



auto-graphics, inc.

Quarterly Report

Quarter Ended September 30, 2006

Trading Symbol: **AUGR.PK**



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

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Unaudited Condensed Consolidated Balance Sheet

<u>ASSETS</u>	
Current assets:	
Cash	\$ 1,245,455
Accounts receivable, less allowance for doubtful accounts of \$39,000	218,238
Unbilled production costs	10,019
Other current assets	<u>164,015</u>
Total current assets	1,637,727
Software, net	2,454,261
Equipment, furniture and leasehold improvements, net	205,946
Other assets	<u>22,522</u>
	<u>\$ 4,320,456</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>	
Current liabilities:	
Accounts payable	\$ 69,413
Deferred income	985,689
Accrued payroll and related liabilities	174,566
Other accrued liabilities	<u>70,310</u>
Total current liabilities	1,299,978
Deferred taxes (Note 4)	<u>91,000</u>
Total liabilities	1,390,978
Stockholders' equity:	
Common stock, 12,000,000 shares authorized, 5,340,586 shares issued and outstanding	4,205,256
Accumulated deficit	(1,235,437)
Other comprehensive loss	<u>(40,341)</u>
Total stockholders' equity	<u>2,929,478</u>
	<u>\$ 4,320,456</u>

See Notes to Unaudited Condensed Consolidated Financial Statements.

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Unaudited Condensed Consolidated
Statements of Operations
For the Three Months Ended September 30,

	<u>2006</u>	<u>2005</u>
Net sales (See Note 3)		
Subscriptions		
and maintenance	\$ 1,137,085	\$ 1,119,440
License and services	<u>126,321</u>	<u>185,713</u>
	1,263,406	1,305,153
Costs and expenses		
Cost of sales	342,605	372,740
Research and development	111,695	145,649
Sales, marketing		
and customer service	525,783	518,950
General and		
Administrative	<u>211,500</u>	<u>208,199</u>
Total costs and expenses	<u>1,191,583</u>	<u>1,245,538</u>
Income from operations	71,823	59,615
Interest/other income	<u>10,670</u>	<u>3,010</u>
Income before taxes	82,493	62,625
Income tax expense	<u>12,000</u>	<u>--</u>
Net income	<u>\$ 70,493</u>	<u>\$ 62,625</u>
<u>Earnings per share (Note 5):</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 Condensed Consolidated Financial Statements.

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Unaudited Condensed Consolidated
Statements of Operations
For the Nine Months Ended September 30,

	<u>2006</u>	<u>2005</u>
Net sales (See Note 3)		
Subscriptions		
and maintenance	\$ 3,427,152	\$ 3,376,500
License and services	<u>396,368</u>	<u>475,190</u>
	3,823,520	3,851,690
Costs and expenses		
Cost of sales	967,639	1,006,546
Research and development	349,516	400,704
Sales, marketing		
and customer service	1,669,379	1,569,778
General and		
Administrative	<u>655,545</u>	<u>722,482</u>
Total costs and expenses	<u>3,642,079</u>	<u>3,699,510</u>
Income from operations	181,441	152,180
Interest/other income	<u>22,170</u>	<u>55</u>
Income before taxes	203,611	152,235
Income tax expense	<u>27,000</u>	<u>--</u>
Net income	<u>\$ 176,611</u>	<u>\$ 152,235</u>
<u>Earnings per share (Note 5):</u>		
Basic income		
per share	\$.03	\$.03
Weighted average		
shares outstanding	5,340,586	5,525,586
Diluted income		
per share	\$.03	\$.03
Weighted average		
shares outstanding	5,910,486	5,935,486

See Notes to Unaudited Condensed Consolidated Financial Statements.

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Unaudited Condensed Consolidated Statement Of Stockholders' Equity
And Comprehensive Income
For the Nine Months Ended September 30,

	<u>Common Stock</u>		Retained Earnings/ (Accumulated Deficit)	Other Comprehensive Income/(Loss)	Total Stockholders' Equity
	<u>Shares</u>	<u>Amount</u>	<u>Deficit</u>	<u>Income/(Loss)</u>	<u>Equity</u>
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)	--	13,881	--	--	13,881
Net income	--	--	176,611	--	176,611
Foreign currency translation adjustments	--	--	--	--	--
Comprehensive income	--	--	--	--	176,611
Balances at September 30, 2006	<u>5,340,586</u>	<u>\$4,205,256</u>	<u>\$(1,235,437)</u>	<u>\$ (40,341)</u>	<u>\$ 2,929,478</u>

See Notes To Unaudited Condensed Consolidated Financial Statements.

