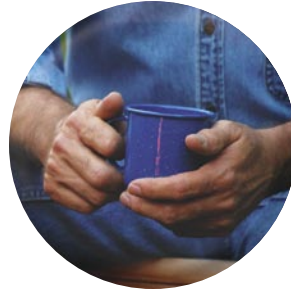


2006 Annual Report



Baker Boyer Bancorp
Walla Walla, Washington



Dear Baker Boyer Shareholder

I am pleased to report that 2006 proved to be another year of progress with solid financial performance and success on our key client initiatives. Net income per share increased to \$3.39 compared to \$3.35 in 2005. Return on assets improved to 1.2% which is 17% higher than our average peer banks. Our profitable client retention rate of 97.5% continues to be exceptional in the industry and the Wealth Management team hit an all time record of \$613 million in assets under management at year-end. The Board of Directors' confidence in the bank's fundamental performance led to a 3.2% increase in dividends to \$2.60 per share. The market rewarded shareholders with a 15% increase in our stock price to \$59.00 per share at the close of the year.

As we look to the future, let me share with you some personal observations and their strategic impact on us as a bank and you as a shareholder.

In the past few years I have had the pleasure to travel with my husband Marty to market our family-owned wines, and whether operating the bank or the winery, I've experienced first hand the new reality in today's business environment. As Thomas Freidman so aptly put it, "The World is Flat." To wit, I remember getting cash with my Baker Boyer debit card at ATMs in Kyoto, Madrid and Lausanne then walking across the street to purchase a chai tea latte in the familiar surroundings of Starbucks.

This increasingly "flat" global economy is creating fierce competition between banks in the communities we serve. The most important impact is the influence of China's monetary policy causing historically low long-term interest rates. China's actions coupled with the Federal Reserve's efforts to slow the US economy are creating an atypical relationship between short- and long-term interest rates. The result, an inverted yield curve, is putting significant pressure on net interest income industry wide.

Our financial team took action by carefully managing credit risk, interest rate risk, net interest margin and net interest income throughout the year. Credit quality improved allowing for a 51% reduction in loan loss provision. In addition, net interest margin increased to 4.67% as net loans grew 8% or \$19 million. Offsetting these favorable trends, deposits declined 1.2% as we consciously allowed higher cost deposits to run-off. Overall net interest income after provision for credit losses was therefore essentially flat.

Baker Boyer is responding to this increasingly competitive global banking environment in four major areas. First, we have successfully held the annual rate of growth on non-interest expense to 1.7% over the past 5 years. Second, we continue to invest in technology to improve customer convenience as illustrated by our introduction of eStatements, as well as operational efficiency via new credit analysis/decision-making software. Third, our relentless focus on an exceptional customer experience for all clients was rewarded

once again as we were voted "Best Bank" in the *Walla Walla Union Bulletin's* reader opinion poll for the third consecutive year.

And, most important, we continue to differentiate ourselves from other financial institutions by truly providing valued financial advice as explained in the sidebar to the right – Guiding You to a Brighter Financial Future. We have a unique breadth of services, from on-line cash management tools, tailored business financing packages, to sophisticated investment management services that guides our clients as they build wealth through all of their life stages. We developed several new marketing pieces to highlight the Baker Boyer difference and are kicking off a major business development initiative this spring (see the following pages). The initiative is all about investing in our future and strengthening core relationships to deliver profitable growth to shareholders.

I am fortunate to lead a dedicated team of banking professionals. We look forward to an exciting and productive year ahead.

Megan F. Clubb

President, CEO and
Chairman of the Board

Guiding You to a Brighter Financial Future.™

Many advisors and financial institutions spend the majority of their efforts solely on short-term results. While extremely important, focusing too much attention on this one cornerstone of financial management does not always build wealth. It takes unique and innovative strategies through all life stages to accomplish financial freedom. We deliver those strategies to our clients every day.



Your Leap, Our Faith
*Starting a business takes
knowledge and courage.
We're behind you all the way.*



Having a Game Plan
*Throughout life your financial
needs will evolve and grow.
We will keep you prepared.*



Securing Their Future
*Your family and their well-being
is important. We will carry out
your wishes.*



atland Bicycle Club and L'Ecole Bicycle
Racing Team.

Securities offered through Primevest Financial Services, Inc. Member NASD/SIPC, an independent, registered broker/dealer providing securities and insurance products • Not FDIC insured • May go down in value • Not a deposit of or guaranteed by any financial institution • Not insured by any federal government agency



Baker Boyer Bank

Guiding to you a brighter financial future.™

Wealth Management Service - Investor Services Group

7 W Main St • Walla Walla, WA 99362

(509) 526-1379 • aveyc@bakerboyer.com

BILL PAY

Customers who use bill pay have a much higher propensity to maintain their relationships at their current bank than customers who don't use online services. This over-sized postcard was one piece of a multi-component campaign that announced and encouraged our free bill pay service. As a result of this effort we achieved our goal for new bill pay clients.

Free Bill Pay is Here!
DON'T MISS OUT!

Now's the time to start paying your bills online.
No more stamps, no more checks, no more hassles!

FREE Bill Pay!
www.bakerboyer.com

Convenient! At bakerboyer.com, we're open 24/7. Whether you're out of state or even the country, simply log on for quick access to your money.

Fast! Online payments are processed immediately, and the money is debited promptly from your accounts. Get the job done in just minutes!

Efficient! Once you've set up your bill payment information, you can log on to pay one or all of your bills. Or, set up recurring payments, where the bank will automatically handle the transaction for you.

Safe. We use top-of-the-line security technology to protect your personal information. And soon, online banking and bill pay will be even safer, with the double protection of dual authentication!

Best of all, it's Free!
Call or stop in to sign up for Free Bill Pay -- today!

BB Baker Boyer Bank
Guiding you to a brighter financial future.™
1-800-234-7923 • www.bakerboyer.com
Member FDIC

Strengthening Core Relationships

At Baker Boyer, we're doing what it takes to make online banking even safer, with an extra layer of security.

Online Banking is Safer Than Ever!

Here's What You Need to Know:
This **NEW security system** is in place to further protect you from the threat of identity theft, by monitoring your account for unusual activity.
If **uncharacteristic activity** is detected, you may be asked to answer security questions.
The new feature will be applied to every online banking account. So when you log on or sign up, you may be asked to answer some **security questions** - which will then be stored for future verification.
Other than that, no action is required, and although we'll be **protecting you 24/7**, you won't even notice a difference!

If you have questions, please contact Karen Luke, our Online Banking Specialist, or visit "Identity Verification Frequently Asked Questions" at www.bakerboyer.com.

Loves the extra security.

Checks his eStatement the day it's ready.

BB Baker Boyer Bank
Guiding you to a brighter financial future.™
1-800-234-7923 • www.bakerboyer.com
Member FDIC

Baker Boyer is happy to announce Free eStatements! Protect a tree AND your identity with this time-saving service.

Lose the paper trail ... with Free eStatements!

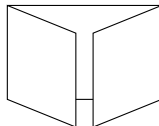
eStatement Benefits:
See your state generated at statements card You'll receive it's ready! No more paper right at your feet They're today eStatements will images. The on less hassles!
How to Sign:
1. Log on to w
2. Stop by any
3. Call and spe
For questi eStatements, c

Concerned about identity theft.

Wants his statements fast.

eSTATEMENT DIRECT MAILER

The convenience of eStatements was recently introduced to our customers in the spring of 2007 via this direct mail piece. By focusing on benefits and presenting the easy sign-up and access procedure, customers enthusiastically selected this new convenience and continue to enjoy the service.



WEALTH MANAGEMENT SERVICES BROCHURE

Providing current and comprehensive information to Wealth Management prospects is critical to building this vital line of business. Our new brochure defines and differentiates our philosophy and our execution, while coordinating with and complementing our Corporate Profile and Business Services Brochure.

