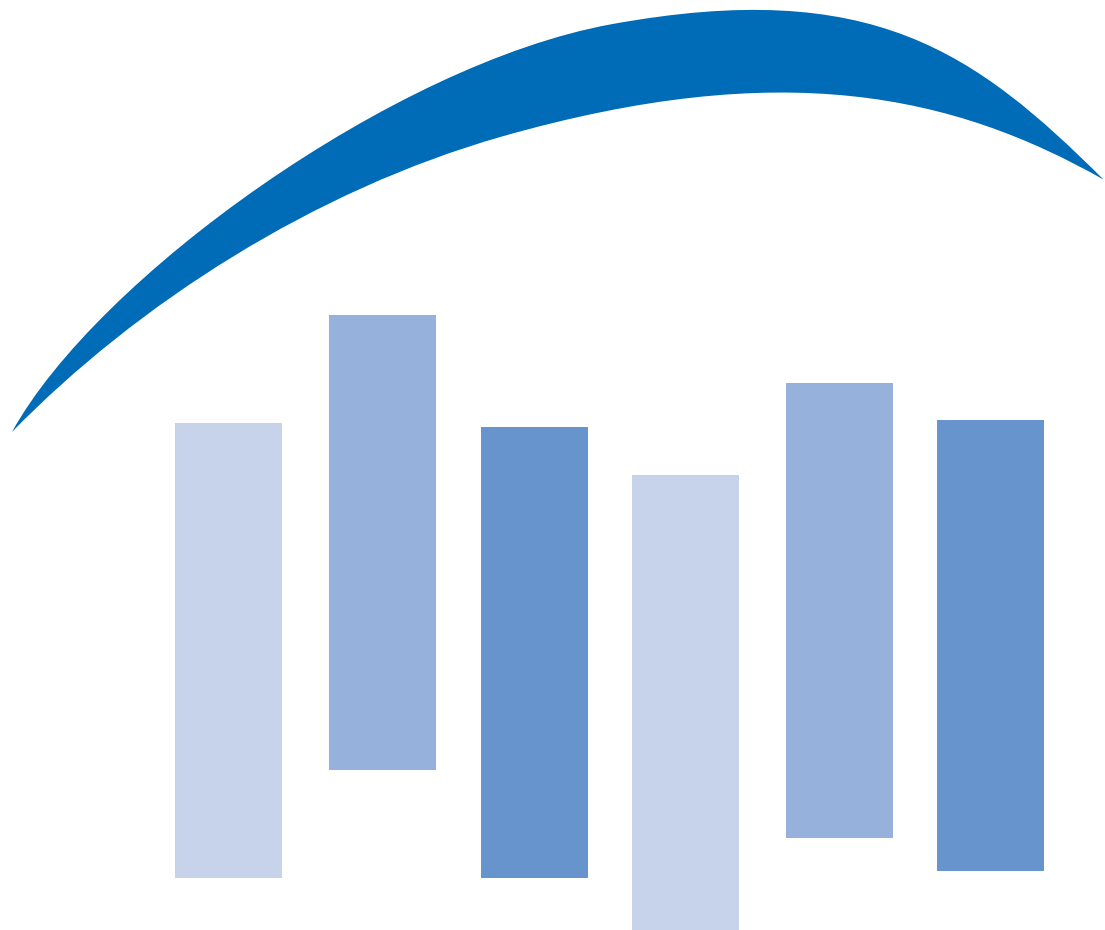




Quarterly Report

Quarter Ended June 30, 2006

Trading Symbol: **AUGR.PK**



AUTO-GRAPHICS, INC.
Quarterly Report
June 30, 2006

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AUTO-GRAPHICS, INC.
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Unaudited Consolidated Balance Sheet

<u>ASSETS</u>	
Current assets:	
Cash	\$ 790,397
Accounts receivable, less allowance for doubtful accounts of \$39,000	210,745
Unbilled production costs	6,591
Other current assets	<u>166,286</u>
Total current assets	1,174,019
Software, net	2,491,502
Equipment, furniture and leasehold improvements, net	206,505
Other assets	<u>22,522</u>
	<u>\$ 3,894,548</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>	
Current liabilities:	
Accounts payable	\$ 82,245
Deferred income	637,813
Accrued payroll and related liabilities	173,192
Other accrued liabilities	<u>54,123</u>
Total current liabilities	947,373
Deferred taxes (Note 5)	<u>91,000</u>
Total liabilities	1,038,373
Stockholders' equity:	
Common stock, 12,000,000 shares authorized, 5,340,586 shares issued and Outstanding (Note 7)	4,202,445
Accumulated deficit	(1,305,929)
Other comprehensive income/(loss)	<u>(40,341)</u>
Total stockholders' equity	<u>2,856,175</u>
	<u>\$ 3,894,548</u>

See Notes to Unaudited Consolidated Financial Statements.