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Unaudited Condensed Consolidated Statements of Cash Flows
For the Nine Months Ended September 30,
Increase (Decrease) in Cash

	2006	2005
Cash flows from operating activities:		
Net income	\$ 176,611	\$ 152,235
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	549,350	675,153
Provision for doubtful accounts	(25,000)	15,000
Stock based compensation (Note 8)	13,881	--
Changes in operating assets and liabilities		
Accounts receivable	36,230	185,817
Unbilled production costs	(10,019)	(3,383)
Other current assets	(11,805)	66,254
Other assets	42,500	1,216
Accounts payable	(12,755)	(2,605)
Deferred revenue	250,192	158,196
Accrued payroll and related liabilities	(18,042)	(16,712)
Other accrued liabilities	(9,304)	(45,586)
Net cash provided by operating activities	981,839	1,185,585
Cash flows from investing activities:		
Capital expenditures	(67,222)	(49,945)
Capitalized software development	(361,368)	(406,250)
Net cash used in investing activities	(428,590)	(456,195)
Cash flows from financing activities (Note 2):		
Surrender of key-man life insurance policies, net	--	100,665
Capital stock purchases (Note 6)	(83,250)	--
Net cash provided by (used in) financing activities	(83,250)	100,665
Net increase (decrease) in cash	469,999	830,055
Foreign currency effect on cash	--	(9,285)
Cash at beginning of year	775,456	58,580
Cash at end of quarter	\$ 1,245,455	\$ 879,350

See Notes to Unaudited Condensed Consolidated Financial Statements.

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Notes To Unaudited Condensed Consolidated Financial Statements

Note 1. The unaudited condensed 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 September 30, 2006, the results of operations and the statement of cash flows for the three and nine months ended September 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 September 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 September 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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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 nine months ended September 30, 2006, and 2005:

	<u>2006</u>	<u>2005</u>
Geographic areas		
Net sales		
United States	\$ 3,161,003	\$ 3,168,170
Foreign - Canada/Other	662,517	683,520
Long-lived assets, net		
United States	2,660,207	2,746,205

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

<u>Nine months ended September 30, 2006</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 176,611	5,340,586	\$ 0.03
Effect of dilutive securities			
Stock options	----- --	----- 569,900	-----
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 176,611</u>	<u>5,910,486</u>	<u>\$ 0.03</u>
<u>Nine months ended September 30, 2005</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 152,235	5,525,586	\$ 0.03
Effect of dilutive securities			
Stock options	----- --	----- 409,900	-----
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 152,235</u>	<u>5,935,486</u>	<u>\$ 0.03</u>
<u>Three months ended September 30, 2006</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 70,493	5,340,586	\$ 0.01
Effect of dilutive securities			
Stock options	----- --	----- 569,900	-----
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 70,493</u>	<u>5,910,486</u>	<u>\$ 0.01</u>

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<u>Three months ended September 30, 2005</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 62,625	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>\$ 62,625</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. Tender Offer

On October 12, 2006, the Company launched a tender offer to repurchase up to 1,000,000 shares of common stock from the public at a price not less than \$0.50 per share or greater than \$0.85 per share payable in cash. The Company intends to use its available cash balance of \$1,237,000 to fund the tender offer of a maximum of \$850,000 assuming the maximum purchase price of \$0.85 per share. In addition, the Company has bank credit facilities totaling \$1,500,000 in available credit. The tender offer expires on November 15, 2006 unless otherwise extended by the Company.

Note 8. In December 2005, the Financial Accounting Standards Board (“FASB”) reissued Statement of Financial Accounting Standards (“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

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\$11,000 (net of tax) in 2006 with approximately \$9,000 (net of tax) charged to expense in the nine months ended September 30, 2006.

Note 9. Recently Issued Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R). This Statement improves financial reporting by requiring an employer to recognize the over-funded or under-funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity. This Statement also improves financial reporting by requiring an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. An employer with publicly traded equity securities is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. The adoption of SFAS No. 158 is not expected to have a significant impact upon the Company's financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The adoption of SFAS No. 157 is not expected to have a significant impact upon the Company's financial condition or results of operations.