Trusted Advice

Sophisticated Services

History of Growth

Wealth Management

Committed Teams

BB Baker Boyer Bank
Guiding you to a brighter financial future.™

Office Locations



MAIN OFFICE

7 W. Main Street, Walla Walla, WA 99362

EASTGATE BRANCH

1931 Isaacs, Walla Walla, WA 99362

PLAZA BRANCH

1530 Plaza Way, Walla Walla, WA 99362



COLLEGE PLACE BRANCH

603 S. College Avenue, College Place, WA 99324

MILTON-FREEWATER BRANCH

320 N. Columbia, Milton-Freewater, OR 97862

WESTON BRANCH

110 N. Water Street, Weston, OR 97886

WHEATLAND VILLAGE BRANCH

1500 S. Catherine Street, Walla Walla, WA 99362



KENNEWICK OFFICE - Tri-Cities Trust & Business Banking Center

7601 W. Clearwater, Suite 404, Kennewick, WA 99336

YAKIMA OFFICE - Investment Management & Trust Services

909 Triple Crown Way, Suite 101, Yakima, WA 98908

www.bakerboyer.com

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Consolidated Balance Sheets, Consolidated Statements of Income, Consolidated Statements of Shareholders' Equity, Consolidated Statements of Cash Flow and Notes.

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Consolidated Average Daily Balance Sheets and Five-Year Highlights.

Directors and Officers *Inside Back Cover*

A directory of Baker Boyer Bancorp and Baker Boyer Bank directors and officers.



Megan F. Clubb
President/Chief Executive Officer
Chairman of the Board
Baker Boyer Bancorp

I, the undersigned, hereby attest to the correctness of information contained in the Annual Report of Baker Boyer Bancorp and its wholly-owned subsidiary, Baker Boyer National Bank. This Annual Report is also furnished to customers of Bancorp pursuant to the requirements of the Federal Deposit Insurance Corporation (FDIC) to provide an annual disclosure statement. This Annual Report has not been reviewed for accuracy or relevance by the FDIC.

Megan F. Clubb

President, CEO and Chairman of the Board
Baker Boyer Bancorp

MEMBER FDIC

Auditor & Stock Information

Independent Public Accountants and Auditors

McGLADREY & PULLEN, LLP - 600 University Street, Suite 1100, Seattle, WA 98109
(206) 281-4444

Market Makers for Baker Boyer Bancorp Stock

HILL THOMPSON MAGID & CO. - 15 Exchange Place, Suite 800, Jersey City, NJ 07302-3912
(800) 631-3083

JEFFRIES GROUP, INC - 520 Madison Avenue, New York, NY 10022
(212) 336-7007

KNIGHT EQUITY MARKETS, LP - 545 Washington Blvd., Jersey City, NJ 07310
(212) 356-1527

MONROE SECURITIES, INC. - 47 State Street., 2nd Floor, Rochester, NY 14614
(800) 766-5560

PERSHING TRADING CO., LP - 1 Pershing Plaza, Jersey City, NJ 07399
(800) 459-1893

RYAN, BECK & CO. - 220 S Orange Avenue, Livingston, NJ 07039-5817
(800) 395-7926

UBS CAPITAL MARKETS, LP - 111 Pavonia Avenue East, Jersey City, New Jersey 07310
(800) 631-3094

WEDBUSH MORGAN SECURITIES - 4949 SW Meadows Road, Suite 100, Lake Oswego, OR 97035
(800) 357-3680

Direct Contacts for Stock Repurchases

MARK HESS, Executive Vice President/Chief Operating Officer
(509) 526-1315

MEGAN F. CLUBB, President/Chief Executive Officer/Chairman of the Board
(509) 526-1318

Corporate and Investor Information

Baker Boyer Bancorp is a Washington corporation registered under the Bank Holding Company Act of 1956 as a bank holding company. The Company's shares are not registered under the Securities Exchange Act of 1934. As of April 1994, the Company's shares were listed on the Over-The-Counter (OTC) Bulletin Board under the symbol BBBK. As of December 31, 2006, there were 1,297,376 shares of common stock issued and outstanding. General shareholder account inquiries should be directed to the Company's Chief Operating Officer at the following address and telephone number:

MARK HESS, Executive Vice President/Chief Operating Officer
7 West Main Street, PO Box 2175, Walla Walla, WA 99362
(509) 525-2000 • (800) 234-7923

Annual Meeting of Shareholders

The Annual Meeting of Shareholders will be held at 3:30 P.M. on Thursday, April 26, 2007, at the Walla Walla Country Club, Vista Rooms, 1390 Country Club Road, Walla Walla, Washington.

Financial Highlights

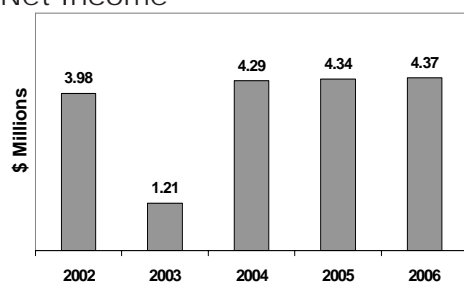
Baker Boyer Bancorp and Subsidiary

Dollars in thousands, except per share amounts

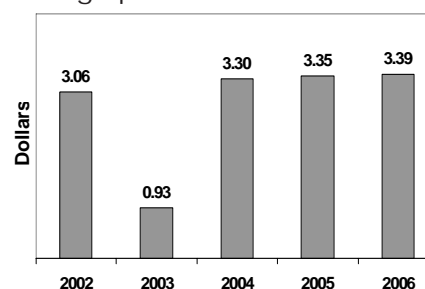
	12/31/06	12/31/05	% Change
Year-to-Date			
Net Income	\$4,374	\$4,339	0.8
Cash Dividends Paid	3,377	3,275	3.1
Return on Avg. Assets	1.19%	1.14%	
Return on Avg. Shareholders' Equity	13.17%	13.31%	
Average Number of Shares Outstanding	1,289,428	1,293,999	
Per Share			
Earnings*	\$3.39	\$3.35	1.2
Cash Dividends Paid	2.60	2.52	3.2
Book Value	26.05	25.24	3.2
At December 31,			
Total Assets	\$376,197	\$379,833	(1.0)
Total Loans	272,769	253,157	7.7
Allowance for Loan Losses	3,591	3,134	14.6
Total Investment Securities	62,712	90,497	(30.7)
Total Deposits	334,576	338,562	(1.2)
Total Shareholders' Equity	33,800	32,798	3.1
Daily Average for the Year			
Assets	\$368,855	\$379,674	(2.8)
Loans - Net	257,602	252,047	2.2
Investment Securities	78,591	100,092	(21.5)
Deposits	326,409	332,072	(1.7)
Shareholders' Equity	33,200	32,601	1.8

*Earnings per share are calculated on the weighted average number of shares outstanding.

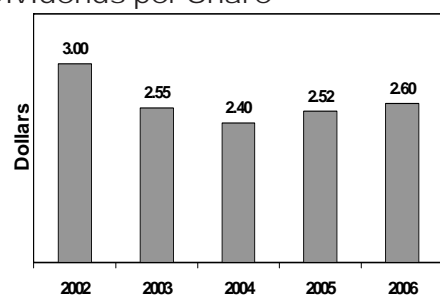
Net Income



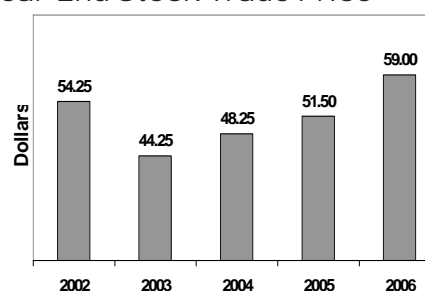
Earnings per Share



Dividends per Share



Year-End Stock Trade Price



Independent Auditor's Report

Board of Directors
Baker Boyer Bancorp
Walla Walla, Washington

We have audited the accompanying consolidated balance sheets of **Baker Boyer Bancorp and Subsidiary** as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 **Baker Boyer Bancorp and Subsidiary** as of December 31, 2006 and 2005, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.



