to the repayment of a loan in accordance with the agreed terms, the loan may be placed on a nonaccrual basis pending

the sale of any collateral or a determination as to whether sources of repayment exist. This action may be taken even though the financial condition of the borrower or the collateral may be sufficient ultimately to reduce or satisfy the obligation. Generally, when a loan is placed on a nonaccrual basis, all payments are applied to reduce principal to the extent necessary to eliminate doubt as to the repayment of the loan. Any interest income on a nonaccrual loan is recognized only on a cash basis.

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

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

The allowance for loan losses represents management's assessment of the risk associated with extending credit and its evaluation of the quality of the loan portfolio. Management analyzes the loan portfolio to determine the adequacy of the allowance for loan losses and the appropriate provision required to maintain a level considered adequate to absorb anticipated loan losses. In assessing the adequacy of the allowance, management reviews the size, quality and risk of loans in the portfolio. Management also considers such factors as the Bank's loan loss experience, the amount of past due and nonperforming loans, specific known risk, the status and amount of nonperforming assets, underlying collateral values securing loans, current and anticipated economic conditions

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

and other factors which affect the allowance for potential credit losses. An analysis of the credit quality of the loan portfolio and the adequacy of the allowance for loan losses is prepared by the Bank's Credit Administration area and presented to the Loan Committee on a quarterly basis. In addition, the Bank has engaged an outside loan review consultant, on a semi-annual basis, to perform an independent review of the quality of the loan portfolio and adequacy of the allowance.

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

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

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

<TABLE>
<CAPTION>

	Allowance for Loan Loss Activity for year ended December 31,				
	1998	1997	1996	1995	1994
			(In thousands)		
<S>	<C>	<C>	<C>	<C>	<C>
Balance at beginning of period	$ 2,125	2,094	2,012	2,100	2,264
Provision for loan losses	891	285	80	--	172
Charge-offs:					
Commercial, financial, and agricultural	42	146	64	43	90
Real estate	--	1	1	1	164
Consumer	272	173	108	113	183
Total charge-offs	314	320	173	157	437
Recoveries:					
Commercial, financial and agricultural	7	15	100	4	7
Real estate	2	3	5	28	34
Consumer	97	48	70	88	60
Total recoveries	106	66	175	120	101
Net charge-offs (recoveries)	208	254	(2)	37	336
Other adjustments (1)	--	--	--	(51)	--
Balance at end of period	$ 2,808	2,125	2,094	2,012	2,100
Ratio of allowance for loan losses to loans outstanding, net of unearned discount	1.28%	1.15%	1.29%	1.43%	1.50%
Ratio of allowance for loan losses to nonaccrual loans, renegotiated loans, and other nonperforming assets	61.14%	--	1,957.01%	1,468.61%	156.72%
Ratio of net charge-offs (recoveries) to average loans outstanding, net of unearned income	0.10%	0.15%	(0.001)%	0.03%	0.26%

</TABLE>

----

(1) In conjunction with the sale of its credit card portfolio in 1995, the Bank reversed the portion of the allowance for loan losses that had been maintained to absorb losses on credit card lines.

During 1998, the Company had loan charge-offs totaling $314,000 and recoveries of $106,000, as compared to $320,000 in charge-offs and recoveries of $66,000 in the prior year. Management believes that the $2,808,000 in allowance for loan losses at December 31, 1998, (1.28% of total outstanding loans, net of unearned income) is adequate to absorb known risks in the portfolio at such date. However, no assurance can be given that adverse economic circumstances

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

will not result in increased losses in the Bank's loan portfolio. The Bank does not currently allocate its allowance for loan losses among its various classifications of loans. The substantial decrease in the ratio of the allowance for loan and lease losses to nonperforming assets between year-end 1997 and year-end 1998 was primarily due to the placement in nonaccrual status of the impaired loan relationship discussed below. Management's assessment of the credit quality of the loan portfolio during 1998 indicated deterioration of a $4.098 million commercial credit such that management's estimate of the necessary level of the allowance increased. This entire credit has been impaired and included in nonaccrual loans since July 1998. The relationship continues to be monitored as part of the Bank's overall credit administration procedures.

While management recognizes that there is more risk traditionally associated with commercial and consumer lending as compared to real estate mortgage lending, the Bank currently has in place a tiered approach to determine the adequacy of its allowance for loan losses. This methodology focuses on the determination of the specific and potential loss allowance for certain loans classified as problem credits and uses a three-year historical loss factor to determine the loss allocation for the remainder of the loan portfolio as opposed to allocations based on major loan categories. Level I includes specific allowances that have been reserved for particular problem loans where management has identified specific losses. Level II allowances are set aside to cover potential losses associated with problem loans which possess more than a normal degree of credit risk but where no specific losses have been identified. These loans have been criticized or classified by the Bank's regulators, external loan reviewers engaged by the Bank, or internally by management. The three-year historical loss factors, subject to certain minimums, for Level II problem loans are applied to the total Level II loans in determining the allocation. Level III is the allowance for the balance of the loan portfolio. The loans in this tier consist of all loans that are not classified as Level I or Level II problem credits, and less risk-free loans. Risk-free loans are defined as loans fully secured by cash or cash equivalents, readily marketable collateral, and portions of the portfolio that are partially covered by a U.S. Government or government agency guaranty. Adjustments are then made for local economic conditions. The allocation for Level III is determined by applying the historical loss factor, derived from the prior three years actual experience, to the adjusted outstanding balance for this classification. The Company is currently expanding its methodology to determine the adequacy of the allowance for loan losses by major loan types. This change is not expected to have a material adverse effect on the Company's consolidated financial condition or the results of operation.

On January 1, 1995, the Company adopted Statement of Financial Accounting Standards No. 114, "Accounting by Creditors for Impairment of a Loan" ("SFAS No. 114") and Statement of Financial Accounting Standards No. 118, "Accounting by Creditors for Impairment of a Loan-Income Recognition and Disclosures" ("SFAS No. 118"), which amends SFAS No. 114, with no material effect on its financial condition or results of operations. At December 31, 1998, the Company had approximately $4,098,000 of impaired loans, which included 3 loans to the same borrower with a total valuation allowance of approximately $564,000. This valuation allowance was established following an independent evaluation of a portion of the collateral securing all 3 loans. In comparison, at December 31, 1997, the Company had approximately $578,000 of impaired loans, which included 1 loan, totaling approximately $72,000 with a valuation allowance of approximately $49,000. No valuation allowance was deemed necessary for the remaining $506,000 of impaired loans in 1997. This increase in impaired loans in 1998 resulted mainly from the relationship mentioned previously.

Nonperforming Assets

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

Nonperforming assets were $4,897,000, $276,000, and $219,000 at December 31, 1998, 1997, and 1996, respectively. These levels represent an increase of $4,621,000 (1674.3%) for the year ended December 31, 1998, and an increase of $57,000 (26.0%) for the year ended December 31, 1997. The increase in 1998 is primarily due to the $4.078 million commercial loan relationship that is classified as impaired. The increase in 1997 is mainly due to a overdrawn checking account.

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

<TABLE>

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

<CAPTION>

	Nonperforming Assets December 31,				
	1998	1997	1996	1995	1994
	(In thousands)				
Nonaccrual loans	$ 4,593	--	107	73	27
Renegotiated loans	--	--	--	--	--
Other nonperforming assets (primarily other real estate)	--	--	--	64	1,313
Accruing loans 90 days or more past due	304	276	112	133	120
Total nonperforming assets	$ 4,897	276	219	270	1,460
Nonaccrual loans and renegotiated loans as a % of total loans, net of unearned income	2.10%	--	0.07%	0.05%	0.02%
Nonaccrual loans, renegotiated loans and other nonperforming assets as a percentage of total loans, net of unearned income	2.10%	--	0.07%	0.10%	0.95%
Nonperforming assets as a percentage of total loans, net of unearned income	2.24%	0.15%	0.14%	0.19%	1.03%

</TABLE>

If nonaccrual loans had performed in accordance with their original contractual terms, interest income would have increased approximately $183,000, $0, and $6,300 for the years ended December 31, 1998, 1997 and 1996 respectively. The amount of interest income earned and collected on nonaccrual loans which is included in net income was $33,000 for 1998, $0 for 1997 and $2,200 for 1996.

Other Potential Problem Loans

Potential problem loans consist of those loans where management has serious doubts as to the borrower's ability to comply with the present loan repayment terms. At December 31, 1998, the Company had identified 77 loans totaling approximately $2,654,000 or 1.2% of total loans, net of unearned income were considered potential problem loans. Such loans have been considered in the determination of the Level II allowance previously discussed.

Deposits

Total deposits increased $9,527,000 (4.3%) to $233,505,000 at December 31, 1998, as compared to $223,978,000 at December 31, 1997. Noninterest-bearing deposits were $34,724,000 and $32,638,000 while total interest-bearing deposits were $198,781,000 and $191,340,000 at December 31, 1998 and 1997, respectively. This trend is the result of management's decision to maintain a competitive position in its deposit rate structure coupled with the Bank's marketing efforts to attract local deposits and fund its loan growth. At December 31, 1998, as a percentage of total deposits, noninterest-bearing accounts comprised approximately 14.9%, while MMDAs, NOWs and regular savings made up approximately 31.9%, certificates of deposit under $100,000 comprised approximately 31.0%, and certificates of deposit and other time deposits of $100,000 or more comprised 22.2%. At December 31, 1997, as a percentage of total deposits, noninterest-bearing accounts comprised approximately 14.6%, while

MMDAs, NOWs and regular savings made up approximately 37.1%, certificates of deposit under $100,000 comprised approximately 31.8%, and certificates of deposit and other time deposits of $100,000 or more comprised 16.5%.

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

<TABLE>
<CAPTION>

	December 31,					
	1998		1997		1996	
	Amount	% Change from prior year end	Amount	% Change from prior year end	Amount	% Change from prior year end

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

(Dollars in thousands)

<S>	<C>	<C>	<C>	<C>	<C>	<C>
Demand deposits	$ 34,724	6.39%	32,638	14.89%	28,407	11.44%
Interest bearing deposits:						
NOWs	21,606	(3.64)%	22,423	11.62%	20,089	(13.48)%
MMDAs	42,271	(16.59)%	50,678	18.81%	42,656	66.35%
Savings	10,536	3.12%	10,217	(0.39)%	10,257	(0.37)%
Certificates of deposit under $100,000	72,425	1.81%	71,136	(4.49)%	74,477	(3.78)%
Certificates of deposit and other time deposits of $100,000 and over	51,943	40.82%	36,886	(9.68)%	40,841	71.95%
Total interest bearing deposits	198,781	3.89%	191,340	16.04%	188,320	17.47%
Total deposits	$ 233,505	4.25%	223,978	3.35%	216,727	16.64%

</TABLE>

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

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

<TABLE>
<CAPTION>

	Year Ended December 31, 1998		
ASSETS	Average Balance	Interest	Yield/ Rate
	(Dollars in thousands)		
<S>	<C>	<C>	<C>
Interest Earning Assets:			
Loans, net of unearned income (1)	$ 200,230	17,468	8.72%
Investment securities:			
Taxable	59,450	3,787	6.37%
Tax-exempt (2)	1,875	164	8.76%
Total investment securities	61,325	3,951	6.44%
Federal funds sold	4,200	236	5.62%
Interest bearing deposits with other banks	1,589	120	7.55%
Total interest earning assets	267,344	21,775	8.14%
Allowance for loan losses	(2,437)		
Cash and due from banks	7,997		
Premises and equipment	3,481		
Rental property, net	1,795		
Other assets	4,863		
Total Assets	$ 283,043		
LIABILITIES & STOCKHOLDERS' EQUITY			
Interest bearing liabilites:			
Deposits:			
Demand	$ 20,646	428	2.07%
Savings and Money Market	58,461	2,531	4.33%
Certificates of deposits less than $100,000	71,616	4,411	6.16%
Certificates of deposit and other time deposits of $100,000 or more	42,685	2,187	5.12%
Total interest bearing deposits	193,408	9,557	4.94%
Federal funds purchased and securities sold under agreements to repurchase	4,554	226	4.96%
Other short term borrowings	0	0	0.00%
Other borrowed funds	24,935	1,402	5.62%
Employee stock ownership plan debt	57	4	7.02%
Total interest bearing liabilities	222,954	11,189	5.02%
Noninterest bearing demand deposits	30,292		
Accrued expenses and other liabilities	1,737		
Stockholders' equity	28,060		

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Total liabilities and stockholders' equity	$ 283,043		
Net Interest Income		$10,586	
Net Yield on Total Interest Earning Assets			3.96%