In June 2006, the FASB issued Financial Interpretation ("FIN") No. 48, Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109 – Accounting for Income Taxes. The Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting for interim

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periods, disclosure and transition. The provisions of this Interpretation will become effective for fiscal years beginning after December 15, 2006. The adoption of FIN No. 48 is not expected to have a significant impact upon the Company's financial condition or results of operations.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140. This Statement amends FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities. This Statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations. This Statement is effective for financial statements issued for fiscal years beginning after September 15, 2006 and interim periods within those fiscal years. The adoption of SFAS No. 156 is not expected to have a significant 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 13 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 12% 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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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 \$425,000 to a surplus of \$338,000 in 2006 up from a working capital deficit of \$87,000 in 2005 due primarily to an increase in cash flow from operations. The cash flow from operations of \$982,000 enabled the Company to fund \$429,000 in capital expenditures and a capital stock repurchase of \$83,000 internally in 2006. Cash at the end of the quarter was \$1,245,000 up \$366,000 from \$879,000 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. 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 \$361,000 and \$406,000 for the nine months ended September 30, 2006 and 2005, respectively. The remainder of investing activities was to acquire hardware and purchased software used to expand

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and enhance online services to the Company's current and prospective ASP customers. Capital expenditures for hardware and purchased software were \$67,000 in 2006 up \$17,000 from \$50,000 in 2005. Total capital expenditures were down \$27,000 to \$429,000 in 2006 from \$456,000 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

Nine Months Ended September 30, 2006 as Compared to 2005

Net sales were \$3,824,000 for the nine months ended September 30, 2006 down \$28,000 or 1% from \$3,852,000 for the same period in 2005. Recurring subscriptions & maintenance sales was up \$51,000 due to additional Verso sales. License and services sales were down \$79,000 due to completion of a large publishing project in 2005.

Cost of sales was down \$39,000 or 4% to \$968,000 in 2006 compared to \$1,007,000 in 2005 due to lower depreciation and amortization. Cost of sales includes \$549,000 and \$675,000 in non-cash depreciation and amortization in 2006 and 2005, respectively. Gross margins improved to 75% in 2006 up from 74% in 2005 as the Company has continued to focus on its core library ASP services business.

Research and development expenses were down \$51,000 or 13% from \$401,000 in 2005 to \$350,000 in 2006 due to lower payroll and training expenses. Research and development is presented net of capitalized software of \$361,000 in 2006 versus \$406,000 in 2005. Gross research and development costs were \$711,000 in 2006 compared to \$807,000 in 2005.

Sales, marketing and customer service expenses increased \$99,000 or 6% from \$1,570,000 in 2005 to \$1,669,000 in 2006 due to marketing expenses for the introduction of the new AGent Search software product.

General and administrative expenses decreased \$66,000 or 9% from \$722,000 in 2005 to \$656,000 in 2006 due to lower legal and non-recurring director expenses and bad debts expense.

Operating income was up \$29,000 or 19% to \$181,000 in 2006 versus \$152,000 in 2005 due to lower cost of sales, research & development and general & administrative expenses.

Interest/other income was \$22,000 in 2006 up 22,000 from \$0 in 2005 due to interest income on higher cash balances in 2006.

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 \$177,000 in 2006 up \$25,000 or 16% from \$152,000 in 2005 due to lower cost of sales, research & development and general & administrative expenses. Basic and diluted earnings per share were \$0.03 in 2006 and 2005, respectively.

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RESULTS OF OPERATIONS

Third Quarter 2006 as Compared to Third Quarter 2005

Net sales were \$1,263,000 for the three months ended September 30, 2006 down 3% or \$42,000 from \$1,305,000 for the same period in 2005. Recurring subscriptions & maintenance sales was up \$18,000 due to additional Verso sales and license and services sales was down \$60,000 due to completion of a large non-recurring publishing project in 2005.

Cost of sales was down \$30,000 or 8% to \$343,000 in 2006 compared to \$373,000 in 2005 due to lower depreciation and amortization. Cost of sales includes \$182,000 and \$265,000 in non-cash depreciation and amortization in 2006 and 2005, respectively. Gross margins increased to 73% in 2006 from 72% in 2005.

Research and development expenses were down \$34,000 or 23% from \$146,000 in 2005 to \$112,000 in 2006 due to lower payroll and consulting expenses. Research and development is presented net of capitalized software of \$112,000 in 2006 versus \$156,000 in 2005. Gross research and development costs were \$224,000 in 2006 compared to \$302,000 in 2005.

Sales, marketing and customer service expenses increased \$7,000 from \$519,000 in 2005 to \$526,000 in 2006 due to marketing expenses for the introduction of the new AGent Search software product.

General and administrative expenses increased \$3,000 to \$211,000 in 2006 up from \$208,000 in 2005.

Operating income was up \$12,000 or 20% to \$72,000 in 2006 versus \$60,000 in 2005 due to lower cost of sales, and research & development expenses.

Interest/other income was \$11,000 in 2006 up \$8,000 from \$3,000 in 2005 due to interest income on higher cash balances in 2006.

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 \$70,000 in 2006 up \$7,000 from \$63,000 in 2005 due to lower cost of sales, and research & development expenses. Basic and diluted earnings per share was \$0.01 in 2006 and 2005, respectively.