Seattle, Washington
February 20, 2007

Consolidated Financial Statements

Baker Boyer Bancorp and Subsidiary

Consolidated Balance Sheets

Dollars in thousands

December 31,	2006	2005
Assets		
Cash and amounts due from banks	\$ 12,854	\$ 14,103
Interest-bearing deposits at other financial institutions	2,520	6
Federal funds sold	11,905	8,920
Total Cash and Cash Equivalents	27,279	23,029
Securities available for sale	42,295	62,450
Securities held to maturity (market value \$20,535 and \$28,215)	20,417	28,047
Federal Home Loan Bank and Federal Reserve Bank stocks, at cost	1,880	1,690
Loans	272,769	253,157
Allowance for credit losses	(3,591)	(3,134)
Net Loans	269,178	250,023
Premises and equipment, net	10,616	9,725
Foreclosed real estate	120	833
Accrued interest receivable	2,762	2,698
Other assets	1,650	1,338
Total Assets	\$376,197	\$379,833
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Demand, non-interest bearing	\$ 77,306	\$ 69,515
Savings and interest-bearing demand	151,489	163,115
Time	105,781	105,932
Total Deposits	334,576	338,562
Accrued interest payable	591	467
Federal funds purchased and security repurchase agreements	6,660	6,543
Other liabilities	570	1,463
Total Liabilities	342,397	347,035
Commitments and Contingencies	--	--
Shareholders' Equity		
Common stock (no par value, stated value \$3.125 per share); authorized 4,000,000 shares; issued and outstanding:		
2006 - 1,297,376 shares; 2005 - 1,299,569 shares	4,054	4,061
Additional paid-in capital	988	1,100
Unearned common stock	(311)	(231)
Retained earnings	29,112	28,115
Accumulated other comprehensive income (loss)	(43)	(247)
Total Shareholders' Equity	33,800	32,798
Total Liabilities and Shareholders' Equity	\$376,197	\$379,833

Consolidated Financial Statements

Baker Boyer Bancorp and Subsidiary

Consolidated Statements of Income

Dollars in thousands, except per share amounts

Years ended December 31,	2006	2005
Interest and Dividend Income		
Loans	\$18,998	\$17,117
Federal funds sold	244	50
Investment securities:		
Taxable	1,488	1,828
Tax-exempt	1,404	1,518
Federal Home Loan Bank and Federal Reserve Bank stock dividends	28	29
Interest-bearing deposits with other financial institutions	42	15
Total Interest and Dividend Income	22,204	20,557
Interest Expense		
Deposits	6,784	4,622
Federal funds purchased and security repurchase agreements	196	273
Total Interest Expense	6,980	4,895
Net Interest Income	15,224	15,662
Provision for Credit Losses	590	1,200
Net Interest Income after Provision for Credit Losses	14,634	14,462
Non-Interest Income		
Trust and investment management fees	4,410	4,154
Service charges on deposit accounts	1,097	1,137
Other service charges and fees	743	643
Non-deposit retail brokerage fees	354	375
Net loss on sale of securities available for sale	--	(16)
Net gain on sale of foreclosed real estate	277	8
Other operating income	224	275
Total Non-Interest Income	7,105	6,576
Non-Interest Expense		
Salaries and employee benefits	10,406	10,077
Occupancy	851	782
Furniture and equipment	711	707
Professional services	572	767
Office supplies and printed forms	241	260
Information systems and data processing	685	726
Other	2,477	2,001
Total Non-Interest Expense	15,943	15,320
Income Before Income Taxes	5,796	5,718
Income Taxes	1,422	1,379
Net Income	\$ 4,374	\$ 4,339
Basic Earnings Per Share	\$3.39	\$3.35
Weighted Average Number of Shares Outstanding	1,289,428	1,293,999

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Financial Statements

Baker Boyer Bancorp and Subsidiary

Consolidated Statements of Shareholders' Equity

Dollars in thousands, except per share amounts

	Shares of Common Stock	Common Stock	Additional Paid-In Capital	Unearned Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2004	1,293,759	\$4,043	\$ 839	\$ --	\$27,051	\$259	\$32,192
Comprehensive income:							
Net income	--	--	--	--	4,339	--	4,339
Other comprehensive income, net of tax:							
Change in fair value of securities available for sale	--	--	--	--	--	(506)	(506)
Comprehensive Income							3,833
Cash dividends paid (\$2.52 per share)	--	--	--	--	(3,275)	--	(3,275)
Stock issued to directors as fees for directors' services	1,115	3	52	--	--	--	55
Restricted stock issued to officers under stock incentive plan	5,935	19	269	(288)	--	--	--
Restricted stock compensation	--	--	--	57	--	--	57
Repurchases of common stock	(1,240)	(4)	(60)	--	--	--	(64)
Balance at December 31, 2005	1,299,569	\$4,061	\$1,100	(\$231)	\$28,115	(\$247)	\$32,798
Comprehensive income:							
Net income	--	--	--	--	4,374	--	4,374
Other comprehensive income, net of tax:							
Change in fair value of securities available for sale	--	--	--	--	--	204	204
Comprehensive Income							4,578
Cash dividends paid (\$2.60 per share)	--	--	--	--	(3,377)	--	(3,377)
Stock issued to directors as fees for directors' services	703	2	35	--	--	--	37
Restricted stock issued to officers under stock incentive plan	3,583	11	176	(187)	--	--	--
Stock issued to officers under stock incentive plan	1,197	3	59	--	--	--	62
Restricted stock compensation	--	--	--	90	--	--	90
Restricted stock forfeited	(328)	--	(15)	17	--	--	2
Repurchases of common stock	(7,348)	(23)	(367)	--	--	--	(390)
Balance at December 31, 2006	1,297,376	\$4,054	\$988	(\$311)	\$29,112	(\$43)	\$33,800

Consolidated Financial Statements

Baker Boyer Bancorp and Subsidiary

Consolidated Statements of Cash Flows

Dollars in thousands

	2006	2005
Cash Flows from Operating Activities		
Net income	\$ 4,374	\$ 4,339
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	590	1,200
Depreciation and amortization	754	772
Restricted stock compensation	92	57
Net investment amortization	403	544
Deferred income taxes	(163)	68
Net loss on sale of investment securities	--	16
Gain on sale of foreclosed real estate	(277)	(8)
Stock dividends received	(5)	(5)
Origination of loans held for sale	(2,772)	(6,373)
Proceeds from sale of loans held for sale	2,779	6,421
Gain on sales of loans	(7)	(48)
(Increase) decrease in interest receivable	(64)	(251)
Increase (decrease) in interest payable	124	119
Loan origination fees (costs) deferred net of amortization	156	98
Other - net	(968)	33
Net cash provided by operating activities	5,016	6,982
Cash Flows from Investing Activities		
Activity in securities available for sale:		
Sales	--	1,797
Maturities, prepayments and calls	20,285	8,655
Purchases	(190)	(740)
Activity in securities held to maturity:		
Maturities, prepayments and calls	7,405	4,681
Increase in loans made to customers, net of principal collections	(20,022)	(5,204)
Purchases of premises and equipment	(1,680)	(2,960)
Proceeds from sale of premises and equipment	(14)	4
Proceeds from sale of foreclosed real estate	1,086	87
Net cash provided by investing activities	6,870	6,320

(continued on next page)

Consolidated Financial Statements

Baker Boyer Bancorp and Subsidiary

Statements of Cash Flows *(continued)*

	2006	2005
Cash Flows from Financing Activities		
Net decrease in deposits	(\$ 3,986)	(\$ 9,244)
Net increase in federal funds purchased & security repurchase agreements	117	1,052
Cash dividends paid	(3,377)	(3,275)
Repurchases of common stock	(390)	(64)
Net cash used in financing activities	(7,636)	(11,531)
Net increase in cash and cash equivalents	4,250	1,771
Cash and Cash Equivalents		
Beginning of year	23,029	21,258
End of year	\$27,279	\$23,029
Supplemental Disclosures of Cash Flow Information		
Interest paid	\$6,856	\$4,776
Income taxes paid	1,635	1,165
Supplemental Disclosures of Non-Cash Investing and Financing Activities		
Fair value adjustment of securities available for sale, net of tax	\$ 204	(\$ 506)
Transfer of loans to foreclosed real estate	(226)	(713)
Financed sale of foreclosed real estate	106	--
Stock issued to directors	37	55
Shares issued to restricted stock plan	187	288
Stock issued to officers under stock incentive plan	62	--

Notes to Consolidated Financial Statements

Note 1 - Summary of Significant Accounting Policies

Nature of Operations

Baker Boyer Bancorp (the Company) and its wholly owned subsidiary, Baker Boyer National Bank (the Bank), provide banking services to the greater Walla Walla Valley area of southeastern Washington and northeastern Oregon. Services are marketed primarily to individuals, small businesses and the agricultural industry. The Company and its subsidiary are subject to competition from other financial institutions, as well as non-financial intermediaries. Primary sources of revenue are loans, investment securities and trust services. The Company and its subsidiary are also subject to the regulations of certain federal and state agencies, and undergo periodic examinations by those regulatory agencies.