<CAPTION>

ASSETS	Year Ended December 31, 1997 Average Balance	Interest	Yield/ Rate
	(Dollars in thousands)		
<S>	<C>	<C>	<C>
Interest Earning Assets:			
Loans, net of unearned income (1)	172,742	15,323	8.87%
Investment securities:			
Taxable	59,829	3,933	6.57%
Tax-exempt (2)	2,031	188	9.28%
Total investment securities	61,860	4,121	6.66%
Federal funds sold	6,778	388	5.72%
Interest bearing deposits with other banks	1,446	81	5.60%
Total interest earning assets	242,826	19,913	8.20%
Allowance for loan losses	(2,151)		
Cash and due from banks	7,652		
Premises and equipment	3,597		
Rental property, net	1,859		
Other assets	3,879		
Total Assets	257,662		

<CAPTION>

LIABILITIES & STOCKHOLDERS' EQUITY			
<S>	<C>	<C>	<C>
Interest bearing liabilities:			
Deposits:			
Demand	20,143	426	2.11%
Savings and Money Market	59,098	2,660	4.50%
Certificates of deposits less than $100,000	71,933	4,495	6.25%
Certificates of deposit and other time deposits of $100,000 or more	37,808	1,952	5.16%
Total interest bearing deposits	188,982	9,533	5.04%
Federal funds purchased and securities sold under agreements to repurchase	2,868	148	5.16%
Other short term borrowings	94	9	9.57%
Other borrowed funds	11,160	645	5.78%
Employee stock ownership plan debt	113	8	7.08%
Total interest bearing liabilities	203,217	10,343	5.09%
Noninterest bearing demand deposits	27,941		
Accrued expenses and other liabilities	2,070		
Stockholders' equity	24,434		
Total liabilities and stockholders' equity	257,662		
Net Interest Income		$9,570	
Net Yield on Total Interest Earning Assets			3.94%

<CAPTION>

ASSETS	Year Ended December 31, 1996 Average Balance	Interest	Yield/ Rate
	(Dollars in thousands)		
<S>	<C>	<C>	<C>
Interest Earning Assets:			
Loans, net of unearned income (1)	150,356	13,067	8.69%
Investment securities:			
Taxable	61,814	4,075	6.59%
Tax-exempt (2)	1,861	180	9.72%

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Total investment securities	63,675	4,255	6.68%
Federal funds sold	6,249	337	5.39%
Interest bearing deposits with other banks	25	2	8.00%
Total interest earning assets	220,305	17,661	8.02%
Allowance for loan losses	(2,055)		
Cash and due from banks	7,207		
Premises and equipment	3,530		
Rental property, net	1,954		
Other assets	2,905		
Total Assets	233,846		
LIABILITIES & STOCKHOLDERS' EQUITY			
Interest bearing liabilites:			
Deposits:			
Demand	20,042	414	2.07%
Savings and Money Market	42,219	1,680	3.98%
Certificates of deposits less than $100,000	75,139	4,998	6.65%
Certificates of deposit and other time deposits of $100,000 or more	28,972	1,592	5.49%
Total interest bearing deposits	166,372	8,684	5.22%
Federal funds purchased and securities sold under agreements to repurchase	7,784	425	5.46%
Other short term borrowings	602	30	4.98%
Other borrowed funds	9,003	513	5.70%
Employee stock ownership plan debt	171	12	7.02%
Total interest bearing liabilities	183,932	9,664	5.25%
Noninterest bearing demand deposits	26,131		
Accrued expenses and other liabilities	1,896		
Stockholders' equity	21,887		
Total liabilities and stockholders' equity	233,846		
Net Interest Income		$7,997	
Net Yield on Total Interest Earning Assets			3.63%

</TABLE>

(1) Loans on nonaccrual status have been included in the computation of average balances.

(2) Yields on tax-exempt securities have been computed on a tax-equivalent basis using an income tax rate of 34%.

The following table presents the maturities of certificates of deposit and other time deposits of $100,000 or more at December 31, 1998:

	Maturities of Time Deposits over $100,000 December 31, 1998 (In thousands)
Three months or less......................	$ 25,276
After three within six months.............	7,203
After six within twelve months............	4,563
After twelve months.......................	14,901
Total................................	$ 51,943
Weighted Average rate on time deposits of $100,000 or more at period-end......	5.40%

Schedule of Short-term Borrowings (1)

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

<TABLE>
<CAPTION>

Year ended	Maximum Outstanding at	Average	Interest Rate	Ending	Weighted Average Interest

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

December 31	any Month-end	Balance	During Year	Balance	Rate at Year-end
		(Dollars in thousands)			
1998	$12,944	$4,554	4.96%	$12,944	4.99%
1997	8,516	2,962	5.30%	1,274	5.29%
1996	12,774	8,386	5.42%	5,856	5.13%

(1) Consists of federal funds purchased; treasury, tax and loan; securities sold under agreements to repurchase; and borrowings from the FHLB-Atlanta that mature either overnight or on a fixed maturity not to exceed three months.

Capital Resources

The Company's consolidated stockholders' equity was $28,943,000 and $26,047,000 at December 31, 1998 and 1997, respectively, an increase of $2,896,000 (11.1%) since year end 1997. The Company has funded its capital growth primarily through retained earnings since its early 1995 sale of common stock that raised approximately $1,234,000 of net proceeds to the Company.

On May 12, 1998, the Company's Board of Directors approved a three for one stock split effected in the form of a dividend payable on June 25, 1998 to shareholders of record on June 10, 1998. All share and per share information in the accompanying financial statements has been restated to reflect the effect of the additional shares outstanding resulting from the stock split. Common stock and surplus have been restated also to reflect the stock split retroactively.

During 1998, cash dividends of $759,000 or $0.19 per share, were declared on the Common Stock as compared to $627,000, or $0.16 per share, in 1997, representing an increase of $132,000 (21.1%). The Company plans to continue a dividend payout policy that provides cash returns to its investors and allows the Company to maintain adequate capital to support future growth and capital adequacy; however, the Company is dependent on dividends from the Bank as discussed subsequently. Management believes that a strong capital position is vital to the continued profitability of the Company and provides a foundation for future growth as well as promoting depositor and investor confidence in the institution. See "SUPERVISION AND REGULATION."

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

	Equity and Asset Ratios December 31,		
	1998	1997	1996
Return on average assets	1.22%	1.20%	1.18%
Return on average equity	12.26%	12.61%	12.58%
Common dividend payout ratio	21.59%	20.25%	20.00%
Average equity to average asset ratio	9.91%	9.48%	9.36%

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory actions, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification of the Bank are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Management believes, as of December 31, 1998, that the Bank meets all capital adequacy requirements to which it is subject. See "SUPERVISION AND REGULATION."

The following table sets forth the Bank's actual capital levels and the related required capital levels at December 31, 1998:

	Actual Capital Amount	Actual Ratio	Required Capital Amount	Required Ratio
Tier 1 Risk-Based Capital	$ 26,173	12.33%	$ 12,213	greater than or equal to 4%
Leverage Capital	26,173	8.57%	8,495	greater than or equal to 4%
Total Qualifying Capital	28,829	13.58%	16,988	greater than or equal to 8%

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Effective January 1, 1998, the Company adopted the provisions of SFAS No. 130, "Reporting Comprehensive Income." This statement establishes standards for reporting and displaying comprehensive income and its components in a full set of general purpose financial statements. SFAS No. 130 requires all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed in equal prominence with the other financial statements. The term "comprehensive income" is used in the statement to describe the total of all components of comprehensive income including net income. "Other comprehensive income" for the Company consists of items recorded directly in stockholder's equity under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities."

Effective January 1, 1998, the Company also adopted the provisions of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 establishes new standards for the disclosures made by public business enterprises to report information about operating segments in annual financial statements and requires those enterprises to report selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosures about products and services, geographic areas, and major customers. The Company does not have any segments other than banking that are considered material.

In June 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. This statement is effective for all fiscal quarters of fiscal years

beginning after June 15, 1999. The Company has not yet determined the impact of SFAS No. 133 on the Company's financial statements upon adoption.

Liquidity

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

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

Sources of liability liquidity include customer deposits, federal funds purchased and investment securities sold under agreements to repurchase. Although deposit growth historically has been a primary source of liquidity, such balances may be influenced by changes in the banking industry, interest rates available on other investments, general economic conditions, competition and other factors. The Bank has participated in the FHLB-Atlanta's advance program to obtain funding for its growth. Advances include both fixed and variable terms and are taken out with varying maturities. The Bank has a current line of credit of $40,000,000. This line is collateralized by a blanket lien against its one to four family residential mortgage loans. At December 31, 1998, the Bank had credit available from FHLB-Atlanta of $9,242,000, and had $30,758,000 in advances drawn down.

Overall, net cash provided from financing activities increased $37,896,000 (1576.4%) to $40,300,000 during 1998 from the previous year's total of $2,404,000. Net cash provided by operating activities decreased $718,000 (18.5%) to $3,174,000 from $3,892,000 for the year ended December 31, 1998. $48,878,000 of cash was used in investing activities during 1998.

The Company depends mainly on dividends, management fees and lease payments from the Bank, for its liquidity. The Company only receives cash dividends from the Bank if the cash flow from other sources is not sufficient to maintain a positive cash flow, also giving consideration to regulatory restrictions. Accordingly, the Bank paid the Company $385,000, $697,000, and $265,000 in cash dividends for 1998, 1997, and 1996 respectively. The Company provides services to the Bank for which it is paid a management fee comparable to a third party vendor. The Bank paid the Company $314,000 and $295,000 in management fees and $187,000 and $187,000 in lease payments for the years ended December 31, 1998 and 1997, respectively. These funds were used to pay operating expenses and fund dividends to the Company's shareholders. In addition, the Bank makes transfers to the Company, under its Tax Sharing Agreement, for payment of consolidated tax obligations. The Tax Sharing Agreement calls for the allocation of the consolidated tax liability or benefit between the Company and each Subsidiary based on their individual tax positions as if each entity filed a separate tax return.

Management has made the decision to allow the Bank's capital position to

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

grow to support its growth in capital adequacy.

Year 2000

The Company is aware of the issues associated with the programming code in existing computer systems as the millennium ("Year 2000") approaches. The Company has conducted a comprehensive review of its computer systems to identify the systems that could be affected by the Year 2000 issue and has developed a plan to resolve the mission critical modifications necessary in order to be prepared for the new millennium. The Company has reviewed both information technology (IT) systems and non-IT systems. All mission critical systems have been upgraded, as needed, and tested. The majority of the remaining systems have been tested, however, final modifications are expected to be completed by June 30, 1999. The Company has received certification of Year 2000 compliance from their critical vendors used in the major operations of the Company. The Company has followed the Federal Reserve guidelines for preparing for Year 2000. The Company also reports quarterly to its Board of Directors the progress of the Year 2000 project. Accordingly, the Company does not expect the Year 2000 issue to

pose any significant operational problems and has not discovered any Year 2000 problems with significant counter-parties that it believes will have material effect on the financial position or results of operations of the Company. However, the Company has not fully evaluated the effect of any Year 2000 problems on its loan and deposit customers. No assurance can be given that potential Year 2000 problems of those with whom the Company does business will not occur, and if they occur, that the consequences to the Company will not be material.

The total cost of the Year 2000 project is estimated not to exceed $250,000, of which $100,750 was expensed through 1998, and is estimated to be funded through operating cash flows. Contingency Plans have been developed to ensure direction in the event a non-compliant system or component is detected. The Company currently has in place a disaster recovery plan. A business resumption plan and a remediation plan have been developed based upon certain circumstances. Part of the business resumption plan includes an agreement with a third-party vendor which would enable the Bank to use the third-parties' computer systems as a worst case scenario. These plans will provide the Company direction in the event an unforeseen circumstance arises due to the Year 2000. The Bank has held Y2K Customer Awareness Seminars, mailed Y2K information to all customers, requested copies of the status of loan customers' Y2K plan and examined all large loan customers for potential impacts on the customer's creditworthiness. All plans will be finalized and implemented by September 30, 1999.

Interest Rate Sensitivity Management

An integral part of the funds management of the Company and the Bank is to maintain a reasonably balanced position between interest rate sensitive assets and liabilities. The Bank's Asset/Liability Management Committee ("ALCO") is charged with the responsibility of managing, to the degree prudently possible, its exposure to "interest rate risk," while attempting to provide earnings enhancement opportunities. The dollar difference between rate sensitive assets and liabilities for a given period of time is referred to as the rate sensitive gap ("GAP"). A GAP ratio is calculated by dividing rate sensitive assets by rate sensitive liabilities. Due to the nature of the Bank's balance sheet structure and the market approach to pricing of liabilities, management and the Board of Directors recognize that achieving a perfectly matched GAP position in any given time frame would be extremely rare. ALCO has determined that an acceptable level of interest rate risk would be for net interest income to fluctuate no more than 5.0% 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, the Bank's net interest income at December 31, 1998, would decrease approximately 1.39% in a rising rate environment and increase approximately 1.57% in a falling rate environment. Interest rate scenario models are prepared on the Bank's Balance Sheet Information System created by Darling Consulting Group.