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Unaudited Consolidated
Statements of Operations
For the Six Months Ended June 30,

	<u>2006</u>	<u>2005</u>
Net sales (See Note 4)		
Subscriptions		
and maintenance	\$ 2,290,068	\$ 2,257,060
License and services	<u>270,046</u>	<u>289,475</u>
	2,560,114	2,546,535
Costs and expenses (See Note 1)		
Cost of sales	625,034	633,807
Research and development	237,821	255,054
Sales, marketing		
and customer service	1,143,596	1,050,827
General and		
Administrative	<u>443,890</u>	<u>514,285</u>
Total costs and expenses	<u>2,450,341</u>	<u>2,453,973</u>
Income from operations	109,773	92,562
Interest/other expense	<u>11,346</u>	<u>(2,960)</u>
Income before taxes	121,119	89,602
Income tax expense (Note 5)	<u>15,000</u>	<u>--</u>
Net income	<u>\$ 106,119</u>	<u>\$ 89,602</u>
<u>Earnings per share (Note 6):</u>		
Basic income		
per share	\$.02	\$.02
Weighted average		
shares outstanding	5,340,586	5,525,586
Diluted income		
per share	\$.02	\$.02
Weighted average		
shares outstanding	5,910,486	5,935,486

See Notes to Unaudited Consolidated Financial Statements.

AUTO-GRAPHICS, INC.
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Unaudited Consolidated
Statements of Operations
For the Three Months Ended June 30,

	<u>2006</u>	<u>2005</u>
Net sales (See Note 4)		
Subscriptions		
and maintenance	\$ 1,150,940	\$ 1,131,440
License and services	<u>137,647</u>	<u>208,594</u>
	1,288,587	1,340,034
Costs and expenses (See Note 1)		
Cost of sales	328,653	321,305
Research and development	118,082	135,324
Sales, marketing		
and customer service	570,485	531,906
General and		
Administrative	<u>216,739</u>	<u>298,660</u>
Total costs and expenses	<u>1,233,959</u>	<u>1,287,195</u>
Income from operations	54,628	52,839
Interest/other expense	<u>8,744</u>	<u>(1,597)</u>
Income before taxes	63,372	51,242
Income tax expense (Note 5)	<u>10,000</u>	<u>--</u>
Net income	<u>\$ 53,372</u>	<u>\$ 51,242</u>
<u>Earnings per share (Note 6):</u>		
Basic income		
per share	\$.01	\$.01
Weighted average		
shares outstanding	5,340,586	5,525,586
Diluted income		
per share	\$.01	\$.01
Weighted average		
shares outstanding	5,910,486	5,935,486

See Notes to Unaudited Consolidated Financial Statements.

AUTO-GRAPHICS, INC.
Unaudited Consolidated Statement Of Stockholders' Equity
And Comprehensive Income
For the Six Months Ended June 30,

	<u>Common Stock</u>		Retained	Other	Total
	<u>Shares</u>	<u>Amount</u>	(Accumulated Deficit)	Comprehensive Income/(Loss)	Stockholders' Equity
Balances at December 31, 2005	5,525,586	\$4,274,625	\$(1,412,048)	\$ (40,341)	\$ 2,822,236
Stock repurchase	(185,000)	(83,250)	--	--	(83,250)
Stock based compensation (Note 8)	--	11,070	--	--	11,070
Net income	--	--	106,119	--	106,119
Foreign currency translation adjustments	--	--	--	--	--
Comprehensive income	--	--	--	--	106,119
Balances at June 30, 2006	<u>5,340,586</u>	<u>\$4,202,445</u>	<u>\$(1,305,929)</u>	<u>\$ (40,341)</u>	<u>\$ 2,856,175</u>

See Notes To Consolidated Financial Statements.