Principles of Consolidation

The consolidated financial statements include the amounts of the parent company and its wholly owned subsidiary. All significant intercompany transactions and balances have been eliminated.

Consolidated Financial Statement Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and practices within the banking industry. The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, as of the date of the balance sheet, and the reported amounts of revenues and expenses during the reporting 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 credit losses.

Certain prior year amounts have been reclassified to conform to the 2006 presentation, with no impact on shareholders' equity and net income as previously reported.

Interest-Bearing Deposits at Other Financial Institutions

Interest-bearing deposits at other financial institutions mature within one year and are carried at cost.

Securities Available for Sale

Securities available for sale consist of debt securities that the Bank intends to hold for an indefinite period, but not necessarily to maturity, and certain equity securities. Such securities may be sold to implement the Bank's asset/liability management strategies and in response to changes in interest rates and similar factors. Securities available for sale are reported at fair value. Unrealized gains and losses, net of the related deferred tax effect, are reported as a net amount in a separate component of shareholders' equity entitled "accumulated other comprehensive income (loss)." Realized gains and losses on securities available for sale, determined using the specific-identification method, are included in earnings. Amortization of premiums and accretion of discounts are recognized in interest income over the period to maturity.

Securities Held to Maturity

Debt securities for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for amortization of premiums and accretion of discounts, which are recognized in interest income over the period to maturity.

(continued)

Notes to Consolidated Financial Statements

Note 1 - Summary of Significant Accounting Policies *(continued)*

Securities Impairment

Declines in the fair value of individual securities held to maturity and available for sale below their cost that are other than temporary result in write-downs of the individual securities to their fair value. Management evaluates individual securities for other than temporary impairment on a quarterly basis based on the securities' current credit quality, interest rates, term to maturity and management's intent and ability to hold the securities until the net book value is recovered. Any other than temporary declines in fair value are recognized on the consolidated statements of income as loss on sale of investments.

Federal Home Loan Bank and Federal Reserve Bank Stocks

The Bank, as a member of the Federal Home Loan Bank (FHLB) system, is required to maintain an investment in FHLB capital stock in an amount equal to the greater of \$500 or .75 percent of its outstanding home loans and pass-through securities plus 3.5 percent of advances outstanding from FHLB. The recorded amount of FHLB stock equals its fair value because the shares can only be redeemed by the FHLB at the \$100 per share par value.

As a national bank, the Bank is required to own stock in the Federal Reserve Bank (FRB) in an amount based on its capital. The recorded amount of FRB stock equals its fair value because the shares can only be redeemed by FRB at their par value.

Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balances adjusted for any charge-offs, the allowance for credit losses, and any deferred fees or costs on originated loans, and unamortized premiums or discounts on purchased loans. Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income.

Because some loans may not be repaid in full, an allowance for credit losses is recorded. An allowance for credit losses is a valuation allowance for probable incurred credit losses. The allowance for credit losses is increased by a provision for credit losses charged to expense and decreased by charge-offs (net of recoveries). The allowance is based on ongoing, quarterly assessments of the probable and estimable losses inherent in the loan portfolio. The Company's methodology for assessing the appropriateness of the allowance consists of several key elements, which include the formula allowance and specific allowances.

The formula portion of the general credit loss allowance is established by applying a loss percentage factor to the different loan types. The allowances are provided based on management's continuing evaluation of the pertinent factors underlying the quality of the loan portfolio, including changes in the size and composition of the loan portfolio, actual loan loss experience, current economic conditions, geographic concentrations, seasoning of the loan portfolio, specific industry conditions, and the duration of the current business cycle. The recovery of the carrying value of loans is susceptible to future market conditions beyond the Company's control, which may result in losses or recoveries differing from those provided.

Specific allowances are established in cases where management has identified significant conditions or circumstances related to a loan that management believes indicate the probability that a loss has been incurred. Impaired loans consist of loans receivable that are not expected to be repaid in accordance with their contractual terms and are measured using the fair value of the collateral. Smaller balance loans are excluded from this analysis.

Notes to Consolidated Financial Statements

Note 1 - Summary of Significant Accounting Policies *(continued)*

Loans Receivable *(concluded)*

Interest income on loans is accrued over the term of the loans based upon the principal outstanding. The accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. Past due status is based on contractual terms of the loan. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent that cash payments are received until, in management's judgment, the borrower has the ability to make contractual interest and principal payments, in which case the loan is returned to accrual status.

The ultimate recovery of all loans is susceptible to future market factors beyond the Bank's control. These factors may result in losses or recoveries differing significantly from those provided in the consolidated financial statements. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses and may require the Bank to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

Premises and Equipment

Premises and equipment are recorded at cost. Depreciation is computed on the straight-line method over the following estimated useful lives: building and improvements - up to forty years; software, furniture and equipment - three to seven years; and automobiles - five years. Amortization of leasehold improvements is calculated on the straight-line method over the shorter of the estimated useful lives of the assets or corresponding contractual lease term, which does not generally include renewal options. These assets are reviewed for impairment when events indicate their carrying value may not be recoverable. If management determines an impairment exists, the asset is reduced with an offsetting charge to expense. The cost of maintenance and repairs is charged to expense as incurred. Gains and loss on dispositions are reflected in earnings.

Servicing

Loan servicing rights are capitalized when acquired through the origination of loans that are subsequently sold with the servicing rights retained, and are amortized as an offset to servicing income on loans sold in proportion to and over the period of estimated net servicing income. The value of loan servicing rights at the date of the sale of loans is determined based on the discounted present value of expected future cash flows using key assumptions for servicing income and costs and prepayment rates on the underlying loans. The estimated fair value is periodically evaluated for impairment by comparing actual cash flows and estimated future cash flows from the servicing assets to those estimated at the time servicing assets were originated. Fair values are estimated using discounted cash flows based on current market rates of interest. For purposes of measuring impairment, the rights must be stratified by one or more predominant risk characteristics of the underlying loans. The Bank stratifies its capitalized mortgage servicing rights based on product type, interest rate and term of the underlying loans. The amount of impairment recognized is the amount, if any, by which the amortized cost of the rights for each stratum exceeds their fair value.

Foreclosed Real Estate

Real estate properties acquired through, or in lieu of, foreclosure are to be sold and are initially recorded at the lower of cost or fair value of the properties less estimated costs of disposal. Any write-down to fair value at the time of transfer to foreclosed real estate is charged to the allowance for credit losses. Properties are evaluated regularly to ensure that the recorded amounts are supported by their current fair values. Any

(continued)

Notes to Consolidated Financial Statements

Note 1 - Summary of Significant Accounting Policies *(continued)*

Foreclosed Real Estate *(concluded)*

subsequent reductions in carrying values and revenues and expenses from the operations of properties are charged to operations.

Trust Assets

Assets held by the Company in a fiduciary or agency capacity for trust department customers are not included in the consolidated financial statements because such items are not assets of the Company or its subsidiary. Assets totaling \$612,576,000 and \$546,315,000 were held in trust as of December 31, 2006 and 2005, respectively.

Transfers of Financial Assets

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

Advertising Costs

Advertising costs are expensed as incurred.

Income Taxes

Deferred income taxes reflect the effect of temporary differences between the tax basis of assets and liabilities and the reported amounts of those assets and liabilities for financial reporting purposes. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Cash Equivalents and Cash Flows

The Company considers all amounts included in the balance sheet caption "Cash and amounts due from banks, interest-bearing deposits at other financial institutions, and federal funds sold" to be cash equivalents. Cash flows from loans, federal funds purchased and security repurchase agreements, federal funds sold, and deposits are reported net.

The Company maintains balances in depository institution accounts, which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts.