For purposes of measuring interest rate sensitivity, Company management assumes that the asset and liability balances remain constant over the 12-month period. Deposit withdrawals are only considered in measuring liquidity. Although demand and savings accounts are subject to immediate withdrawal, all passbook savings and regular NOW accounts are reflected to reprice in over 5 years due to their historically stable volume and limited repricing. High balance MMDAs and NOW accounts are considered volatile and, as such, are shown as repricing in 1-3 months. Certificates of deposits 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.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

<TABLE>
<CAPTION>

Interest Sensitivity Analysis

December 31, 1998	Immediate	One to Three Months	Four to Twelve Months	One to Five Years	Over Five Years and Non-rate Sensitive	Total
			(In thousands)			
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Earning Assets:						
Loans, net of unearned	$ 42,778	24,157	32,737	100,122	18,893	218,687
Taxable investment securities	--	1,232	1,078	3,193	1,431	6,934
Tax-exempt investment securities	--	255	80	431	394	1,160
Investment securities available for sale	--	6,669	7,324	25,677	23,359	63,029
Federal funds sold and securities purchased under agreements to resell	260	--	--	--	--	260
Interest bearing deposits with other banks	134	--	--	--	--	134
Total earning assets	43,172	32,313	41,219	129,423	44,077	290,204
Interest bearing liabilities:						
Demand deposits	--	1,829	--	--	54,502	56,331
Savings and Money Market	--	42,270	--	--	10,536	52,806
Certificates of deposit less than $100,000	--	32,286	22,131	18,007	--	72,424
Certificates of deposit and other time deposits of $100,000 or more	--	24,862	11,766	15,316	--	51,944
Federal funds purchased and securities sold under agreements to repurchase	--	12,944	--	--	--	12,944
Other short-term borrowings	--	--	--	--	--	--
FHLB and other borrowings	--	24	72	10,537	20,367	31,000
Total interest bearing liabilities	--	114,215	33,969	43,860	85,405	277,449
Interest sensitivity gap	43,172	(81,902)	7,250	85,563	(41,328)	12,755
Cumulative interest sensitivity gap	$ 43,172	(38,730)	(31,480)	54,083	12,755	

</TABLE>

The interest sensitive assets at December 31, 1998, that reprice or mature within 12 months were $116,704,000 while the interest sensitive liabilities that reprice or mature within the same time frame were $148,184,000. At December 31, 1998, the 12 month cumulative GAP position, including the effect of off-balance sheet items, was a negative $31,480, resulting in a GAP ratio of 79.0%. This negative GAP indicates that the Company has more interest-bearing liabilities than interest-earning assets that reprice within the GAP period.

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

The Bank's Asset Liability Management Policy states that establishing limits on interest rate swaps, caps, and floors can be somewhat confusing or misleading since the notional amount by which these instruments are expressed is never exchanged between counterparties and therefore is not "at risk." Furthermore, since they

represent off-balance sheet tools used by ALCO to manage imbalances in the Bank's balance sheet in a prudent and cost effective manner, the appropriate volume of swaps for the Bank is not static; it changes with elements such as the economic environment, the capital position, and the ability to efficiently replicate hedging actions in the cash markets. The Bank endeavors to limit

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

outstanding notional value of off-balance sheet contracts executed for purposes of managing net interest income to 25% of total assets as reported in the most recent quarterly call report. Notional value of off-balance sheet contracts executed with one counterparty are limited to 10% of total assets as reported in the Bank's most recent quarterly call report.

The following table presents the Company's interest rate swaps and floors position as of December 31, 1998:

	Notional Amount	Carrying Value	Estimated Fair Value	Weighted Average Rate (1) Received	Paid	Weighted Average Remaining Life (Years)
	(Dollars in thousands)					
Swaps:						
Receive fixed:						
One year or less	10,000	--	41	6.42%	5.88%	0.25
Floors						
Purchased						
Over two years through five years	10,000	6	20	--	--	1.25
Over two years through five years	10,000	17	106	6.00%	--	1.25
	$ 30,000	$ 23	$ 167			

----

(1) The weighted average rates received/paid are shown only for swaps and floors for which net interest amounts were receivable or payable at the end of each period. For floors when the index rate has not been reached, no rate is shown. Interest rates on variable rate derivative products held by the Bank are derived from the 3 month LIBOR rate.

As part of its overall interest rate risk management activities, the Company utilizes off-balance sheet derivatives to modify the repricing characteristics of on-balance sheet assets and liabilities. The primary instruments utilized by the Company are interest rate swaps and interest rate floor and cap agreements. The fair values of these off-balance sheet derivative financial instruments are based on dealer quotes and third party financial models. See "Results of Operations - Net Interest Income."

Interest rate swaps, floors and caps are accounted for on an accrual basis, and the net interest differential, including premiums paid, if any, is recognized as an adjustment to interest income or expense of the related designated asset or liability. Changes in the fair values of the swaps, floors and caps are not recorded in the consolidated statements of income because these agreements are being treated as a synthetic alteration of the designated assets or liabilities. The Company considers its interest rate swaps to be a synthetic alteration of an asset or liability as long as (i) the swap is designated with a specific asset or liability or finite pool of assets or liabilities; (ii) there is a high correlation, at inception and throughout the period of the synthetic alteration, between changes in the interest income or expense generated by the swap and changes in the interest income or expense generated by the designated asset or liability; (iii) the notional amount of the swap is less than or equal to the principal amount of the designated asset or liability; and (iv) the swap term is less than or equal to the remaining term of the designated asset or liability. The criteria for consideration for a floor or cap as a synthetic alteration of an asset or liability are generally the same as those for a swap arrangement.

If the swap, floor or cap arrangements are terminated before their maturity, the net proceeds received or paid are deferred and amortized over the shorter of the remaining contract life or the maturity of the designated asset

or liability as an adjustment to interest income or expense. If the designated asset or liability is sold or matures, the swap agreement is marked to market and the gain or loss is included with the gain or loss on the sale/maturity of the designated asset or liability. Changes in the fair value of any undesignated swaps, floors and caps are included in other income in the consolidated statement of income.

Effects of Inflation and Changing Prices

Inflation generally increases the costs of funds and operating overhead, and to the extent loans and other assets bear variable rates, the yields on such assets. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result,

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

interest rates generally have a more significant effect on the performance of a financial institution than the effects of general levels of inflation. In addition, inflation affects financial institutions' cost of goods and services purchased, the cost of salaries and benefits, occupancy expense, and similar items. Inflation and related increases in interest rates generally decrease the market value of investments and loans held and may adversely affect liquidity, earnings, and stockholders' equity. Mortgage originations and refinancings tend to slow as interest rates increase, and likely will reduce the Company's volume of such activities and the income from the sale of residential mortgage loans in the secondary market.

Results of Operations

Net Income

Net income increased $359,000 (11.7%) to $3,439,000 during 1998 from $3,080,000 for the year ended December 31, 1997. Basic income per share was $0.88 and $0.79 for 1998 and 1997, respectively, an increase of 11.4%. Comparatively, net income during 1997 increased $327,000 (11.9%) from the 1996 total of $2,753,000, while basic income per share showed a similar increase of $0.09 per share for 1997 from a 1996 per share total of $0.70.

The increase in net income for 1998 is attributable to higher net interest income and noninterest income offset by a higher noninterest expense. The increase in 1997 was due to higher net interest income offset by lower noninterest income and higher noninterest expense for the year.

Net Interest Income

Net interest income is the difference between the interest the Company earns on its loans, investment securities and other earning assets and the interest cost of its deposits, borrowed funds and other interest-bearing liabilities. This is the primary component of the Company's earnings. Net interest income was $10,531,000 for the year ended December 31, 1998. This increase of $1,024,000 (10.8%) over 1997 is due to the increase in average interest earning assets during 1998 and an increase in the net yield on total interest earning assets of 2 basis points to 3.96%.

Net interest income for 1997 was $9,507,000, $1,570,000 (20.0%) higher than 1996 net interest income of $7,937,000. This increase over 1996 is due to the increase in average interest earning assets during 1997 and an increase in the net yield on total interest earning assets of 31 basis points to 3.94%.

The Company uses interest rate protection contracts, primarily interest rate swaps, caps and floors, to protect the yields on earning assets and the rates paid on interest-bearing liabilities. Such contracts act as hedges against unfavorable rate changes. The income and expense associated with interest rate swaps, caps and floors are ultimately reflected as adjustments to the net interest income or expense of the underlying assets or liabilities. The effect of such interest rate protection contracts resulted in a net increase in net interest income of $93,194, $43,525 and $6,000 during 1998, 1997 and 1996, respectively. It is the intention of the Company to continue to utilize interest rate protection contracts to manage exposure to certain future changes in interest rate environments. However, there can be no assurance that such transactions will positively affect earnings. See "-- INTEREST RATE

SENSITIVITY MANAGEMENT", the "CONSOLIDATED AVERAGE BALANCES, INTEREST INCOME/EXPENSE AND YIELDS/RATES" table appearing elsewhere herein and the "RATE/VOLUME VARIANCE ANALYSIS" tables immediately following.

<TABLE>
<CAPTION>

Rate/Volume Variance Analysis

Taxable-Equivalent Basis (1)(2) Years Ended December 31, 1998 Compared to 1997	Net change	Change Due to Rate	Volume	Rate/ volume
		(In thousands)		
<S>	<C>	<C>	<C>	<C>
Earning Assets:				
Loans, net of unearned income	$ 2,145	(293)	2,398	40
Investment securities:				
Taxable	(146)	(121)	(24)	(1)
Tax-exempt	(24)	(10)	(13)	(1)
Total investment securities	(170)	(131)	(37)	(2)
Federal funds sold	(152)	(4)	(145)	(3)
Interest bearing deposits with other banks	39	31	11	(3)
Total earning assets	$ 1,862	(397)	2,227	32

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

	=====	=====	=====	====
Interest bearing liabilities:				
Deposits:				
Demand	$ 2	(9)	11	--
Savings	(129)	(100)	(28)	(1)
Certificates of deposit less than $100,000	(84)	(64)	(20)	--
Certificates of deposit and other time deposits of $100,000 or more	235	(17)	250	2
Total interest bearing deposits	24	(190)	213	1
Federal funds purchased and securities sold under agreements to repurchase	78	(8)	83	(3)
Other short term borrowings	(9)	--	--	(9)
Other borrowed funds	753	(42)	772	23
Total interest bearing liabilities	$ 846	(240)	1,068	18

</TABLE>

----

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

(2) The change in interest due to rate is calculated by multiplying the previous volume by the rate change and the change in interest due to volume is calculated by multiplying the change in volume by the previous rate. Changes attributable to both changes in rate and volume are calculated by multiplying the change in volume by the change in rate.

<TABLE>
<CAPTION>

Rate/Volume Variance Analysis

Taxable-Equivalent Basis (1)(2) Years Ended December 31, 1997 Compared to 1996	Net change	Change Due to Rate	Volume	Rate/ volume
		(In thousands)		
<S>	<C>	<C>	<C>	<C>
Earning Assets:				
Loans, net of unearned income	$ 2,256	310	1,986	(40)
Investment securities:				
Taxable	(142)	(11)	(131)	--
Tax-exempt	8	(9)	16	1
Total investment securities	(134)	(20)	(115)	1
Federal funds sold	51	22	31	(2)
Interest bearing deposits with other banks	79	(35)	80	34
Total earning assets	$ 2,252	277	1,982	(7)
	=====	===	=====	===
Interest bearing liabilities:				
Deposits:				
Demand	$ 12	10	2	--
Savings	980	308	760	(88)
Certificates of deposit less than $100,000	(503)	(290)	(200)	(13)
Certificates of deposit and other time deposits of $100,000 or more	360	(126)	457	29
Total interest bearing deposits	849	(98)	1,019	(72)
Federal funds purchased and securities sold under agreements to repurchase	(277)	(9)	(253)	(15)
Other short term borrowings	(21)	4	(48)	23
Other borrowed funds	128	8	121	(1)
Total interest bearing liabilities	$ 679	(95)	839	(65)
	===	====	===	====

</TABLE>

----

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

(2) The change in interest due to rate is calculated by multiplying the previous volume by the rate change and the change in interest due to volume is calculated by multiplying the change in volume by the previous rate. Changes attributable to both changes in rate and volume are

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

calculated by multiplying the change in volume by the change in rate.