AUTO-GRAPHICS, INC.
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Unaudited Consolidated Statements of Cash Flows
For the Six months Ended June 30,
Increase (Decrease) in Cash

	2006	2005
Cash flows from operating activities:		
Net income	\$ 106,119	\$ 89,602
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	367,514	409,816
Provision for doubtful accounts	(25,000)	15,000
Stock based compensation (Note 8)	11,070	--
Changes in operating assets and liabilities		
Accounts receivable	43,723	218,667
Unbilled production costs	(6,591)	(2,249)
Other current assets	(14,076)	25,446
Other assets	42,500	1,216
Accounts payable	78	(20,095)
Deferred revenue	(97,685)	73,492
Accrued payroll and related liabilities	(10,678)	(12,378)
Other accrued liabilities	(34,229)	(60,626)
Net cash provided by operating activities	382,745	737,891
Cash flows from investing activities:		
Capital expenditures	(35,080)	(29,440)
Capitalized software development	(249,475)	(250,000)
Net cash used in investing activities	(284,555)	(279,440)
Cash flows from financing activities (Note 2):		
Surrender of Key-man Life Insurance Policies, Net	--	100,665
Capital stock purchases (Note 7)	(83,250)	--
Net cash provided by (used in) financing activities	(83,250)	100,665
Net increase (decrease) in cash	14,940	559,116
Foreign currency effect on cash	--	(9,285)
Cash at beginning of year	775,456	58,580
Cash at end of quarter	\$ 790,396	\$ 608,411

See NOTES to Unaudited Consolidated Financial Statements.

AUTO-GRAPHICS, INC.
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Notes To Unaudited Consolidated Financial Statements

Note 1. The unaudited consolidated financial statements included herein have been prepared by management and include all normal and recurring adjustments which are, in the opinion of management, necessary for a fair presentation of the financial position at June 30, 2006, the results of operations and the statement of cash flows for the three and six months ended June 30, 2006 and 2005 in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of Auto-Graphics, Inc. and its wholly owned subsidiary, A-G Canada Ltd. The Company has no so-called special purpose entities or off-balance sheet or derivative financing of any kind. All entities have been consolidated and all material intercompany accounts and transactions have been eliminated.

The results of operations for the subject periods are not necessarily indicative of the results for the entire year.

This Quarterly Report is qualified in its entirety by the information included in the Company's Annual Report for the period ending December 31, 2005 including, without limitation, the financial statements and notes therein.

Note 2. In August 2006, the bank renewed and extended the Company's credit facility through May 1, 2008. The credit facility is composed of a \$500,000 revolving line of credit for working capital and a second \$1,000,000 five-year term facility to fund major investments. The interest rate on both credit facilities is the bank prime rate plus 1.0% margin (9.25% at June 30, 2006). The credit facility is secured by all of the assets of the Company and its subsidiary, A-G Canada Ltd. and requires that the Company maintain certain minimum financial covenant ratios. The Company was in compliance with all of its financial loan covenants, there were no outstanding borrowings under either credit facility and there was \$1,500,000 in available credit as of June 30, 2006.

Note 3. Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" establishes standards for reporting information about operating segments in interim and annual financial statements.

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Notes To Unaudited Consolidated Financial Statements

The following table summarizes sales based on the location of the customers and assets based on the location of the asset presented on the basis of generally accepted accounting principles for the three months ended June 30, 2006, and 2005:

	<u>2006</u>	<u>2005</u>
Geographic areas		
Net sales		
United States	\$ 2,106,496	\$ 2,090,128
Foreign - Canada/Other	453,618	456,407
Long-lived assets, net		
United States	2,698,007	2,834,785

Note 4. Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been reported in the Company's financial statements or tax returns. The valuation allowance at December 31, 2005 reflects an unrecognized U.S. and foreign tax loss carryforward. At December 31, 2005, the Company had available net operating loss carryforwards of \$2,849,000 for federal income tax purposes, \$1,250,000 for state income tax purposes and \$61,000 for foreign income tax purposes. These net operating loss carryforwards expire through 2020 for federal taxes, through 2010 for state and for foreign taxes.