Fair Values of Financial Instruments

Statement of Financial Accounting Standards No. 107, *Disclosures About Fair Value of Financial Instruments*, requires disclosure of estimated fair values for financial instruments. Such estimates are subjective in nature, and significant judgment is required regarding the risk characteristics of various financial instruments at a discrete point in time. Therefore, such estimates could vary significantly if assumptions regarding uncertain

Notes to Consolidated Financial Statements

Note 1 - Summary of Significant Accounting Policies *(continued)*

Fair Values of Financial Instruments *(concluded)*

factors were to change. Major assumptions, methods and fair value estimates for the Company's significant financial instruments are set forth below:

Cash and Amounts Due from Banks, Interest-Bearing Deposits at Other Financial Institutions, and Federal Funds Sold

The recorded amount is a reasonable estimate of fair value.

Securities Available for Sale and Held to Maturity

Fair value for securities is based on quoted market prices.

Federal Home Loan Bank and Federal Reserve Bank Stocks

The carrying value of stock holdings approximates fair value.

Loans

For variable rate loans that reprice frequently and have no significant change in credit risk, fair value is based on carrying value. Fair value for fixed rate loans is estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair value for impaired loans is estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposits

The fair value of deposits with no stated maturity date is included at the amount payable on demand. The fair value of fixed maturity certificates of deposit is estimated by discounting future cash flows using the rates currently offered by the Bank for deposits of similar remaining maturities.

Federal Funds Purchased and Security Repurchase Agreements

Carrying amounts of federal funds purchased and other short-term borrowings maturing within 90 days approximate their fair value. Fair value of other short-term borrowings is estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements.

Accrued Interest

Carrying amounts of accrued interest approximate their fair values.

Off-Balance-Sheet Instruments

The fair value of commitments to extend credit and standby letters of credit was estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the customers. Since the majority of the Bank's off-balance-sheet instruments consist of non-fee producing, variable-rate commitments, the Bank has determined they do not have a distinguishable fair value.

(continued)

Notes to Consolidated Financial Statements

Note 1 - Summary of Significant Accounting Policies *(concluded)*

Stock-Based Compensation

Effective January 1, 2006 the Company adopted the fair value recognition provision of SFAS No. 123-R (SFAS 123-R), *Share-Based Payment*. Prior to this time the Company accounted for its stock-based compensation awards under the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*. Therefore there were no significant changes to the accounting treatment from those previously applied. Compensation expense, based on the fair market value of the stock at the date of the award, is recognized in the consolidated statements of income for stock awards under the stock incentive plan.

The Company records compensation expense in the accompanying consolidated statement of income related to restricted stock awards by recognizing the grant date fair value of such awards over the vesting period. Unearned shares are reflected as unearned common stock on the consolidated statement of shareholders' equity. At December 31, 2006, compensation expense related to nonvested restricted stock awards was \$311,000 and is expected to be recognized as follows (dollars in thousands):

	Stock-Based Compensation Expense
2007	\$ 92
2008	92
2009	92
2010	35
Total	\$311

Earnings Per Share

Basic earnings per share are computed by dividing net income by the weighted-average number of common shares outstanding.

Recent Accounting Pronouncements

Accounting for Servicing of Financial Assets

In March 2006, FASB issued SFAS No. 156 (SFAS No. 156), *Accounting for Servicing of Financial Assets*. SFAS No. 156 amends Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to require all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS No. 156 also permits servicers to subsequently measure each separate class of servicing assets and servicing liabilities at fair value rather than at the lower of cost or market. For those companies that elect to measure their servicing assets and liabilities at fair value, SFAS No. 156 requires the difference between the recorded value and fair value at the date of adoption to be recognized as a cumulative effect adjustment to retained earnings as of the beginning of the fiscal year in which the election is made. Management does not believe adoption of this statement will materially impact the Company's consolidated financial statements. SFAS No. 156 is effective as of the beginning of the first fiscal year beginning after September 15, 2006.

Notes to Consolidated Financial Statements

Note 1 - Summary of Significant Accounting Policies *(concluded)*

Recent Accounting Pronouncements *(concluded)*

Accounting for Uncertainty in Income Taxes

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*. This interpretation applies to all tax positions accounted for in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 clarifies the application of SFAS No. 109 by defining the criteria that an individual tax position must meet in order for the position to be recognized within the financial statements and provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition for tax positions. This interpretation is effective for fiscal years beginning after December 15, 2006, with earlier adoption permitted. The Company does not expect that the adoption of this interpretation will have a material impact on its financial position, results of operation and cash flows.

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. It clarifies that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. This Statement does not require any new fair value measurements, but rather, it provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. This Statement is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. The Company does not expect that the adoption of this Statement will have a material impact on its financial position, results of operation and cash flows.

Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* – including an amendment of SFAS No. 115, which provides all entities with an option to report selected financial assets and liabilities at fair value. The objective of the statement is to improve financial reporting by providing entities with the opportunity to mitigate volatility in earnings caused by measuring assets and liabilities differently without having to apply complex provisions of hedge accounting. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes. The Statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007, with early adoption permitted provided the entity also elect the provisions of SFAS No. 157. The Company does not expect the adoption of this statement will have a material impact on its financial position, results of operation and cash flows.

Note 2 - Restricted Assets

Federal Reserve Board regulations require that the Bank maintain reserves in the form of cash and deposit balances with the Federal Reserve Bank, based on a percentage of deposits. The amounts of such balances for the years ended December 31, 2006 and 2005 were approximately \$849,000 and \$918,000, respectively.

Notes to Consolidated Financial Statements

Note 3 - Debt and Equity Securities

Debt and equity securities have been classified according to management's intent. The amortized cost of securities and their approximate fair values were as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Values
Securities Available for Sale				
December 31, 2006				
U.S. Government and agency securities	\$29,005	\$ 9	\$485	\$28,530
State and political securities	12,817	76	127	12,766
Equity securities	539	492	31	999
Total	\$42,361	\$577	\$643	\$42,295
December 31, 2005				
U.S. Government and agency securities	\$46,835	\$ --	\$ 913	\$45,922
State and political securities	13,948	137	152	13,933
Other debt securities	1,502	--	11	1,491
Equity securities	539	599	34	1,104
Total	\$62,824	\$736	\$1,110	\$62,450
Securities Held to Maturity				
December 31, 2006				
State and political securities	\$20,417	\$176	\$57	\$20,535
December 31, 2005				
U.S. Government and agency securities	\$ 3,000	\$ --	\$ 5	\$ 2,995
State and political securities	25,047	272	99	25,220
Total	\$28,047	\$272	\$104	\$28,215

Notes to Consolidated Financial Statements

Note 3 - Debt and Equity Securities *(continued)*

The fair value of temporarily impaired securities, the amount of unrealized losses, and the length of time these unrealized losses existed as of December 31 are as follows (dollars in thousands):

Description of Securities	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities Available for Sale						
December 31, 2006						
U.S. Government and agency	\$ --	\$ --	\$28,020	\$485	\$28,020	\$485
State and political securities	281	1	5,732	126	6,013	127
Equity securities	--	--	499	31	499	31
Total	\$281	\$ 1	\$34,251	\$642	\$34,532	\$643
December 31, 2005						
U.S. Government and agency	\$ 492	\$ 6	\$45,429	\$ 907	\$45,921	\$ 913
State and political securities	1,232	17	4,828	135	6,060	152
Other debt securities	499	2	991	9	1,490	11
Equity securities	--	--	496	34	496	34
Total	\$2,223	\$25	\$51,744	\$1,085	\$53,967	\$1,110
Securities Held to Maturity						
December 31, 2006						
State and political securities	\$618	\$--	\$6,842	\$57	\$7,460	\$57
December 31, 2005						
U.S. Government and agency	\$ 2,995	\$ 5	\$ --	\$ --	\$ 2,995	\$ 5
State and political securities	8,649	62	2,552	37	11,201	99
Total	\$11,644	\$67	\$2,552	\$37	\$14,196	\$104

The Company has evaluated these securities and has determined that the decline in the value is temporary. The decline in value is not related to any company or industry specific event. Despite the unrealized loss position of these securities, management has concluded, as of December 31, 2005, that these investments are not other-than-temporarily impaired. This assessment was based on the following factors: i) the length of time and the extent to which the market value has been less than cost; ii) the financial condition and near-term prospects of the issuer; iii) the intent and ability of the Company to retain its investment in a security for a period of time sufficient to allow for any anticipated recovery in market value; and iv) general market conditions which reflect prospects for the economy as a whole, including interest rates and sector credit spreads.