Interest Income

Interest income is a function of the volume of interest earning assets and their related yields. Interest income was $21,720,000, $19,849,000, and $17,601,000 for the years ended December 31, 1998, 1997, and 1996, respectively. Average interest earning assets increased $24,518,000 (10.0%) during 1998, $22,521,000 (10.2%) during 1997, and $18,831,000 (9.4%) during 1996, while the fully taxable equivalent yields on average earning assets decreased 6 basis points in 1998 after increasing 18 basis points in 1997 and decreasing 4 basis points in 1996. The combination of these factors resulted in increases in interest income of $1,871,000 (9.4%), $2,248,000 (12.8%) and $1,439,000 (8.9%) during 1998, 1997 and 1996, respectively. See "--CONSOLIDATED AVERAGE BALANCES, INTEREST INCOME/EXPENSE AND YIELDS/RATES" and THE "RATE/VOLUME VARIANCE ANALYSIS" tables.

Loans are the main component of the Bank's earning assets. Interest and fees on loans were $17,468,000, $15,323,000, and $13,067,000 for the years ended December 31, 1998, 1997, and 1996, respectively. These levels reflected increases of $2,145,000 (14.0%) during 1998, $2,256,000 (17.3%) during

1997, and $949,000 (7.8%) during 1996 due to increases in the average volume outstanding on loans over the past three years. While the level of average balances has grown to $200,230,000 in 1998 from $172,742,000 and $150,356,000 for 1997 and 1996, respectively, the fully taxable equivalent yield on loans decreased 15 basis points to 8.72% in 1998, and increased 18 basis points to 8.87% in 1997 from the 1996 average yield of 8.69%.

Interest income on investment securities decreased $161,000 (4.0%) to $3,896,000 in 1998, following a decrease of $138,000 (3.3%) to $4,057,000 in 1997 and an increase of $500,000 (13.5%) to $4,195,000 in 1996. The 1998 decrease was due to the combination of a $535,000 decrease in average volume outstanding and a 22 basis point decrease in the fully taxable equivalent yield over 1997 levels. The 1997 decrease was due to the combination of a $1,815,000 decrease in average volume outstanding and a 2 basis point decrease in the fully taxable equivalent yield over 1996 levels. The fully taxable equivalent yields on investment securities were 6.44% in 1998, 6.66% in 1997, and 6.68% in 1996. See "FINANCIAL CONDITION--INVESTMENT SECURITIES."

Interest Expense

Total interest expense was $11,189,000, $10,343,000 and $9,664,000 for the years ended December 31, 1998, 1997 and 1996 respectively, representing increases of $846,000 (8.2%), $679,000 (7.0%) and $806,000 (9.1%) during 1998, 1997, and 1996, respectively. Total average balances outstanding of interest-bearing liabilities have continued an upward trend over the last three years to $222,954,000 in 1998 from $203,217,000 in 1997 and $183,932,000 in 1996. The rates paid on these liabilities decreased 7 basis points in 1998 to 5.02% after decreasing 16 basis points to 5.09% during 1997, and decreasing 3 basis points to 5.25% during 1996.

Interest on deposits, the primary component of total interest expense, increased $24,000 to $9,557,000 (0.3%) during 1998 from $9,533,000 in 1997, which in turn represents a $849,000 (9.8%) increase from the 1996 level of $8,684,000. The average balance outstanding of interest-bearing deposits has increased steadily to the 1998 level of $193,408,000 as compared to $188,982,000 in 1997 and $166,372,000 in 1996. The 1998 increase is attributable to growth in certificates of deposit over $100,000 accounts in the normal course of business, while the 1997 increase was due to new deposit growth in money market deposit accounts also in the normal course of business. The average rates paid on interest-bearing deposits were 4.94%, 5.04%, and 5.22% for 1998, 1997, and 1996, respectively.

Interest expense on borrowed funds, including both short term borrowings and other borrowed funds, was $1,406,000 in 1998, $662,000 in 1997, and $555,000 in 1996. These levels represent an increase of $744,000 (112.4%) during 1998, an increase of $107,000 (19.3%) during 1997, and a decrease of $95,000 (14.6%) during 1996. The increase in 1998 is primarily due to increases in FHLB advances of $19,882,000 compared to 1997.

Provision for Loan Losses

During 1998, the Company made a total provision for loan losses of $891,000 based on management's assessment of the risk in the loan portfolio, the growth of the loan portfolio and historical loan loss trends, and an evaluation of certain significant problem loans. During 1997 and 1996, the Company made total provisions for loan losses of $285,000 and $80,000, respectively. See "FINANCIAL CONDITION -- ALLOWANCE FOR LOAN LOSSES AND RISK ELEMENTS."

Noninterest Income

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Noninterest income increased $408,000 (19.7%) to $2,479,000 for the year ended December 31, 1998, from the 1997 total of $2,071,000, which in turn represented a decrease of $337,000 (14.0%) from the total of $2,408,000 for 1996.

Service charges on deposit accounts increased $113,000 (13.1%) during 1998 and $64,000 (8.0%) in 1997 both primarily due to increases in nonsufficient funds and overdraft charges.

During 1998, the Company experienced net gains of $14,000 on the sale, in the ordinary course of business, of investment securities available for sale, as compared to net losses of $60,000 in 1997 and net gains of $26,000 in 1996. See "FINANCIAL CONDITION - INVESTMENT SECURITIES."

Other noninterest income increased $222,000 (17.6%) to $1,487,000 in 1998 from $1,265,000 in 1997. Comparatively, the 1997 total represented a decrease of $316,000 (20.0%) from $1,581,000 in 1996. The increase in 1998 was due to a $81,000 increase in Mastercard/VISA income mainly due to one merchant, a $64,000 increase in stock dividends resulting from additional shares purchased in Southeastern Bankcard Association, Inc. and FHLB Atlanta stock, offset by a $34,000 decrease in lease income due to lease expirations. The decrease in 1997 was due to a $30,000 decrease in rental income, an $18,000 increase in ATM transaction fees and a $151,000 decrease in dividends from other companies primarily due to the one time dividend of $150,000 paid in 1996 in connection with the sale of Alert. See "Item 1 - Business - Services"

Noninterest Expense

Total noninterest expense was $6,838,000 for 1998, $6,385,000 for 1997, and $6,007,000 for 1996 reflecting an increase of $453,000 (7.1%) for 1998, an increase of $378,000 (6.3%) for 1997 and a decrease of $412,000 (6.4%) for 1996.

Salaries and benefits increased $94,000 (3.0%) to $3,237,000 for the year ended December 31, 1998, and increased $202,000 (6.9%) to $3,143,000 for the year ended December 31, 1997, from the 1996 total of $2,941,000. At December 31, 1998, the Company had 108 full-time equivalent employees, an increase of 4 over the level at December 31, 1997. At December 31, 1997, the Company had 104 full-time equivalent employees, an increase of 2 over the level at December 31, 1996. The salary and benefit increases for 1998 and 1997 were primarily due to new hires and merit raises and the cost of benefits associated with such increases.

Net occupancy expense was $1,022,000, $972,000, and $817,000 for 1998, 1997 and 1996, respectively, representing increases of $50,000 (5.1%) in 1998 and $155,000 (19.0%) in 1997 over the previous year's levels. The 1998 increase resulted primarily from a $17,000 increase in furniture and equipment depreciation due to the opening of the Wal-Mart branch, a $16,000 increase in real estate rentals of the Wal-Mart branch, and a $16,000 increase in lease payments for furniture and equipment due new leases on computer equipment. The 1997 increase resulted primarily from a $30,000 increase in property taxes, a $24,000 increase in furniture and equipment depreciation, a $18,000 increase in service contract expense, a $43,000 increase in leases payments due to the new Winn Dixie branch and a $40,000 increase in equipment lease payments.

Other noninterest expense was $2,578,000 for 1998, $2,270,000 for 1997, and $2,250,000 for 1996. These levels represent an increase of $308,000 (13.6%) in 1998 and an increase of $20,000 (0.9%) in 1997 over the respective previous years. The 1998 increase resulted from a $54,000 increase in loan expenses, including legal, loan review and administration, primarily related to the $4.078 million commercial loan classified as impaired, a $106,000 increase in Mastercard/VISA expense due to the merchant mentioned above, a $44,000 increase in ATM expense due to increases in ATM rent and courier expenses, a $37,000 increase in network expenses due to the Visa Checkcard that was launched in 1998, a $99,000 increase in professional fees due to management's development of a strategic plan, a $20,000 increase in director's fees due to an increase in board meeting fees, offset by a $27,000 decrease in computer software expense due to fully amortized software, a $37,000 decrease in personnel, education and training and a $37,000 decrease in marketing expense due to 1997 expenses for the Winn Dixie branch opening and promotion for the Visa Checkcard.

The 1997 increase resulted from a $40,000 increase in electronic services due to Mastercard/Visa processing expenses and ATM expenses, a $25,000 increase in FICO assessments, $70,000 decrease in professional fees mainly due to expenses in 1996 to set up the dividend reinvestment plan, and a $28,000 increase in marketing expenses due to the Winn Dixie branch opening and the promotion of the Checkcard. See "SUPERVISION AND REGULATION-FDIC INSURANCE ASSESSMENTS."

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Income Taxes

The Company's income tax expense was $1,842,000, $1,828,000, and $1,505,000 in 1998, 1997 and 1996, respectively. These levels represent an effective tax rate on pre-tax earnings of 34.9% for 1998, 37.2% for 1997, and 35.3% for 1996. Details of the tax provision for income taxes are included in Note 10, "Income Tax Expense" in the Notes to the Consolidated Financial Statements included elsewhere herein.

ITEM 7. FINANCIAL STATEMENTS

See pages 38 to 72.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

Information required by this item is set forth under the heading "Information about Nominees for Directors" on Pages 2 through 4 and under the heading "Executive Officers" on Pages 5 and 6 of the definitive proxy statement for the Company's Annual Meeting to be held on May 11, 1999, and is incorporated herein by reference.

ITEM 10. EXECUTIVE COMPENSATION

Information required by this item is set forth under the heading "Meetings and Committees of the Board of Directors" on Pages 4 and 5 and under the heading "Summary Compensation of Executive Officers" on Pages 6 and 7 of the definitive proxy statement for the Company's Annual Meeting to be held on May 11, 1999, and is incorporated herein by reference.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information required by this item is set forth under the heading "Information about Nominees for Directors" on Pages 2 through 4 of the definitive proxy statement for the Company's Annual Meeting to be held on May 11, 1999, and is incorporated herein by reference.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information required by this item is set forth under the heading "Certain Transactions and Business Relationships on Page 8 of the definitive proxy statement for the Company's Annual Meeting to be held on May 11, 1999, and is incorporated herein by reference.

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

3. A. Certificate of Incorporation of Auburn National Bancorporation, Inc. (incorporated by reference from Registrant's Registration Statement on Form SB-2 (File No. 33-86180)).

   B. Bylaws of Auburn National Bancorporation, Inc. (incorporated by reference from Registrant's Registration Statement on Form SB-2 (File No. 33-86180)).

10. Material Contracts

   A. Auburn National Bancorporation, Inc. 1994 Long-Term Incentive Plan (incorporated by reference from Registrant's Registration Statement on Form SB-2 (File No. 33-86180)).

   B. Lease and Equipment Purchase Agreement, dated September 15, 1987 (incorporated by reference from Registrant's Registration Statement on Form SB-2 (File No. 33-86180)).

21. Subsidiaries of Registrant

23. Consent of Accountants

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

27. Financial Data Schedule

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the last quarter of the fiscal year ended December 31, 1998

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARY

Consolidated Financial Statements

December 31, 1998, 1997, and 1996

With Independent Auditors' Report Thereon

Independent Auditors' Report

The Board of Directors
Auburn National Bancorporation, Inc. and Subsidiary:

We have audited the accompanying consolidated balance sheets of Auburn National Bancorporation, Inc. and subsidiary (the Company) as of December 31, 1998 and 1997, and the related consolidated statements of earnings, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 1998. 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 generally accepted auditing standards. 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 subsidiary as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1998, in conformity with generally accepted accounting principles.

KPMG LLP

Atlanta, Georgia
February 4, 1999

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARY
Consolidated Balance Sheets
December 31, 1998 and 1997

<TABLE>
<CAPTION>

Assets	1998	1997
<S>	<C>	<C>
Cash and due from banks (note 2)	$ 9,220,225	12,268,412
Federal funds sold	260,000	2,615,000
Cash and cash equivalents	9,480,225	14,883,412
Interest-earning deposits with other banks	133,600	1,722,982
Investment securities held to maturity (fair value of $8,227,385 and $14,401,723 for December 31, 1998 and 1997, respectively) (note 3)	8,094,283	14,364,262

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

	1998	1997
Investment securities available for sale (note 3)	63,585,573	40,445,856
Loans:		
Loans, less unearned income of $15,494 and $36,706 at December 31, 1998 and 1997, respectively	218,686,991	185,493,178
Less allowance for loan losses	(2,808,307)	(2,125,104)
Loans, net (notes 4 and 8)	215,878,684	183,368,074
Premises and equipment, net (note 5)	3,434,964	3,520,542
Rental property, net	1,760,294	1,807,359
Other assets (note 10)	5,506,649	3,916,190
Total assets	$ 307,874,272	264,028,677

</TABLE>

See accompanying notes to consolidated financial statements.