Note 5. Earnings Per Share

Statement of Financial Accounting Standards No. 128, "Earnings per Share" requires the presentation of basic earnings per share and diluted earnings per share. Basic and diluted earnings per share computations presented by the Company conform to the standard and are based on the weighted average number of shares of Common Stock outstanding during the year. During the three months ended June 30, 2006, the Board of Directors awarded stock option grants totaling 165,000 shares at a fair market value of \$0.55 and stock option grants for 5,000 shares were forfeited.

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Notes To Unaudited Consolidated Financial Statements

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations:

<u>Six months ended June 30, 2006</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 106,119	5,340,586	\$ 0.02
Effect of dilutive securities			
Stock options	<u> --</u>	<u> 569,900</u>	<u> </u>
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 106,119</u>	<u>5,910,486</u>	<u>\$ 0.02</u>
<u>Six months ended June 30, 2005</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 89,602	5,525,586	\$ 0.02
Effect of dilutive securities			
Stock options	<u> --</u>	<u> 409,900</u>	<u> </u>
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 89,602</u>	<u>5,935,486</u>	<u>\$ 0.02</u>
<u>Three months ended June 30, 2006</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 53,372	5,340,586	\$ 0.01
Effect of dilutive securities			
Stock options	<u> --</u>	<u> 569,900</u>	<u> </u>
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 53,372</u>	<u>5,910,486</u>	<u>\$ 0.01</u>

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Notes To Unaudited Consolidated Financial Statements

<u>Three months ended June 30, 2005</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 51,242	5,525,586	\$ 0.01
Effect of dilutive securities			
Stock options	<u> --</u>	<u> 409,900</u>	<u> </u>
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 51,242</u>	<u>5,935,486</u>	<u>\$ 0.01</u>

Note 6. In February 2006, the Company repurchased 185,000 shares representing 3.3% of its issued and outstanding Common Stock in a private transaction at a price of \$0.45 per share for a total cost of \$83,250. The share repurchase transaction was approved by the Board of Directors and major shareholders and reviewed by the Company’s primary bank. These shares were retired and returned to authorized but unissued Common Stock.

Note 7. In December 2005, the Financial Accounting Standards Board (“FASB”) reissued SFAS No. 123R, “Share-Based Payments.” This Statement is a revision of SFAS No. 123, “Accounting for Stock-Based Compensation,” and supersedes APB Opinion No. 25, “Accounting for Stock Issued to Employees.” This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This Statement requires that the cost resulting from all share-based payment transactions be recognized in the financial statements effective as of the beginning of the first interim or annual reporting period beginning after December 15, 2005. The Company has adopted this Standard in 2006, which will result in a charge to earnings of approximately \$9,000 (net of tax) in 2006 with approximately \$7,000 (net of tax) charged to expense in the six months ended June 30, 2006. (See Notes to Consolidated Financial Statements)

Note 8. Recently Issued Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 154, Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS No. 154 requires retrospective application to prior periods’ financial statements of voluntary changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative

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Notes To Unaudited Consolidated Financial Statements

effect of the change. This statement also requires that a change in depreciation, amortization, or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate affected by a change in accounting principle. The provisions of this statement will become effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154 is not expected to have a significant impact upon the Company's financial condition or results of operations.

In March 2005, the FASB issued Interpretation No. 47 ("FIN 47"), Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143. FIN 47 clarifies that an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. This interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. This interpretation is effective no later than the end of fiscal years ending after December 15, 2005. The adoption of FIN 47 does not have a material impact upon the Company's financial condition or results of operations.

In November 2005, the FASB issued FASB Staff Positions ("FSP") FAS 115-1 and FAS 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. This FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. This FSP is effective for reporting periods beginning after December 15, 2005. The adoption of this FSP is not expected to have a material impact upon the Company's financial condition or results of operations.