(continued)

Notes to Consolidated Financial Statements

Note 3 - Debt and Equity Securities *(concluded)*

The contractual maturities of debt securities held to maturity and available for sale at December 31, 2006 are as follows (dollars in thousands):

	Held to Maturity		Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 2,887	\$ 2,896	\$ 9,918	\$ 9,839
Due from one year to five years	5,322	5,379	23,643	23,287
Due from five to ten years	7,381	7,433	7,095	7,004
Due after ten years	4,827	4,827	1,166	1,166
Total	\$20,417	\$20,535	\$41,822	\$41,296

There were no gross realized gains on sales of securities in 2006 or 2005. There were no gross realized losses on sales of securities in 2006. Gross realized losses on sales of securities in 2005 were \$16,000.

Securities, carried at approximately \$33,530,000 at December 31, 2006 and \$37,478,000 at December 31, 2005, were pledged to secure repurchase agreements, public and trust deposits, and for other purposes required or permitted by law.

Note 4 - Loans

Loans at December 31 consist of the following (dollars in thousands):

	2006	2005
Commercial, agricultural and industrial	\$ 70,959	\$ 62,560
Real estate - 1 to 4 family residential	90,533	81,231
Real estate - all others	96,392	94,079
Installment and student	15,569	15,815
	273,453	253,685
Less net deferred loan origination fees	684	528
Total loans	\$272,769	\$253,157

Changes in the allowance for credit losses for the years ended December 31 are as follows (dollars in thousands):

	2006	2005
Balance at beginning of year	\$3,134	\$2,978
Provision for credit losses	590	1,200
Charge-offs	(291)	(1,136)
Recoveries	158	92
Net charge-offs	(133)	(1,044)
Balance at end of year	\$3,591	\$3,134

Notes to Consolidated Financial Statements

Note 4 - Loans *(concluded)*

Following is a summary of information pertaining to impaired loans (dollars in thousands):

December 31	2006	2005
Impaired loans without a valuation allowance	\$725	\$738
Impaired loans with a valuation allowance	1	-
Total impaired loans	\$726	\$738
Valuation allowance related to impaired loans	\$1	\$-
Years Ended December 31		
Average investment in impaired loans	\$526	\$1,869
Interest income recognized on a cash basis on impaired loans	39	8

At December 31, 2006, there were no commitments to lend additional funds to borrowers whose loans have been modified. Loans 90 days and over past due still accruing interest were \$119,000 and \$640,000 at December 31, 2006 and 2005, respectively.

Certain related parties of the Bank, principally Bank directors and their associates, were loan customers of the Bank in the ordinary course of business during 2006 and 2005. Total loans outstanding at December 31, 2006 and 2005, to key officers and directors were \$6,777,000 and \$6,958,000, respectively. During 2006 loan advances totaled \$7,589,000, and loan repayments totaled \$7,770,000 on these loans. During 2005 loan advances totaled \$2,537,000, and loan repayments totaled \$2,006,000.

Note 5 - Servicing

Mortgage loans serviced for others are not included on the accompanying consolidated balance sheets. The unpaid principal balances of mortgage and other loans serviced for others were \$11,791,000 and \$10,368,000 at December 31, 2006 and 2005, respectively. The balance of capitalized servicing rights included in other assets at December 31, 2006 and 2005 was \$4,000 and \$8,000, respectively. The amount of mortgage servicing rights amortized at December 31, 2006 and 2005 was \$4,000 and \$5,000, respectively.

Note 6 - Premises and Equipment

The components of premises and equipment at December 31 are as follows (dollars in thousands):

	2006	2005
Land	\$ 1,271	\$ 1,271
Buildings	11,084	8,949
Construction in Progress	1,002	1,872
Furniture and Equipment	5,832	5,500
Assets in Progress	39	154
	19,228	17,746
Less accumulated depreciation and amortization	8,612	8,021
Total premises and equipment	\$ 10,616	\$ 9,725

(continued)

Notes to Consolidated Financial Statements

Note 6 - Premises and Equipment *(concluded)*

The Bank leases premises and equipment under various operating leases expiring through 2009. Rental expense of leased premises and equipment totaled \$116,000 and \$131,000 in 2006 and 2005, respectively, which are included in occupancy and furniture and equipment expense.

Minimum net rental commitments under noncancellable leases having an original or remaining term of more than one year for future years ending December 31 are as follows (dollars in thousands):

2007	\$125
2008	128
2009	88
	<u>\$341</u>

Certain leases contain renewal options from two to five years and escalation clauses based on increases in property taxes and other costs.

Note 7 - Deposits

The aggregate amount of certificates of deposit with balances of \$100,000 or more was approximately \$32,871,000 and \$32,769,000 at December 31, 2006 and 2005, respectively.

Scheduled maturities of certificates of deposit for future years ending December 31 are as follows (dollars in thousands):

2007	\$ 78,712
2008	13,746
2009	5,539
2010	4,388
2011	3,054
Thereafter	342
Total	<u>\$105,781</u>

Note 8 - Federal Funds Purchased and Security Repurchase Agreements

Federal funds purchased and security repurchase agreements generally mature within one to four days from the transaction date. Information concerning these borrowings is summarized as follows for the years ended December 31 (dollars in thousands):

	2006	2005
Average balance during the year	\$ 6,791	\$10,708
Average interest rate during the year	2.12%	1.69%
Maximum month-end balance during the year	\$14,998	\$19,747
Balance outstanding at year-end	\$ 6,660	\$ 6,543
Average interest rate at year-end	2.36%	1.49%

Notes to Consolidated Financial Statements

Note 9 - Employee Benefits

401(k) Profit Sharing Plan

The Company has a profit-sharing thrift - 401(k) plan, with cash or deferred arrangements permitted by Internal Revenue Code subsection 401(k). Eligibility for the plan is six months of service and attainment of age 21, with plan entry the following January 1 or July 1. The Company's profit-sharing contribution is 6 percent of eligible compensation. The Company's safe-harbor matching contribution is 100 percent of the first 6 percent of a participant's eligible compensation per payroll period deferred as 401(k) contributions. Under the 401(k) savings aspect of the plan, employees may contribute up to the dollar limitation for deferrals, plus the catch-up dollar limitation. Employer contributions do not have an hours of service or employment on the last day of the plan year accrual requirement.

Total employer contribution expenses were \$776,000 and \$867,000 for 2006 and 2005, respectively.

Outside Directors' Nonqualified Deferred Compensation Plan

The Company has an outside directors' nonqualified deferred compensation plan. Under the terms of the plan, an outside director (a non-employee director) may participate in the plan. The participant may elect to defer a portion of his or her directors' fees as designated at the beginning of each plan year. The Company does not make nonelective contributions to the plan. Payments begin after termination of service for any reason. Payments may begin prior to termination of service for an unforeseeable emergency. There are currently four participants in the plan. Total deferrals plus earnings were \$340,000 and \$265,000 at December 31, 2006 and 2005, respectively. The expense to the Company for this plan is \$2,000 and \$0 for the 2006 and 2005 plan years, respectively.

Stock Incentive Plan

In February 1979, and as amended in March 1997, the Company adopted a non-qualified stock incentive plan for the benefit of key employees. The objective of the plan is to retain personnel of experience and ability in key positions by providing them with a proprietary interest in the Company. The plan is also expected to enhance the ability of the Company to attract and retain key employees. The Company's plan is administered by its board of directors' Executive Compensation Committee. Members of this committee consist only of non-officer, outside directors.

The plan allows for the issuance to participants of up to 240,800 shares of the Company's common stock.

For the year ended December 31, 2006, the Company awarded 3,583 shares of restricted stock with a fair market value of \$52.30 per share under the plan. The restricted stock is awarded to the employees at the end of a five year vesting period. During the vesting period the employees do have voting rights and dividend rights. Compensation expense in the amount of the fair value of the common stock at the date of the grant to the plan participants will be recognized straight line over the five-year vesting period. Compensation expense related to the plan was \$90,000 and \$57,000 for the years ended December 31, 2006 and 2005, respectively. The tax benefit recognized on this compensation was \$31,000 and \$19,000 for the years ending December 31, 2006 and 2005, respectively.