<TABLE>
<CAPTION>

Liabilities and Stockholders' Equity	1998	1997
<S>	<C>	<C>
Deposits:		
Noninterest-bearing	$ 34,724,182	32,638,352
Interest-bearing (note 6)	198,780,568	191,339,635
Total deposits	233,504,750	223,977,987
Securities sold under agreements to repurchase (note 7)	12,944,004	1,273,507
Other borrowed funds (note 8)	31,000,458	11,138,850
Accrued expenses and other liabilities	1,481,564	1,533,992
Employee Stock Ownership Plan debt (note 11)	--	56,934
Total liabilities	278,930,776	237,981,270
Stockholders' equity (notes 14 and 15):		
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 at December 31, 1998 and 1997	39,571	39,571
Additional paid-in capital	3,707,472	3,707,472
Retained earnings	25,077,126	22,396,461
Accumulated other comprehensive income	333,926	175,436
Less:		
Treasury stock, 32,562 shares at December 31, 1998 and 1997, at cost	(214,599)	(214,599)
Employee Stock Ownership Plan debt	--	(56,934)
Total stockholders' equity	28,943,496	26,047,407
Commitments and contingencies (note 12)		
Total liabilities and stockholders' equity	$ 307,874,272	264,028,677

</TABLE>

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARY

Consolidated Statements of Earnings

Years Ended December 31, 1998, 1997, and 1996

<TABLE>
<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Interest income:			
Interest and fees on loans	$ 17,467,725	15,323,433	13,067,275
Interest and dividends on investment securities:			
Taxable	3,787,501	3,933,478	4,074,730
Tax-exempt	108,308	123,290	119,956

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Total interest and dividends on investment securities	3,895,809	4,056,768	4,194,686
Interest on federal funds sold	236,494	387,773	337,452
Interest on interest-earning deposits with other banks	120,268	81,421	1,550
Total interest income	21,720,296	19,849,395	17,600,963
Interest expense:			
Interest on deposits (note 6)	9,557,171	9,532,606	8,684,432
Interest on federal funds purchased	--	86	11,040
Interest on securities sold under agreements to repurchase (note 7)	225,524	148,216	413,650
Interest on other borrowings (note 8)	1,406,271	661,592	554,606
Total interest expense	11,188,966	10,342,500	9,663,728
Net interest income	10,531,330	9,506,895	7,937,235
Provision for loan losses (note 4)	891,030	285,245	80,102
Net interest income after provision for loan losses	9,640,300	9,221,650	7,857,133
Noninterest income:			
Service charges on deposit accounts	978,303	865,473	801,124
Investment securities gains (losses), net (note 3)	14,277	(59,876)	26,478
Other (note 16)	1,486,796	1,265,389	1,580,735
Total noninterest income	2,479,376	2,070,986	2,408,337
Noninterest expense:			
Salaries and benefits (note 11)	3,237,336	3,142,740	2,940,791
Net occupancy expense	1,022,405	972,108	816,653
Other (note 16)	2,578,477	2,269,782	2,249,867
Total noninterest expense	6,838,218	6,384,630	6,007,311
Earnings before income taxes	5,281,458	4,908,006	4,258,159
Income tax expense (note 10)	1,842,041	1,827,963	1,504,805
Net earnings	$ 3,439,417	3,080,043	2,753,354
Basic income per share (note 1)	$ .88	.79	.70
Weighted-average shares outstanding (note 1)	3,924,573	3,916,446	3,914,226

</TABLE>

See accompanying notes to consolidated financial statements.

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARY
Consolidated Statements of Stockholders' Equity and Comprehensive Income
Years ended December 31, 1998, 1997, and 1996

<TABLE>
<CAPTION>

	Comprehensive	Common stock	Additional paid-in	Retained

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

<S>	income <C>	Shares <C>	Amount <C>	capital <C>	earnings <C>
Balance at December 31, 1995		3,957,135	$ 39,571	3,659,107	17,749,910
Comprehensive income:					
Net earnings	$ 2,753,354	--		--	2,753,354
Other comprehensive income (loss) due to unrealized gain (loss) on mutual funds and investment securities available for sale, net (note 9)	(237,303)	--	--	--	--
Total comprehensive income	$ 2,516,051				
Cash dividends paid ($0.14 per share)		--	--	--	(560,284)
Payment of Employee Stock Ownership Plan debt		--	--	--	--
Sale of Treasury stock (1,111 shares)		--	--	5,611	--
Purchase of Treasury stock (11,265 shares)		--	--	--	--
Balance at December 31, 1996		3,957,135	39,571	3,664,718	19,942,980
Comprehensive income:					
Net earnings	$ 3,080,043	--	--	--	3,080,043
Other comprehensive income due to unrealized gain (loss) on mutual funds and investment securities available for sale, net (note 9)	321,964	--	--	--	--
Total comprehensive income	$ 3,402,007				
Cash dividends paid ($0.16 per share)		--	--	--	(626,562)
Payment of Employee Stock Ownership Plan debt		--	--	--	--
Sale of Treasury stock (5,488 shares)		--	--	42,754	--
Purchase of Treasury stock (368 shares)		--	--	--	--
Balance at December 31, 1997		3,957,135	39,571	3,707,472	22,396,461
Comprehensive income:					
Net earnings	$ 3,439,417	--	--	--	3,439,417
Other comprehensive income due to unrealized gain (loss) on mutual funds and investment securities available for sale, net (note 9)	158,490	--	--	--	--
Total comprehensive income	$ 3,597,907				
Cash dividends paid ($0.19 per share)		--	--	--	(758,752)
Payment of Employee Stock Ownership Plan debt		--	--	--	--
Balance at December 31, 1998		3,957,135	$ 39,571	3,707,472	25,077,126

<CAPTION>

<S>	Accumulated other comprehensive income <C>	Employee stock ownership plan debt <C>	Treasury stock <C>	Total <C>
Balance at December 31, 1995	90,775	(170,946)	(99,755)	21,268,662
Comprehensive income:				
Net earnings	--	--	--	2,753,354
Other comprehensive income (loss) due to unrealized gain (loss) on mutual funds and investment securities available for sale, net (note 9)	(237,303)	--	--	(237,303)
Total comprehensive income				
Cash dividends paid ($0.14 per share)	--	--	--	(560,284)
Payment of Employee Stock Ownership Plan debt	--	57,006	--	57,006
Sale of Treasury stock (1,111 shares)	--	--	16,887	22,498
Purchase of Treasury stock (11,265 shares)	--	--	(221,141)	(221,141)
Balance at December 31, 1996	(146,528)	(113,940)	(304,009)	23,082,792
Comprehensive income:				
Net earnings	--	--	--	3,080,043
Other comprehensive income due to unrealized gain (loss) on mutual funds and investment securities available for sale, net (note 9)	321,964	--	--	321,964
Total comprehensive income				

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Cash dividends paid ($0.16 per share)	--	--	--	(626,562)
Payment of Employee Stock Ownership Plan debt	--	57,006	--	57,006
Sale of Treasury stock (5,488 shares)	--	--	98,058	140,812
Purchase of Treasury stock (368 shares)	--	--	(8,648)	(8,648)
Balance at December 31, 1997	175,436	(56,934)	(214,599)	26,047,407
Comprehensive income:				
Net earnings	--	--	--	3,439,417
Other comprehensive income due to unrealized gain (loss) on mutual funds and investment securities available for sale, net (note 9)	158,490	--	--	158,490
Total comprehensive income				
Cash dividends paid ($0.19 per share)	--	--	--	(758,752)
Payment of Employee Stock Ownership Plan debt	--	56,934	--	56,934
Balance at December 31, 1998	333,926	--	(214,599)	28,943,496

</TABLE>

See accompanying notes to consolidated financial statements.

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARY
Consolidated Statements of Cash Flows
Years Ended December 31, 1998, 1997, and 1996

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>	1996 <C>
Cash flows from operating activities:			
Net earnings	$ 3,439,417	3,080,043	2,753,354
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	606,127	524,338	519,063
Net (accretion) amortization of investment discounts/premiums	(89,505)	(95,906)	46,623
Provision for loan losses	891,030	285,245	80,102
Deferred tax (benefit) expense	(84,982)	(76,861)	55,231
Loans originated for resale	(31,294,332)	(14,185,691)	(13,730,694)
Proceeds from sale of loans originated for resale	30,561,484	14,184,327	12,480,598
(Gain) loss on sale of investment securities	(14,277)	59,876	(26,478)
Increase in interest receivable	(346,662)	(261,171)	(241,612)
(Increase) decrease in other assets	(441,377)	(493,632)	332,842
(Decrease) increase in interest payable	(151,352)	129,857	(94,652)
Increase in accrued expenses and other liabilities	98,924	741,983	17,896
Net cash provided by operating activities	3,174,495	3,892,408	2,192,273
Cash flows from investing activities:			
Proceeds from sales of investment securities available for sale	4,970,085	11,288,950	3,871,059
Proceeds from maturities/calls/paydowns of investment securities held to maturity	6,844,848	6,908,351	6,668,991
Purchases of investment securities held to maturity	(425,000)	(3,325,876)	(17,800)
Proceeds from maturities/calls/paydowns of investment securities available for sale	17,689,859	14,699,633	16,102,270
Purchases of investment securities available for sale	(45,581,599)	(21,907,663)	(33,557,621)
Other net increase in loans	(32,668,792)	(24,092,861)	(20,078,467)
Purchases of premises and equipment	(359,187)	(504,116)	(224,636)
Proceeds from sale of other real estate	--	65,699	82,500
Additions to rental property	(48,094)	(1,670)	(35,745)
with other banks	1,589,382	(1,716,628)	756
Increase in investment in FHLB stock	(889,300)	--	--
Net cash used in investing activities	(48,877,798)	(18,586,181)	(27,188,693)
Cash flows from financing activities:			
Net increase in noninterest-bearing deposits	2,085,830	4,231,406	2,915,890
Net increase in interest-bearing deposits	7,440,933	3,019,407	28,008,756
Net increase (decrease) in securities sold under agreements to repurchase	11,670,497	(3,379,327)	(2,357,264)
Borrowings from FHLB	25,000,000	251,261	5,000,000
Repayments to FHLB	(5,118,256)	--	(100,000)
Repayments of other borrowed funds	(20,136)	(20,749)	(20,800)

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Net (decrease) increase in other short-term borrowings	--	(1,203,130)	730,935
Proceeds from sale of treasury stock	--	140,812	22,498
Purchase of treasury stock	--	(8,648)	(221,141)
Dividends paid	(758,752)	(626,562)	(560,284)
Net cash provided by financing activities	40,300,116	2,404,470	33,418,590
Net (decrease) increase in cash and cash equivalents	(5,403,187)	(12,289,303)	8,422,170
Cash and cash equivalents at beginning of year	14,883,412	27,172,715	18,750,545
Cash and cash equivalents at end of year	$ 9,480,225	14,883,412	27,172,715

</TABLE>

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARY
Consolidated Statements of Cash Flows
Years Ended December 31, 1998, 1997, and 1996

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>	1996 (Continued) <C>
Supplemental information on cash payments:			
Interest paid	$ 11,340,318	10,212,643	9,758,380
Income taxes paid	$ 2,161,351	1,596,005	1,239,739
Supplemental information on noncash transactions:			
Loans transferred to other real estate	$ --	129,699	82,500
Loans to facilitate the sale of other real estate	$ --	64,000	--

</TABLE>

See accompanying notes to consolidated financial statements.

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 1998, 1997, and 1996

(1) Summary of Significant Accounting Policies

Auburn National Bancorporation, Inc. (the Company) provides a full range of banking services to individual and corporate customers in Lee County, Alabama and surrounding counties through its subsidiary, AuburnBank (the Bank). The Company is subject to competition from other financial institutions. The Company is also subject to the regulations of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities.

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

(a) Basis of Financial Statement Presentation

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

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

connection with the determination of the allowances for loan losses and foreclosed real estate owned, management obtains independent appraisals for significant properties.

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

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

(b) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiary, AuburnBank. During the year ended December 31, 1997, the Company merged its existing subsidiary, ANB Systems, Inc. into the Company. All significant intercompany accounts and transactions have been eliminated.

(c) Cash Equivalents

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

(d) Investment Securities

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

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

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

The Company uses interest rate swaps, caps, and floors as part of its overall interest rate risk management. Any premiums or discounts arising from the use of interest rate contracts are deferred and amortized over the lives of the underlying assets or liabilities as an adjustment to interest income or expense. Interest income or expense related to interest rate swaps, caps, and floors is recorded over the life of the agreement as an adjustment to interest income or expense. Interest rates on variable rate derivative products held by the Bank are derived from the three- month LIBOR rate.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

(e) Loans

Loans are stated at principal amounts outstanding, net of unearned income. Interest on fixed rate precomputed installment loans is credited to income based on a method which approximates the level-yield method. Interest on all other loans is credited to income on the simple interest method.