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Management Discussion And Analysis

CRITICAL ACCOUNTING POLICIES

The Company maintains its accounting books and records in accordance with accounting principles generally accepted in the United States of America. The preparation of the financial statements of the Company in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and sales and expenses during the reporting period. These estimates are based on information available as of the date of the financial statements. Actual results may materially differ from those estimated. The Company's critical accounting policies include the following:

- Capitalized software development costs
- Amortization of software development costs
- Revenue recognition

The Company accounts for internally developed software in accordance with Statement of Financial Accounting Standard (SFAS) No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed." After technical feasibility has been established, the Company capitalizes the average cost per billable hour of its software development process including payroll and payroll benefits, training and recruiting costs. The Company collects and records the programming labor hours invested in software development projects. Annually, the Company evaluates these accumulated costs for recoverability against estimated future revenues and determines the amount, which will be capitalized. To the extent that more development costs are capitalized, the Company's net income will improve, and, to the extent that more software development costs are expensed instead of capitalized, the Company's net income will decline.

The Company amortizes its software development costs in accordance with the estimated economic life of the software, which generally is seven years. The Company's typical product lifecycle has been about 15 years, which was true for its prior film/fiche product line, CD-ROM product line and current Internet/Web product line, which has now been deployed for 12 years and is still growing. To the extent the actual useful life varies significantly from the estimated useful life, amortization expense may be understated or overstated. Generally, amortization expense averages approximately 13% of total sales.

Revenue recognition policies vary according to the nature of the revenue. The Company's primary revenue stream is outsourced web hosting services, which are sold on a subscription basis. Generally, these large contract services are billed in advance on an annual, semi-annual or quarterly basis. Revenue is then recognized monthly as services are rendered. Revenues, which have been

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Management Discussion And Analysis

billed, and payment collected in advance are booked as deferred revenue until the services are provided and revenues earned. For certain small annual subscriptions, one-fourth of the annual revenue is recognized in the quarter the annual subscription is billed (or renews) and the balance is recognized evenly over the next three quarters in accordance with Statement of Position ("SOP") 97-2, "Software Revenue Recognition," as amended by SOP 98-4 and 98-9. Certain contract job processing services are progress billed and revenues recognized as the processing services are performed on a monthly basis. Certain software and hardware sales are billed when the product is shipped or access rights are provided to the customer.

LIQUIDITY AND CAPITAL RESOURCES

Working capital improved by \$466,000 to a surplus of \$227,000 in 2006 up from a working capital deficit of \$239,000 in 2005 due primarily to an increase in cash flow from operations. The cash flow from operations of \$340,000 enabled the Company to fund \$285,000 in capital expenditures and a capital stock repurchase of \$83,000 internally in 2006. Cash at the end of the quarter was \$790,000 up \$182,000 from \$608,000 for the same period in 2005. The Company's excess cash is invested in uninsured investment grade securities on a short-term basis.

The Company's primary AGent™ product is sold on an annual subscription basis with fees for services billed to the customer and paid annually or quarterly in advance. These cash payments are received and booked to deferred revenue on the balance sheet to be applied as the monthly sales revenues are earned and recognized on a pro-rata basis. A growing percentage of sales (approximately 65%) of the Company's sales revenues are now being paid through customer advances without ever flowing through accounts receivable. Therefore, the average accounts receivable balance is lower than it would otherwise historically be and there is a substantial deferred revenue balance in current liabilities representing revenues to be earned from future services for customers who have paid in advance.

At December 31, 2005, the Company's principal financial commitments, other than its bank line of credit involved the lease of corporate facilities in Pomona, California and in Toronto, Canada. Total commitments over next three years total approximately \$544,000.

The Company's principal use of cash for investing activities during 2006 and 2005 were directed primarily towards continuing development of the Company's AGent™ and VERSO™ software and ASP (Application Service Provider) services. The amount invested in capitalized software was \$249,000 and \$250,000 for the six months ended June 30, 2006 and 2005, respectively. The remainder of investing activities was to acquire hardware and software used to expand and enhance

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Management Discussion And Analysis

online services to the Company's current and prospective ASP customers. Total capital expenditures were up \$6,000 to \$285,000 in 2006 from \$279,000 in 2005.

Information Relating To Forward-Looking Statements

The Company wants to provide stockholders and investors with meaningful and useful information. Therefore, this report may contain forward-looking information, describing the Company's belief concerning future events or business conditions, and the outlook of the Company based on currently available information. These forward looking statements are subject to risks and uncertainties which could cause actual events or the Company's actual results or performance to differ materially from those expressed in these statements. Readers are encouraged to read the Company's Annual Report for a more complete description of these factors. The Company assumes no obligation to update the information contained in this Quarterly Report.