As of December 31, 2006, shares remaining in reserve for issuance under the plan were 78,179. Subsequent to December 31, 2006, additional shares of restricted stock were approved to be awarded prior to March 15, 2007.

Notes to Consolidated Financial Statements

Note 9 - Employee Benefits *(concluded)*

Stock Incentive Plan *(concluded)*

The following summarizes activity under the restricted stock plan for the year December 31, 2006:

	Shares	Aggregate Intrinsic Value	Weighted Average Grant Date Fair Value
Restricted stock grants unearned at December 31, 2004	--	\$ --	\$ --
Granted	5,935	--	48.60
Restricted stock grants unearned at December 31, 2005	5,935	\$307,000	\$48.60
Granted	3,583	--	52.30
Forfeited	(328)	--	50.38
Restricted stock grants unearned at December 31, 2006	9,190	\$542,000	\$50.24

Note 10 - Income Taxes

Income taxes are comprised of the following for the years ended December 31 (dollars in thousands):

	2006	2005
Current	\$1,585	\$1,311
Deferred taxes	(163)	68
Total income taxes	\$1,422	\$1,379

The following is a reconciliation between the statutory and the effective federal income tax rate for the years ended December 31 (dollars in thousands):

	2006		2005	
	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income
Income tax at statutory rates	\$2,029	35.0%	\$2,001	35.0%
Increase (decrease) resulting from:				
Tax-exempt income	(503)	(8.7)	(526)	(9.2)
Other	(104)	(1.8)	(96)	(1.7)
Total income taxes expense	\$1,422	24.5%	\$1,379	24.1%

Notes to Consolidated Financial Statements

Note 10 - Income Taxes *(concluded)*

Tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities at December 31 are as follows (dollars in thousands):

	2006	2005
Deferred Tax Assets		
Allowance for credit losses	\$ 483	\$ 367
Deferred compensation	90	81
Other	16	43
Unrealized loss on securities available for sale	22	127
Stock-based compensation on restricted stock	50	-
Total deferred tax assets	661	618
Deferred Tax Liabilities		
Accumulated depreciation and amortization	495	502
Deferred income	495	527
Difference between financial versus tax basis of bonds purchased	15	15
Other	92	68
Total deferred tax liabilities	1,097	1,112
Net deferred tax liabilities	\$ 436	\$ 494

Note 11 - Commitments and Contingencies

The Bank is 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. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized on the consolidated balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. A summary of the Bank's commitments at December 31 is as follows (dollars in thousands):

	2006	2005
Commitments to extend credit	\$55,732	\$58,287
Standby letters of credit	939	1,024

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. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank's experience has been that approximately 46 percent of loan commitments is drawn upon by customers. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the

(continued)

Notes to Consolidated Financial Statements

Note 11 - Commitments and Contingencies *(concluded)*

Bank upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above, and is required in instances where the Bank deems necessary.

The Bank has agreements with commercial banks for lines of credit totaling \$34,000,000, none of which was used at December 31, 2006, and a credit line with the Federal Home Loan Bank of Seattle totaling 10 percent of assets, none of which was used at December 31, 2006.

Because of the nature of its activities, the Company is subject to various pending and threatened legal actions which arise in the ordinary course of business. In the opinion of management, liabilities arising from these claims, if any, will not have a material effect on the financial position of the Company.

The Company has entered into employment contracts with its president and other key officers which provide for deferred compensation at retirement and for contingent payments subject to future events.

Note 12 - Significant Concentrations of Credit Risk

Most of the Bank's business activity is with customers located in Washington and northeastern Oregon. Investments in state and municipal securities involve governmental entities primarily within the state of Washington. Loans are generally limited, by federal banking regulations, to 15 percent of the Bank's shareholder's equity, excluding accumulated other comprehensive income (loss).

Note 13 - Regulatory Matters

The Company and the 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 Bank's and Company's financial statements. Under capital adequacy guidelines of the regulatory framework for prompt corrective action, the Bank must meet specific capital adequacy guidelines that involve quantitative measures of the Company's assets, liabilities and certain off-balance-sheet items, as calculated under regulatory accounting practices. The Bank's capital classification is 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 the Bank to maintain minimum amounts and ratios (set forth in the table below) of Tier 1 capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of Tier 1 and total capital (as defined) to risk-weighted assets (as defined).

As of December 31, 2006, the most recent notification from the Bank's regulator categorized the Bank 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 1 risk-based, and Tier 1 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 category.

Notes to Consolidated Financial Statements

Note 13 - Regulatory Matters *(concluded)*

The Company's and the Bank's actual capital amounts and ratios are also presented in the following table. Management believes, as of December 31, 2006, that the Company and the Bank meet all capital requirements to which they are subject (dollars in thousands):

	Actual Amount	Ratio	Capital Adequacy Purposes Amount	Ratio	To be Well Capitalized Under Prompt Corrective Action Provisions Amount	Ratio
December 31, 2006						
<i>Tier 1 capital (to average assets):</i>						
Company	\$33,843	9.1%	\$14,887	4.0%	N/A	N/A
Bank	33,454	9.0	14,887	4.0	\$18,609	5.0%
<i>Tier 1 capital (to risk-weighted assets):</i>						
Company	33,843	10.2	13,239	4.0	N/A	N/A
Bank	33,454	10.1	13,239	4.0	19,859	6.0
<i>Total capital (to risk-weighted assets):</i>						
Company	37,641	11.4	26,479	8.0	N/A	N/A
Bank	37,252	11.3	26,479	8.0	33,099	10.0
December 31, 2005						
<i>Tier 1 capital (to average assets):</i>						
Company	\$33,045	8.8%	\$15,054	4.0%	N/A	N/A
Bank	32,715	8.7	15,054	4.0	\$18,817	5.0%
<i>Tier 1 capital (to risk-weighted assets):</i>						
Company	33,045	11.6	11,365	4.0	N/A	N/A
Bank	32,715	11.5	11,365	4.0	17,047	6.0
<i>Total capital (to risk-weighted assets):</i>						
Company	36,400	12.8	22,729	8.0	N/A	N/A
Bank	36,070	12.7	22,729	8.0	28,411	10.0

Notes to Consolidated Financial Statements

Note 14 - Condensed Financial Information - Parent Company Only

Condensed Balance Sheets - December 31

(Dollars in Thousands)

	2006	2005
Assets		
Cash	\$ 84	\$ 58
Investment in Bank	33,411	32,468
Other assets	305	487
Total assets	\$33,800	\$33,013
Liabilities	\$ --	\$ 215
Shareholders' Equity	33,800	32,798
Total liabilities and shareholders' equity	\$33,800	\$33,013

Condensed Statements of Income - Years Ended December 31

(Dollars in Thousands)

	2006	2005
Dividend Income from the Bank	\$3,698	\$3,280
Expenses	95	95
Income before income taxes and equity in undistributed income of the Bank	3,603	3,185
Income Tax Benefit	32	32
Income before undistributed income of the Bank	3,635	3,217
Equity in Undistributed Income of the Bank	739	1,122
Net income	\$4,374	\$4,339

Notes to Consolidated Financial Statements

Note 14 - Condensed Financial Information - Parent Company Only *(concluded)*

Condensed Statements of Cash Flows - Years Ended December 31

(Dollars in Thousands)

	2006	2005
Cash Flows from Operating Activities		
Net income	\$4,374	\$4,339
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed income of the Bank	(739)	(1,122)
Net earned restricted stock	92	57
Other - net	(33)	(31)
Net cash provided by operating activities	3,694	3,243
Cash Flows from Financing Activities		
Cash dividends paid	(3,377)	(3,275)
Stock issued to directors	37	55
Stock issued to officers	62	-
Repurchase of common stock	(390)	(64)
Net cash used in financing activities	(3,668)	(3,284)
Increase (decrease) in cash	26	(41)
Cash		
Beginning of year	58	99
End of year	\$ 84	\$ 58

Note 15 - Fair Value of Financial Instruments

The estimated fair value of the Company's financial instruments at December 31 was as follows (dollars in thousands):

	2006		2005	
	Carrying Amounts	Fair Value	Carrying Amounts	Fair Value
Financial Assets				
Cash and cash equivalents	\$ 27,279	\$ 27,279	\$ 23,029	\$ 23,029
Securities available for sale	42,295	42,295	62,450	62,450
Securities held to maturity	20,417	20,535	28,047	28,215
Federal Home Loan Bank and Federal Reserve Bank stocks	1,880	1,880	1,690	1,690
Loans receivable, net	269,178	270,948	250,023	249,921
Accrued interest receivable	2,762	2,762	2,698	2,698

(continued)

Notes to Consolidated Financial Statements

Note 15 - Fair Value of Financial Instruments *(concluded)*

	2006		2005	
	Carrying Amounts	Fair Value	Carrying Amounts	Fair Value
Financial Liabilities				
Deposits	\$334,576	\$335,392	\$338,562	\$339,124
Federal funds purchased and security repurchase agreements	6,660	6,660	6,543	6,543
Accrued interest payable	591	591	467	467

The Bank assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Bank's financial instruments will change when interest rate levels change, and that change may either be favorable or unfavorable to the Bank. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities, and attempts to minimize interest rate risk by adjusting terms of new loans and deposits, and by investing in securities with terms that mitigate the Bank's overall interest rate risk.