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

The Company accounts for impaired loans in accordance with SFAS 114, Accounting by Creditors for Impairment of a Loan, as amended by SFAS 118, Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures. Under the provisions of SFAS 114 and 118, management considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is considered impaired, the amount of impairment is measured based on the present value of expected future cash flows discounted at the note's effective interest rate. If the loan is collateral-dependent, the fair value of the collateral is used to determine the amount of impairment. Impairment losses are included in the allowance for loan losses through the provision for loan losses. Impaired loans are charged to the allowance when such loans are deemed to be uncollectible. Subsequent recoveries are added to the allowance.

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

A loan is also considered impaired if its terms are modified in a troubled debt restructuring. For those accruing impaired loans, cash receipts are typically applied to principal and interest receivable in accordance with the terms of the restructured loan agreement. Interest income is recognized on these loans using the accrual method of accounting.

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

(f) Allowance for Loan Losses

The amount of provision for loan losses charged to earnings is based on actual loss experience and management's evaluation of the loan portfolio under current economic conditions. In addition, loans are examined for credit quality, documentation, and financial information annually by a qualified non-employee loan review examiner. Such provisions, adjusted for loan charge-offs and recoveries, comprise the allowance for loan losses. Provision amounts are largely determined based on loan classifications

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

determined through credit quality review using estimated loss factors based on historical loss experience. Such loss factors are adjusted periodically based on changes in loss experience.

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

(g) Premises and Equipment

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

(h) Rental Property

Rental property consists of land; buildings; and furniture, fixtures, and equipment which are rented to the Bank and the general public. Rental property is stated at cost less accumulated depreciation. Depreciation is computed on both the double-declining balance and straight-line methods for buildings and principally on a straight-line method for furniture, fixtures, and equipment over the estimated useful lives of the assets.

(i) Other Real Estate

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

(j) Derivative Financial Instruments

The Bank uses derivative financial instruments to swap floating rate assets or liabilities to fixed rate and to hedge the interest rate spread between assets and liabilities. These transactions serve to better match the repricing characteristics of various assets and liabilities, reduce spread risk, adjust overall rate sensitivity and enhance net interest income.

Interest rate swaps, purchased floors, and purchased caps are accounted for on an accrual basis, and the net interest differential, including premiums paid, if any, is recognized as an adjustment to interest income or expense of the related designated asset or liability. Changes in fair values of the swaps, purchased floors, or purchased caps are not recorded in the consolidated statements of income because these agreements are being treated as a synthetic alteration of the designated assets or liabilities. The Bank considers its interest rate swaps to be a synthetic alteration of an asset or liability as long as (i) the swap is designated with a specific asset or liability or finite pool of assets or liabilities; (ii) there is a high correlation at inception and throughout the period of the synthetic alteration, between changes in the interest income or expense generated by the swap and changes in the interest income or expense generated by the designated asset or liability; (iii) the notional amount of the swap is less than or equal to the principal amount of the designated asset or liability; and (iv) the swap term is less than or equal to the remaining term of the designated asset or liability. The criteria for consideration of a floor or cap as a synthetic alteration of an asset or liability are generally the same as those for a swap arrangement.

If the swap, floor, or cap arrangements are terminated before their maturity, the net proceeds received or paid are deferred and amortized over the shorter of the remaining contract life or the maturity of the designated asset or liability as an adjustment to interest income or expense. If the designated asset or liability is sold or matures, the swap agreement is marked to market and the gain or loss is included in the gain or loss on the sale/maturity of the designated asset or liability.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

(k) Income Taxes

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

The Company files its federal income tax returns on a consolidated basis.

(l) Earnings per Share

Basic income per share is computed on the weighted-average number of shares outstanding in accordance with SFAS No. 128, Earnings Per Share. The Company reserved 75,000 shares of common stock in May 1994 for issuance under stock option plans; however, no options have been granted as of December 31, 1998, thus there are no potential common shares that would result in diluted earnings per share.

On May 14, 1998, the Company's Board of Directors approved a three-for-one stock split effected in the form of a dividend payable on June 25, 1998 to shareholders of record on June 10, 1998. All share and per share information in the accompanying financial statements has been restated to reflect the effect of the additional shares outstanding resulting from the stock split.

(m) Comprehensive Income

Effective January 1, 1998, the Company adopted the provisions of SFAS No. 130, Reporting Comprehensive Income. This statement establishes standards for reporting and displaying comprehensive income and its components in a full set of general purpose financial statements. SFAS No. 130 requires all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed in equal prominence with the other financial statements. The term "comprehensive income" is used in the statement to describe the total of all components of comprehensive income including net income. "Other comprehensive income" for the Company consists of items recorded directly in stockholders' equity under SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities.

(n) Segment Disclosures

Effective January 1, 1998, the Company also adopted the provisions of SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. SFAS No. 131 establishes new standards for the disclosures made by public business enterprises to report information about operating segments in annual financial statements and requires those enterprises to report selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosures about products and services, geographic areas, and major customers. The Company does not have any segments other than banking that are considered material.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

(o) Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. This statement is effective for all fiscal quarters of fiscal years beginning after June 15, 1999. The Company has not yet determined the impact of SFAS No. 133 on the Company's financial statements upon adoption.

(p) Reclassifications

Certain of the 1997 and 1996 amounts have been reclassified to conform to the 1998 presentation.

(2) Cash and Due from Banks

The Bank is required to maintain certain average cash reserve balances in accordance with Federal Reserve Board requirements. The amounts of those required balances as of December 31, 1998 and 1997 were approximately $1,397,000 and $1,243,000, respectively.

(3) Investment Securities

The amortized cost and approximate fair value of investment securities at December 31, 1998, were as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Approximate fair value
Investment securities held to maturity:				
State and political subdivisions	$ 1,585,000	29,911	--	1,614,911
Mortgage-backed securities	6,509,283	103,418	227	6,612,474
	$ 8,094,283	133,329	227	8,227,385
Investment securities available for sale:				
U.S. government agencies excluding mortgage-backed securities	$ 17,025,648	313,834	--	17,339,482
Mortgage-backed securities	17,630,259	91,407	10,619	17,711,047
Collateralized mortgage obligations	27,524,735	229,643	102,818	27,651,560
State and political subdivisions	848,388	35,096	--	883,484
	$ 63,029,030	669,980	113,437	63,585,573

The amortized cost and approximate fair value of investment securities at December 31, 1998, by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties.

	Amortized cost	Approximate fair value
Investment securities held to maturity:		
Due in one year or less	$ 595,000	602,048
Due after one year through five years	200,000	202,978

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Due after five years through ten years	365,000	381,877
Due after ten years	425,000	428,008
Subtotal	1,585,000	1,614,911
Mortgage-backed securities	6,509,283	6,612,474
Total	$ 8,094,283	8,227,385
Investment securities available for sale:		
Due after one year through five years	$ 9,984,690	10,119,482
Due after five years through ten years	7,889,346	8,103,484
Subtotal	17,874,036	18,222,966
Mortgage-backed securities	17,630,259	17,711,047
Collateralized mortgage obligations	27,524,735	27,651,560
	$ 63,029,030	63,585,573

</TABLE>

The amortized cost and approximate fair value of investment securities at December 31, 1997, were as follows:

<TABLE>
<CAPTION>

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Approximate fair value
<S>	<C>	<C>	<C>	<C>
Investment securities held to maturity:				
U.S. government agencies excluding mortgage-backed securities	$ 3,216,614	--	71,264	3,145,350
State and political subdivisions	1,478,866	41,216	--	1,520,082
Mortgage-backed securities	9,469,748	67,907	--	9,537,655
Collateralized mortgage obligations	199,034	--	398	198,636
	$ 14,364,262	109,123	71,662	14,401,723
Investment securities available for sale:				
U.S. government agencies excluding mortgage-backed securities	$ 12,056,107	41,107	--	12,097,214
Mortgage-backed securities	7,957,596	32,576	--	7,990,172
Collateralized mortgage obligations	19,659,759	234,443	33,519	19,860,683
State and political subdivisions	480,000	17,787	--	497,787
	$ 40,153,462	325,913	33,519	40,445,856

</TABLE>

There were no sales of investment securities held to maturity during any of the years in the three-year period ended December 31, 1998. Proceeds from sales of investment securities available for sale were $4,970,085, $11,288,950, and $3,871,059 for the years ended December 31, 1998, 1997, and 1996, respectively. Gross losses of $59,876 were realized on sales of investment securities for the year ended December 31, 1997. Gross gains of $14,277 and $26,478 were realized on sales for the years ended December 31, 1998 and 1996, respectively.

Investment securities with an aggregate carrying value of $65,826,237 and $50,086,378 at December 31, 1998 and 1997, respectively, were pledged to secure public and trust deposits as required by law and for other purposes.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The Company maintains a diversified investment portfolio, including held-to-maturity and available-for-sale securities, with limited concentration in any given region, industry, or economic characteristic. Investments in municipal governments are made throughout the U.S. with no concentration in any given state.

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; therefore, the fair value of such stock is assumed to approximate cost. The investment in the stock is required of every member of the FHLB system. The investment in the stock was $1,788,900 and $899,600 at December 31, 1998 and 1997, respectively.

(4) Loans

At December 31, 1998 and 1997, the composition of the loan portfolio was as follows:

<TABLE>
<CAPTION>

	1998	1997
Commercial, financial, and agricultural	$ 61,074,779	46,328,523
Real estate - construction:		
Commercial	8,112,199	3,172,382
Residential	4,543,748	3,582,534
Real estate - mortgage:		
Commercial	61,113,412	51,713,918
Residential	60,135,660	58,645,606
Real estate - held for sale	4,199,818	3,466,970
Consumer installment	19,522,869	18,619,951
Total loans	218,702,485	185,529,884
Less:		
Unearned income	(15,494)	(36,706)
Allowance for loan losses	(2,808,307)	(2,125,104)
Loans, net	$ 215,878,684	183,368,074

</TABLE>

During 1998 and 1997, 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, 1998 and 1997 amounted to $7,404,807 and $7,072,874, respectively. The change from 1997 to 1998 reflects payments of $7,197,008 and advances of $7,528,941. In management's opinion, these loans were made in the ordinary course of business at normal credit terms, including interest rate and collateral requirements, and do not represent more than normal credit risk.

A summary of the transactions in the allowance for loan losses for the years ended December 31, 1998, 1997, and 1996 is as follows:

<TABLE>
<CAPTION>

	1998	1997	1996
Balance at beginning of year	$ 2,125,104	2,093,682	2,012,133
Provision charged to earnings	891,030	285,245	80,102
Loan recoveries	105,901	66,224	174,050
Loans charged off	(313,728)	(320,047)	(172,603)
Balance at end of year	$ 2,808,307	2,125,104	2,093,682

</TABLE>

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

At December 31, 1998 and 1997, the Company had $4,098,533 and $578,130, respectively, of impaired loans. Impaired loans at December 31, 1998 consist of one loan with a related valuation allowance of $564,313. Impaired loans at December 31, 1997 include loans of $71,983 that had a related valuation allowance of $49,450.

For the years ended December 31, 1998, 1997, and 1996, the average recorded investment in the impaired loans was $2,370,393, $593,750, and $655,907, respectively. The related amount of interest income recognized during 1998, 1997, and 1996 amounted to $110,367, $54,459, and $54,258, respectively.

Nonperforming loans, consisting of loans on nonaccrual status and accruing loans past due greater than 90 days, amounted to $4,896,756 and $276,000 at December 31, 1998 and 1997, respectively. Nonaccrual loans were $4,593,108 at December 31, 1998. There were no nonaccrual loans at December 31, 1997. Interest that would have been recorded on nonaccrual loans had they been in accruing status was approximately $183,000 in 1998 and $6,000 in 1996. The amount of interest collected and recorded on nonaccrual loans was approximately $33,000 in 1998 and $2,000 in 1996.

The Company's loan servicing portfolio consisted of 869 loans with an outstanding balance of $65,661,064, 832 loans with an outstanding balance of $63,565,693, and 730 loans with an outstanding balance of $53,774,538, as of December 31, 1998, 1997, and 1996, respectively.