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Management Discussion and Analysis

RESULTS OF OPERATIONS

Six Months Ended June 30, 2006 as Compared to 2005

Net sales were \$2,560,000 for the six months ended June 30, 2006 up \$13,000 from \$2,547,000 for the same period in 2005. Recurring subscriptions & maintenance sales was up \$33,000 due to additional Verso sales and license and services sales was down \$19,000 due to completion of a large publishing project in 2005.

Cost of sales was down \$9,000 to \$625,000 in 2006 compared to \$634,000 in 2005 due to lower depreciation and amortization. Cost of sales includes \$368,000 and \$410,000 in non-cash depreciation and amortization in 2006 and 2005, respectively. Gross margins improved to 76% in 2006 up from 75% in 2005 as the Company has continued to focus on its core library ASP services business.

Research and development expenses were down \$17,000 or 7% from \$255,000 in 2005 to \$238,000 in 2006 due to lower payroll and training expenses. Research and development is presented net of capitalized software of \$249,000 in 2006 versus \$250,000 in 2005. Gross research and development costs were \$487,000 in 2006 compared to \$505,000 in 2005.

Sales, marketing and customer service expenses increased \$93,000 or 9% from \$1,051,000 in 2005 to \$1,144,000 in 2006 due to additional trade show and customer service payroll expenses, and marketing expenses for the introduction of the new AGent Search software product.

General and administrative expenses decreased \$70,000 or 14% from \$514,000 in 2005 to \$444,000 in 2006 due to lower legal and non-recurring director expenses and bad debts expense.

Operating income was up \$17,000 or 19% to \$110,000 in 2006 versus \$93,000 in 2005 due to higher sales.

Interest/other income was \$11,000 in 2006 up from an expense of \$3,000 in 2005 due to interest income on higher cash balances in 2006 versus interest expense on higher borrowings in 2005.

Provision for taxes based on income in 2006 and 2005 reflects the effect of minimum state taxes offset by federal and state net operating loss carryforwards.

Net income was \$106,000 in 2006 up \$16,000 or 18% from \$90,000 in 2005 due to higher sales. Basic and diluted earnings per share was \$0.02 in 2006 and 2005, respectively.

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Management Discussion and Analysis

RESULTS OF OPERATIONS

Second Quarter 2006 as Compared to Second Quarter 2005

Net sales were \$1,289,000 for the three months ended June 30, 2006 down 4% or \$51,000 from \$1,340,000 for the same period in 2005. Recurring subscriptions & maintenance sales was up \$20,000 and license and services sales was down \$71,000 due to completion of a large non-recurring publishing project in 2005.

Cost of sales was up \$7,000 or 2% to \$329,000 in 2006 compared to \$321,000 in 2005 due to higher payroll and variable costs offset by lower depreciation and amortization. Cost of sales includes \$183,000 and \$211,000 in non-cash depreciation and amortization in 2006 and 2005, respectively. Gross margins declined to 75% in 2006 from 76% in 2005 due to the decline in sales.

Research and development expenses were down \$17,000 or 13% from \$135,000 in 2005 to \$118,000 in 2006. Research and development is presented net of capitalized software of \$105,000 in 2006 versus \$125,000 in 2005. Gross research and development costs were \$223,000 in 2006 compared to \$260,000 in 2005.

Sales, marketing and customer service expenses increased \$39,000 or 7% from \$532,000 in 2005 to \$570,000 in 2006 due to additional trade show and customer service payroll expenses, and marketing expenses for the introduction of the new AGent Search software product.

General and administrative expenses decreased \$82,000 or 27% to \$217,000 in 2006 down from \$299,000 in 2005 due to lower legal and non-recurring director expenses and bad debts expense.

Operating income was up \$2,000 or 3% to \$55,000 in 2006 versus \$53,000 in 2005.

Interest/other income was \$9,000 in 2006 up from an expense of \$2,000 in 2005 due to interest income on higher cash balances in 2006 versus interest expense on higher borrowings in 2005.

Provision for taxes based on income in 2006 and 2005 reflects the effect of minimum state taxes offset by federal and state net operating loss carryforwards.

Net income was \$53,000 in 2006 up \$2,000 or 4% from \$51,000 in 2005. Basic and diluted earnings per share was \$0.01 in 2006 and 2005, respectively.