Note 16 - Comprehensive Income

Unrealized gains of \$204,000, net of tax, during 2006 were included in comprehensive income in 2006; net losses of \$516,000, net of tax, and reclassification adjustments of \$10,000 for losses were included in comprehensive income in 2005, respectively, as follows (dollars in thousands):

	Before- Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Year Ended December 31, 2006			
Unrealized holding gains arising during the year	\$309	\$105	\$204
Year Ended December 31, 2005			
Unrealized holding losses arising during the year	(\$782)	\$266	(\$516)
Reclassification adjustments for losses realized in net income	16	6	10
Net unrealized losses	(\$766)	\$260	(\$506)

Other Financial Information - Baker Boyer Bancorp and Subsidiary

Average Daily Balance Sheets (unaudited)

Dollars in thousands

	2006	2005
Assets		
Cash and due from banks	\$ 10,641	\$ 11,131
Interest-bearing deposits at other financial institutions	825	652
Federal funds sold and security resell agreements	4,850	1,425
Securities available for sale	52,428	67,967
Securities held to maturity	26,163	32,125
Federal Home Loan Bank and Federal Reserve Bank stocks, at cost	1,690	1,689
Loans	261,075	254,928
Allowance for credit losses	(3,473)	(2,881)
Net Loans	257,602	252,047
Premises and equipment	9,872	8,171
Accrued interest receivable	2,930	2,888
Other assets	1,854	1,579
Total Assets	\$368,855	\$379,674
Liabilities and Shareholders' Equity		
Deposits		
Demand, non-interest bearing	\$ 66,116	\$ 65,947
Savings and interest-bearing demand	150,082	161,218
Time	110,211	104,907
Total Deposits	326,409	332,072
Federal funds purchased and security repurchase agreements	6,791	10,708
Borrowings from Federal Home Loan Bank and Federal Reserve Bank	1,013	2,337
Accrued interest payable	636	430
Other liabilities	807	1,526
Total Liabilities	335,656	347,073
Shareholders' Equity		
Common stock (no par value, stated value \$3.125 per share)	4,057	4,059
Unearned common stock	(342)	(220)
Additional paid-in capital	1,027	1,075
Retained earnings	28,769	27,804
Accumulated other comprehensive income (loss)	(311)	(117)
Total Shareholders' Equity	33,200	32,601
Total Liabilities and Shareholders' Equity	\$368,856	\$379,674

Other Financial Information - Baker Boyer Bancorp and Subsidiary

Five Year Highlights (unaudited)

	2006	2005	2004	2003	2002
Per Share					
Earnings	\$3.39	\$3.35	\$3.30	\$0.93	\$3.06
Cash dividends	2.60	2.52	2.40	2.55	3.00
Book value, year-end	26.05	25.24	24.88	24.17	26.18
For the Year (Dollars in Thousands)					
Net income	\$4,374	\$4,339	\$4,285	\$1,208	\$3,980
Cash dividends	3,377	3,275	3,119	3,312	3,897
Performance Measures					
Return on average assets	1.19%	1.14%	1.10%	0.31%	1.05%
Return on average equity	13.17	13.31	13.42	3.62	11.62
Yield on average earning assets fully taxable equivalent	6.70	6.01	5.69	6.20	6.95
Average cost of interest bearing liabilities	2.60	1.75	1.47	1.83	2.44
Net interest margin - fully taxable equivalent	4.67	4.63	4.52	4.73	4.99
Average equity to average assets ratio	9.00	8.59	8.16	8.60	9.07
Dividend payout ratio	77.21	75.48	72.79	274.17	97.91
Net charge-offs to average loans	0.05	0.41	0.51	1.99	1.01
Year-end ratio of allowance for loan losses to total loans	1.32	1.24	1.19	1.35	1.00
Weighted average number of shares outstanding					
	1,289,428	1,293,999	1,299,661	1,298,772	1,299,107
Number of Full-Time Equivalent Employees at Year-End					
	180	173	188	187	203

Audit fees paid by the Company for the audit provided by McGladrey & Pullen LLP for fiscal years ending 2006 and 2005, were approximately \$63,000 and \$57,000, respectively. Audit and tax fees paid to RSM McGladrey Inc. for 2006 and 2005, were approximately \$26,000 and \$25,600, respectively.

Directors & Officers

Baker Boyer Bancorp

Board of Directors

MEGAN F. CLUBB, President, CEO and Chairman of the Board

STEPHEN G. KIMBALL, Chairman Emeritus

D.F. BAKER, Retired General Service Manager - Holt of California

JON S. BREN, Executive Vice President

DAVID B. CAMPBELL, Retired Project Development - Renewable Energy Systems NA

THOMAS W. CAMPBELL, Secretary, Retired Executive Vice President

FRED J. KIMBALL, President - K-Farms, Inc.

EDWARD N. LANGE, Attorney, Retired Partner - Davis Wright Tremaine

SUSAN C. PRATT, Retired Assistant Attorney General - State of Washington

ROBERT R. RICHARDS, Retired President and CEO - The Commerce Bancorporation,
Retired Managing Director - The Commerce Bank of Washington

Executive Committee

MEGAN F. CLUBB, Chair of the Executive Committee - President, CEO and Chairman of the Board

JON S. BREN, Executive Vice President - Investment Management &
Trust Services Division Manager

LYLE W. HANSEN, Executive Vice President - Banking Division Manager

MARK A. HESS, Executive Vice President - Chief Operating Officer

Other Officers

LORRAINE A. MANUEL, Auditor

JOLENE RIGGS, Controller

Baker Boyer Bank

Board of Directors

MEGAN F. CLUBB, President, CEO and Chairman of the Board

STEPHEN G. KIMBALL, Chairman Emeritus

D.F. BAKER, Retired General Service Manager - Holt of California

JON S. BREN, Executive Vice President

LYNNE E. BUSH, Eleemosynary Consultant

DAVID B. CAMPBELL, Project Development - Renewal Energy Systems NA

THOMAS W. CAMPBELL, Secretary - Retired Vice President and Cashier

FRED J. KIMBALL, President - K-Farms, Inc.

SUSAN C. PRATT, Retired Assistant Attorney General - State of Washington

Executive Committee

MEGAN F. CLUBB, Chair of the Executive Committee - President, CEO and Chairman of the Board

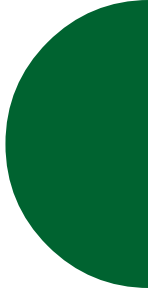
JON S. BREN, Executive Vice President - Investment Management &
Trust Services Division Manager

LYLE W. HANSEN, Executive Vice President - Banking Division Manager

MARK A. HESS, Executive Vice President - Chief Operating Officer

Auditor

LORRAINE A. MANUEL





BAKER BOYER BANK

bank with the best...

2005, 2006, 2007 Voted **Best Bank** in Walla Walla Valley,
Union-Bulletin Reader Poll

2005, 2006 Voted one of the **Best Companies to Work For**,
Washington CEO Magazine

2005 Voted **Most Community Reflective in Architectural Excellence**,
Independent Banker Magazine