(5) Premises and Equipment

Premises and equipment at December 31, 1998 and 1997 are summarized as follows:

	1998	1997
Land	$ 407,747	407,747
Buildings	2,730,244	2,713,251
Furniture, fixtures, and equipment	3,824,649	3,961,765
Total premises and equipment	6,962,640	7,082,763
Less accumulated depreciation	(3,527,676)	(3,562,221)
	$ 3,434,964	3,520,542

(6) Interest-Bearing Deposits

At December 31, 1998 and 1997, the composition of interest-bearing deposits was as follows:

	1998	1997
NOW, Super NOW, and Automatic Transfer Service	$ 21,606,033	22,422,519
Money market	42,270,612	50,677,710
Savings	10,535,711	10,217,311
Certificates of deposit under $100,000	72,424,754	71,136,109
Certificates of deposit and other time deposits of $100,000 and over	51,943,458	36,885,986
	$ 198,780,568	191,339,635

Interest expense on certificates of deposit and other time deposits of $100,000 and over amounted to approximately $2,187,000, $1,972,000, and $1,592,000 in 1998, 1997, and 1996, respectively.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 1998, 1997, and 1996

The following table presents the maturities of certificates of deposit and other time deposits of $100,000 or more at December 31, 1998.

Years ending December 31,		
1999	$	33,734,483
2000		11,880,153
2001		1,727,151
2002		1,226,908
2003		2,843,513
Thereafter		531,250
	$	51,943,458

(7) Securities Sold Under Agreements to Repurchase

The securities sold under agreements to repurchase at December 31, 1998 and 1997 are collateralized by obligations of the U.S. Government or its corporations and agencies, state and municipal securities, or mortgage-backed securities, which are held by independent trustees. The following summarizes pertinent data related to the securities sold under agreements to repurchase as of and for the years ended December 31, 1998, 1997, and 1996.

<TABLE>
<CAPTION>

<S>	<C> 1998	<C> 1997	<C> 1996
Weighted-average borrowing rate at year-end	4.99%	5.29	5.12
Weighted-average borrowing rate during the year	4.96%	5.16	5.46
Average daily balance during the year	$ 4,554,000	2,868,000	7,784,000
Maximum month-end balance during the year	$ 12,944,004	8,516,000	12,067,000

</TABLE>

AUBURN NATIONAL BANCORPORATION, INC.
AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 1998, 1997, and 1996

(8) Other Borrowed Funds

Other borrowed funds at December 31, 1998 and 1997 consisted of the following:

<TABLE>
<CAPTION>

<S>	<C> Maturity date	<C> Interest rate	<C> 1998	<C> 1997
Federal Home Loan Bank borrowings	February 2017	6.64	$ 333,005	351,261
	March 2003	5.79	425,000	525,000
	January 2001	5.87	5,000,000	5,000,000
	May 1998	5.63	--	5,000,000
	January 2008	5.46	5,000,000	--

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

	March 2008	5.51	5,000,000	--
	June 2008	5.51	10,000,000	--
	October 2003	3.90	5,000,000	--
Small Business Administration debt	June 2004	3.00	21,842	27,355
	June 2004	5.08	220,611	235,234
			$ 31,000,458	11,138,850

</TABLE>

The Bank has a $40,000,000 available line of credit from the FHLB which is reviewed annually by the FHLB. The above advances are against this line of credit. Interest expense on FHLB advances was $1,386,924, $630,494, and $498,705 in 1998, 1997, and 1996, respectively. All interest rates on outstanding advances are fixed interest rates. The advances and line of credit are collateralized by the Bank's investment in the stock of the FHLB and all first mortgage residential loans, which are sufficient to draw the full line of credit.

(9) Other Comprehensive Income

The following table sets forth the amounts of other comprehensive income included in stockholders' equity along with the related tax effect for the years ended December 31, 1998, 1997, and 1996.

<TABLE>
<CAPTION>

<S>	<C> Pretax amount	<C> Tax (expense) benefit	<C> Net of tax amount
1998:			
Net unrealized holding gains on investment securities available for sale arising during the year	$ 278,426	(111,370)	167,056
Less reclassification adjustment for net gains realized in net income	14,277	(5,711)	8,566
Other comprehensive income	$ 264,149	(105,659)	158,490
1997:			
Net unrealized holding gains on investment securities available for sale arising during the year	$ 447,549	(163,577)	283,972
Less reclassification adjustment for net losses realized in net income	(59,876)	21,884	(37,992)
Other comprehensive income	$ 507,425	(185,461)	321,964
1996:			
Net unrealized holding losses on investment securities available for sale arising during the year	$ (342,683)	122,401	(220,282)
Less reclassification adjustment for net gains realized in net income	26,478	(9,457)	17,021
Other comprehensive income loss	$ (369,161)	131,858	(237,303)

</TABLE>

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

(10) Income Tax Expense

Total income tax expense (benefit) for the years ended December 31, 1998, 1997, and 1996 was allocated as follows:

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>	1996 <C>
Income from continuing operations	$ 1,842,041	1,827,963	1,504,805
Stockholders' equity, for accumulated other comprehensive income	$ 105,659	185,461	(131,858)

</TABLE>

For the years ended December 31, 1998, 1997, and 1996 the components of income tax expense were as follows:

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>	1996 <C>
Current income tax expense:			
Federal	$ 1,760,302	1,733,135	1,314,952
State	166,721	171,689	134,622
Total	1,927,023	1,904,824	1,449,574
Deferred income tax expense (benefit):			
Federal	(75,526)	(68,833)	45,912
State	(9,456)	(8,028)	9,319
Total	(84,982)	(76,861)	55,231
	$ 1,842,041	1,827,963	1,504,805

</TABLE>

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

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>	1996 <C>
Income tax expense at statutory rate	$ 1,795,696	1,668,722	1,447,774
Increase (decrease) resulting from:			
Tax-exempt interest	(36,625)	(49,177)	(59,513)
State income tax expense net of Federal income tax benefit	103,795	108,016	95,001
Increase (decrease) in valuation allowance for deferred tax assets	(1,533)	7,956	--
Other	(19,292)	92,446	21,543
	$ 1,842,041	1,827,963	1,504,805

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

</TABLE>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1998 and 1997 are presented below:

<TABLE>
<CAPTION>

	1998	1997
Deferred tax assets:		
<S>	<C>	<C>
Loans, principally due to allowance for loan losses	$ 700,465	658,913
Principal amortization for leases being depreciated for tax	92,677	77,487
Capital loss carry forward	6,423	7,956
Other	17,629	17,313
Total gross deferred tax assets before valuation allowance	817,195	761,669
Valuation allowance	(6,423)	(7,956)
Total deferred tax assets	810,772	753,713
Deferred tax liabilities:		
Premises and equipment, principally due to differences in depreciation	263,927	280,058
Investments, principally due to discount accretion	87,864	109,337
FHLB stock dividend	21,068	21,068
Prepaid expenses	64,800	69,952
Loans, principally due to differences in deferred loan fees	57,151	42,681
Unrealized gain on investment securities available for sale	222,617	116,958
Other	4,490	4,127
Total deferred tax liabilities	721,917	644,181
Net deferred tax asset	$ 88,855	109,532

</TABLE>

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

(11) Retirement Plans

The Bank sponsored two retirement plans, the Auburn National Bancorporation, Inc. Employee Incentive Plan and the Auburn National Bancorporation, Inc. Employee Stock Ownership Plan (ESOP). In January 1994, the two plans were merged into one plan, Auburn National Bancorporation, Inc. 401(k) and Employee Stock Ownership Plan. The plan covers substantially all employees. Participants become 20 percent vested in their accounts after two years of service and 100 percent vested after six years of service. Contributions to the plan are determined by the board of directors. Company contributions to the plan amounted to $130,123, $125,870, and $121,076 in 1998, 1997, and 1996, respectively.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

During 1989, the ESOP borrowed $570,062 from an unrelated financial institution to purchase 6,306 shares of common stock of the Company. The remaining unallocated common stock acquired by the ESOP collateralizes the loan. The note was payable in annual principal installments of $57,006 and quarterly interest payments until December 31, 1998. The note was paid in full as of December 31, 1998.

(12) Off-Balance-Sheet Risk and Contingent Liabilities

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

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

The financial instruments whose contract amounts represent credit risk as of December 31, 1998 are as follows:

Commitments to extend credit	$ 4,065,000
Standby letters of credit	1,925,000

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

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

The Bank enters into interest rate protection contracts to help manage the Bank's interest rate exposure. These contracts include interest rate swaps, caps, and floors. Interest rate swap transactions generally involve the exchange of fixed and floating rate interest payment obligations without the exchange of the underlying principal amounts. Entering into interest rate swap agreements involves not only the risk of dealing with counterparties and their ability to meet the terms of the contracts but also the risk associated with the movements in interest rates. Notional principal amounts often are used to express the volume of these transactions; however, the amounts potentially subject to credit risk are much smaller. The notional principal amount related to these contracts was $30,000,000 at December 31, 1998. Risks associated with interest rate contracts include interest rate risk and creditworthiness of the counterparty. These risks are considered in the Bank's overall asset liability management program. The Bank utilizes periodic financial statements issued by the counterparty to analyze the creditworthiness of the counterparty prior to entering into a contract and to monitor changes in the financial condition of the counterparty throughout the term of the contract. Although none of the interest rate protection agreements are traded on any organized exchange, the Company believes that an active secondary market exists for such contracts.

In February 1995, the Bank entered into two interest rate floors with respect to $20,000,000 in variable rate loans. These agreements allow the Bank to receive interest payments based on three-month LIBOR should the floor rate fall below 5.00% and 6.00%, respectively. The agreements required the Bank to pay a fixed amount of $26,000 and $76,500, respectively, upon consummation of the agreements. The purpose of these contracts was to reduce interest rate exposure to variable assets in a low

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

interest rate environment.

In May 1997, the Bank entered into an interest rate swap with respect to $10,000,000 in two-year 6.25% certificates of deposit. This agreement allows the Bank to receive fixed interest payments at 6.42% per annum and to pay a variable rate equal to three-month LIBOR. The purpose of this contract was to reduce the Bank's effective cost of funds to better match the costs of funding variable rate loans.

The following table summarizes information on interest rate swaps and floors at December 31, 1998:

<TABLE>
<CAPTION>

INTEREST RATE PROTECTION CONTRACTS

	Thousands			Weighted-average rate		
	Notional amount	Carrying value	Estimated fair value	Received	Paid	Weighted-average remaining life (years)
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Swaps:						
Receive fixed:						
One year or less	$ 10,000	--	41	6.42%	5.88%	.25
Floors:						
Purchased:						
Over two years through five years	10,000	6	20	--	--	1.25
Over two years through five years	10,000	17	106	6.00%	--	1.25
	$ 30,000	23	167			

</TABLE>

All interest rate protection contracts above reprice quarterly. The weighted-average rates received/paid are shown only for swaps and floors for which net interest amounts were receivable or payable at the end of each period. For floors when the index rate has not been reached, no rate is shown. Interest rates on variable rate derivative products held by the Bank are derived from the three-month LIBOR rate.

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

(13) Fair Value of Financial Instruments

Statement of Financial Accounting Standards No. 107 (SFAS 107), Disclosures about Fair Value of Financial Instruments, 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

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

discounted cash flow and other valuation techniques. Discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following fair value estimates cannot be substantiated by comparison to independent markets and should not be considered representative of the liquidation value of the Company's financial instruments, but rather a good-faith estimate of the fair value of financial instruments held by the Company. SFAS 107 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements.

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

(a) Cash, Cash Equivalents, and Interest-Bearing Deposits with Other Banks

Fair value equals the carrying value of such assets.

(b) Investment Securities

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

(c) Loans

The fair value of loans is calculated using discounted cash flows and excludes lease financing arrangements. 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.

(d) Off-Balance-Sheet Instruments

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

(e) Deposits

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

(f) Short-term Borrowings

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

(g) Long-term Borrowings

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

The carrying value and estimated fair value of the Company's financial instruments at December 31, 1998 and 1997 are as follows (in thousands):

<TABLE>
<CAPTION>

<S>	1998 Carrying amount <C>	1998 Estimated fair value <C>	1997 Carrying amount <C>	1997 Estimated fair value <C>
Financial assets:				
Cash and short-term investments	$ 9,614	9,614	16,606	16,606

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Investment securities	$ 71,680	71,813	54,810	54,848
Loans, net of allowance for loan losses	$ 215,879	221,028	183,368	186,582
Financial liabilities:				
Deposits	$ 233,505	234,146	223,978	223,387
Short-term borrowings	$ 12,944	12,944	1,274	1,274
Long-term borrowings	$ 31,000	31,423	11,196	10,999
Off-balance sheet financial instruments:				
Interest rate contracts:				
Swaps	$ --	41	--	76
Caps and floors	23	126	43	84
	$ 23	167	43	160

</TABLE>

(14) Common Stock and Capital Requirements

The Company and Bank are subject to various regulatory capital requirements administered by the 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 direct material effect on the Company's 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, 1998, that the Company and Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 1998, based on its most recent notification, the Bank is categorized as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There are no 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, 1998 and 1997 are as follows (dollars in thousands):

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

	Actual		Minimum for capital adequacy purposes		Minimum to be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Auburn National Bancorporation, Inc.						
As of December 31, 1998						
Total capital (to risk-weighted assets)	$ 31,294	14.58%	$ 17,169	8%	N/A	N/A
Tier I risk-based capital (to risk-weighted assets)	28,610	13.33	8,584	4	N/A	N/A
Tier I leverage capital (to average assets)	28,610	9.29	12,315	4	N/A	N/A
As of December 31, 1997						
Total capital (to risk-weighted assets)	$ 27,997	15.22%	$ 14,717	8%	N/A	N/A
Tier I risk-based capital (to risk-weighted assets)	25,872	14.06	7,359	4	N/A	N/A
Tier I leverage capital (to average assets)	25,872	9.80	10,561	4	N/A	N/A
AuburnBank						
As of December 31, 1998						
Total capital (to risk-weighted assets)	$ 28,829	13.58%	$ 16,988	8%	$ 21,235	10%
Tier I risk-based capital (to risk-weighted assets)	26,173	12.33	12,213	4	12,741	6
Tier I leverage capital (to average assets)	26,173	8.57	8,495	4	15,266	5
As of December 31, 1997						
Total capital (to risk-weighted assets)	$ 25,229	13.89%	$ 14,529	8%	$ 18,161	10%
Tier I risk-based capital (to risk-weighted assets)	23,104	12.72	7,264	4	10,897	6
Tier I leverage capital (to average assets)	23,104	8.84	10,453	4	13,066	5

(15) Dividends from Subsidiary

Dividends paid by the Bank are a principal source of funds available to the Company for payment of dividends to its stockholders and for other needs. Applicable federal and state statutes and regulations impose restrictions on the amounts of dividends that may be declared by the subsidiary bank. State statutes restrict the Bank from declaring dividends in excess of the sum of the current year's earnings plus the retained net earnings from the preceding two years without prior approval. In addition to the formal statutes and regulations, regulatory authorities also consider the adequacy of the Bank's total capital in relation to its assets, deposits, and other such items. Capital adequacy considerations could further limit the availability of dividends from the Bank. At December 31, 1998, the Bank could have declared dividends of approximately $8,253,000 without prior approval of regulatory authorities. As a result of this limitation, approximately $18,254,000 of the Company's investment in the Bank was restricted from transfer in the form of dividends.

(16) Supplemental Information

Components of other noninterest income exceeding one percent of revenues for any of the years in the three-year period ended December 31, 1998, included merchant discounts and fees on MasterCard and Visa sales of $391,315, $310,416, and $293,004 in 1998, 1997, and 1996, respectively; and, gain on sale of mortgage loans of $134,715, $76,747, and $68,433 in

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

1998, 1997, and 1996, respectively. Also included were servicing fees of $176,522, $166,538, and $163,820 in 1998, 1997, and 1996, respectively; and, rental income of $150,623, $138,618, and $161,510 in 1998, 1997, and 1996, respectively.

Components of other noninterest expense exceeding one percent of revenues for any of the years in the three-year period ended December 31, 1998, included professional fees of $254,981, $155,635, and $225,036 in 1998, 1997, and 1996, respectively. Also included were marketing expenses of $184,512, $221,504, and $191,553 in 1998, 1997, and 1996, respectively; rental property expenses of $238,570, $239,192, and $236,206 in 1998, 1997, and 1996, respectively; and, MasterCard and Visa processing fees of $371,361, $254,863, and $231,432 in 1998, 1997, and 1996, respectively.

(17) Parent Company Financial Information

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

<TABLE>
<CAPTION>

Parent Company Only
Condensed Balance Sheets
December 31, 1998 and 1997

Assets	1998	1997
Cash and due from banks	$ 170,713	474,460
Investment securities	642,228	693,221
Investment in bank subsidiary	26,506,602	23,280,149
Premises and equipment, net	44,346	68,194
Rental property	1,760,294	1,807,359
Other assets	152,346	154,238
Total assets	$ 29,276,529	26,477,621
Liabilities and Stockholders' Equity		
Other borrowed funds	$ 242,453	262,589
Accrued expenses and other liabilities	90,580	110,691
Employee Stock Ownership Plan debt	--	56,934
Total liabilities	333,033	430,214
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 at December 31, 1998 and 1997	39,571	39,571
Additional paid-in capital	3,707,472	3,707,472
Retained earnings	25,077,126	22,396,461
Accumulated other comprehensive income	333,926	175,436
Less:		
Employee Stock Ownership Plan debt	--	(56,934)
Treasury stock, 10,854 shares in 1998 and 1997, at cost	(214,599)	(214,599)
Total stockholders' equity	28,943,496	26,047,407
Total liabilities and stockholders' equity	$ 29,276,529	26,477,621

</TABLE>

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Notes to Consolidated Financial Statements

December 31, 1998, 1997, and 1996

Parent Company Only
Condensed Statements of Earnings
Years Ended December 31, 1998, 1997, and 1996

	1998	1997	1996
Income:			
Cash dividends from bank subsidiary	$ 385,000	697,000	265,000
Interest on interest-earning deposits	--	--	7,306
Interest on investment securities:			
Taxable	1,764	3,822	3,453
Tax-exempt	34,982	37,765	43,258
Total interest on investment securities	36,746	41,587	46,711
Other income	640,358	612,970	819,286
Total income	1,062,104	1,351,557	1,138,303
Expense:			
Interest on borrowed funds	19,347	22,450	26,197
Net occupancy expense	24,819	24,218	25,368
Salaries and benefits	332,685	357,186	322,750
Other	341,021	331,948	369,930
Total expense	717,872	735,802	744,245
Earnings before income tax expense (benefit) and equity in undistributed earnings (loss) of subsidiaries	344,232	615,755	394,058
Applicable income tax expense (benefit)	(27,222)	(35,924)	10,917
Earnings before equity in undistributed earnings (loss) of subsidiaries	371,454	651,679	383,141
Equity in undistributed earnings (loss) of subsidiaries:			
Bank	3,067,963	2,429,787	2,370,686
Other	--	(1,423)	(473)
Net earnings	$ 3,439,417	3,080,043	2,753,354

Parent Company Only
Condensed Statements of Cash Flows
Years Ended December 31, 1998, 1997, and 1996

	1998	1997	1996
Cash flows from operating activities:			
Net earnings	$ 3,439,417	3,080,043	2,753,354
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	119,007	116,919	124,980

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Amortization of premium on investment securities held to maturity	--	--	391
Net undistributed earnings of subsidiaries	(3,067,963)	(2,428,364)	(2,370,213)
Decrease (increase) in other assets	1,892	142,437	(191,004)
(Decrease) increase in other liabilities	(20,111)	18,740	17,929
Net cash provided by operating activities	472,242	929,775	335,437
Cash flows from investing activities:			
Proceeds from paydowns of investment securities held to maturity	5,993	9,554	11,155
Proceeds from calls of investment securities held to maturity	45,000	45,000	95,000
Purchase of premises and equipment	--	(83,488)	--
Proceeds from sale of premises and equipment	--	47,444	11,554
Purchase of rental property	(48,094)	(1,978)	(35,746)
Net cash provided by investing activities	2,899	16,532	81,963
Cash flows from financing activities:			
Decrease in other borrowed funds	(20,136)	(20,749)	(20,800)
Proceeds from sale of treasury stock	--	140,812	22,498
Purchase of treasury stock	--	(8,648)	(221,141)
Dividends paid	(758,752)	(626,562)	(560,284)
Net cash used in financing activities	(778,888)	(515,147)	(779,727)
Net (decrease) increase in cash and cash equivalents	(303,747)	431,160	(362,327)
Cash and cash equivalents at beginning of year	474,460	43,300	405,627
Cash and cash equivalents at end of year	$ 170,713	474,460	43,300

</TABLE>

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Auburn, State of Alabama, on the 26th day of March, 1999.

AUBURN NATIONAL BANCORPORATION, INC.
(Registrant)

By: /s/ E. L. SPENCER, JR.

E. L. Spencer, Jr.
President

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ E. L. SPENCER, JR. E. L. Spencer, Jr.	President, CEO and Director	March 26, 1999
/s/ LINDA D. FUCCI Linda D. Fucci	Chief Financial Officer and Chief Accounting Officer	March 26, 1999
/s/ TERRY W. ANDRUS Terry W. Andrus	Director	March 26, 1999
/s/ ANNE M. MAY Anne M. May	Director	March 26, 1999

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

/s/ EMIL F. WRIGHT, JR. Director March 26, 1999

Emil F. Wright, Jr.

AUBURN NATIONAL BANCORPORATION, INC.

EXHIBIT INDEX

<TABLE>
<CAPTION>

Exhibit Number	Description	Sequentially Numbered Page
<S>	<C>	<C>
3.A.	Certificate of Incorporation of Auburn National Bancorporation, Inc. *	-
3.B.	Bylaws of Auburn National Bancorporation, Inc. *	-
4.	Instruments Defining the Rights of Security Holders (See Certificate of Incorporation and Bylaws). *	-
10.A.	Auburn National Bancorporation, Inc. 1994 Long-Term Incentive Plan. *	-
10.B.	Lease and Equipment Purchase Agreement, dated September 15, 1987. *	-
21.	Subsidiaries of Registrant	75
23.	Consent of Accountants	76
27.	Financial Data Schedule	77

</TABLE>

----

* Incorporated by reference from Registrant's Registration Statement on Form SB-2 (File No. 33-86180).

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Exhibit 21

AUBURN NATIONAL BANCORPORATION INC AND SUBSIDIARY
EXHIBIT 21 - SUBSIDIARIES

AuburnBank

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Exhibit 23

AUBURN NATIONAL BANCORPORATION INC AND SUBSIDIARY
EXHIBIT 23 - CONSENT OF ACCOUNTANTS

The Board of Directors
Auburn National Bancorporation, Inc.

We consent to the incorporation by reference in the registration statement (No. 333-03516) on Form S-3 of Auburn National Bancorporation, Inc. of our report dated February 4, 1999, relating to the consolidated balance sheets of Auburn National Bancorporation, Inc. and subsidiary as of December 31, 1998 and 1997, and the consolidated statements of earnings, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 1998, which report appears in the December 31, 1998 annual report on Form 10-KSB of Auburn National Bancorporation, Inc.

KPMG LLP

Atlanta, Georgia
March 26, 1999

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

```
<TABLE> <S> <C>



<ARTICLE> 9
<LEGEND>
THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE 10-KSB
FOR DECEMBER 31, 1998 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH
FINANCIAL STATEMENTS.
</LEGEND>

<S>                               <C>
<PERIOD-TYPE>                     12-MOS
<FISCAL-YEAR-END>                           DEC-31-1998
<PERIOD-START>                              JAN-01-1998
<PERIOD-END>                                DEC-31-1998
<CASH>                                            9,220
<INT-BEARING-DEPOSITS>                              134
<FED-FUNDS-SOLD>                                    260
<TRADING-ASSETS>                                      0
<INVESTMENTS-HELD-FOR-SALE>                      63,586
<INVESTMENTS-CARRYING>                            8,094
<INVESTMENTS-MARKET>                              8,227
<LOANS>                                         218,687
<ALLOWANCE>                                       2,808
<TOTAL-ASSETS>                                  307,874
<DEPOSITS>                                      233,505
<SHORT-TERM>                                     12,944
<LIABILITIES-OTHER>                               1,482
<LONG-TERM>                                      31,000
<PREFERRED-MANDATORY>                                 0
<PREFERRED>                                           0
<COMMON>                                             40
<OTHER-SE>                                       28,903
<TOTAL-LIABILITIES-AND-EQUITY>                  307,874
<INTEREST-LOAN>                                  17,468
<INTEREST-INVEST>                                 3,896
<INTEREST-OTHER>                                    356
<INTEREST-TOTAL>                                 21,720
<INTEREST-DEPOSIT>                                9,557
<INTEREST-EXPENSE>                               11,189
<INTEREST-INCOME-NET>                            10,531
<LOAN-LOSSES>                                       891
<SECURITIES-GAINS>                                   14
<EXPENSE-OTHER>                                   6,838
<INCOME-PRETAX>                                   5,281
<INCOME-PRE-EXTRAORDINARY>                        5,281
<EXTRAORDINARY>                                       0
<CHANGES>                                             0
```

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

<NET-INCOME> 3,439
<EPS-PRIMARY> 0.88
<EPS-DILUTED> 0.88
<YIELD-ACTUAL> 3.96
<LOANS-NON> 4,593
<LOANS-PAST> 304
<LOANS-TROUBLED> 0
<LOANS-PROBLEM> 2,654
<ALLOWANCE-OPEN> 2,125
<CHARGE-OFFS> 314
<RECOVERIES> 106
<ALLOWANCE-CLOSE> 2,808
<ALLOWANCE-DOMESTIC> 2,808
<ALLOWANCE-FOREIGN> 0
<ALLOWANCE-UNALLOCATED> 0

</TABLE>

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document