Oak Valley Bancorp
Form 10-Q
May 16, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended March 31, 2011

OR

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 001-34142

OAK VALLEY BANCORP

(Exact name of registrant as specified in its charter)

California	**26-2326676**
State or other jurisdiction of incorporation or organization	I.R.S. Employer Identification No.

125 N. Third Ave., Oakdale, CA 95361

(Address of principal executive offices)

(209) 848-2265

Issuer s telephone number

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of   large accelerated filer,   accelerated filer,   and   smaller reporting company   in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 7,713,794 shares of common stock outstanding as of April 30, 2011.

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March 31, 2011

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PART I FINANCIAL STATEMENTS

Item 1. Consolidated Financial Statements (Unaudited)

OAK VALLEY BANCORP

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

AT MARCH 31, 2011 AND DECEMBER 31, 2010

	March 31, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$ 40,546,060	$ 28,091,916
Federal funds sold	28,135,000	40,845,000
Cash and cash equivalents	68,681,060	68,936,916
Securities available for sale	73,672,173	53,267,982
Loans, net of allowance for loan loss of $8,765,026 at March 31, 2011 and $8,254,929 at December 31, 2010	385,763,950	395,206,208
Bank premises and equipment, net	10,026,735	10,173,822
Other real estate owned	559,008	778,174
Interest receivable and other assets	24,066,442	24,033,316
	$ 562,769,368	$ 552,396,418
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits	$ 485,640,628	$ 476,738,850
Interest payable and other liabilities	3,349,326	2,999,836
Federal Home Loan Bank advances	8,000,000	8,000,000
Total liabilities	496,989,954	487,738,686
Commitments and contingencies		
Shareholders equity		
Preferred stock, no par value; $1,000 per share liquidation preference, 10,000,000 shares authorized and 13,500 issued and outstanding at March 31, 2011 and December 31, 2010	13,055,606	13,013,945
Common stock, no par value; 50,000,000 shares authorized, 7,713,794 and 7,702,127 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	24,013,443	24,003,549
Additional paid-in capital	2,092,218	2,080,218
Retained earnings	24,971,531	24,016,466
Accumulated other comprehensive income, net of tax	1,646,616	1,543,554
Total shareholders equity	65,779,414	64,657,732
	$ 562,769,368	$ 552,396,418

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

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2011 AND MARCH 31, 2010

	THREE MONTHS ENDED MARCH 31,			
		2011		2010
INTEREST INCOME				
Interest and fees on loans	$	5,941,678	$	6,438,525
Interest on securities available for sale		694,075		584,275
Interest on federal funds sold		15,218		1,558
Interest on deposits with banks		16,671		4,281
Total interest income		6,667,642		7,028,639
INTEREST EXPENSE				
Deposits		440,520		869,406
Federal Home Loan Bank advances		21,674		98,375
Federal funds purchased				110
Total interest expense		462,194		967,891
Net interest income		6,205,448		6,060,748
Provision for loan losses		600,000		1,005,000
Net interest income after provision for loan losses		5,605,448		5,055,748
NON-INTEREST INCOME				
Service charges on deposits		258,095		255,640
Earnings on cash surrender value of life insurance		128,298		103,986
Mortgage commissions		9,873		19,127
Other		274,975		267,847
Total non-interest income		671,241		646,600
NON-INTEREST EXPENSE				
Salaries and employee benefits		2,333,990		2,190,328
Occupancy		656,530		681,508
Data processing fees		258,635		236,533
OREO write downs and expenses		248,778		347,800
Regulatory assessments		198,000		258,000
Other		829,904		731,090
Total non-interest expense		4,525,837		4,445,259
Net income before provision for income taxes		1,750,852		1,257,089
Provision for income taxes		585,376		309,448
NET INCOME	$	1,165,476	$	947,641
Preferred stock dividends and accretion		210,411		210,411
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$	955,065	$	737,230
NET INCOME PER COMMON SHARE	$	0.12	$	0.10
NET INCOME PER DILUTED COMMON SHARE	$	0.12	$	0.10

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

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)

FOR THE YEAR ENDED DECEMBER 31, 2010 AND THE THREE-MONTH PERIOD ENDED MARCH 31, 2011

	YEAR ENDED DECEMBER 31, 2010 AND THREE MONTHS ENDED MARCH 31, 2011								
	Common Stock		Preferred Stock		Additional Paid-in Capital	Retained Earnings	Comprehensive Income	Accumulated Other Comprehensive Income	Total Shareholders Equity
	Shares	Amount	Shares	Amount					
Balances, January 1, 2010	7,681,877	$ 23,933,440	13,500	$ 12,847,297	$ 1,997,747	$ 20,230,683		$ 1,683,084	$ 60,692,251
Stock options exercised	20,250	$ 70,109							$ 70,109
Preferred stock accretion				$ 166,648		$ (166,648)			0
Preferred stock dividend payments						(675,000)			(675,000)
Stock based compensation					82,471				82,471
Comprehensive income:									
Net changes in unrealized gain on available-for-sale securities (net of income tax benefit of $17,015)							(24,334)	(24,334)	(24,334)
Reclassification of realized gains (net of income tax benefit of $80,549)							(115,196)	(115,196)	(115,196)
Net income						4,627,431	4,627,431		4,627,431
Comprehensive income							$ 4,487,901		
Balances, December 31, 2010	7,702,127	$ 24,003,549	13,500	$ 13,013,945	$ 2,080,218	$ 24,016,466		$ 1,543,554	$ 64,657,732
Stock options exercised	3,037	$ 9,894							$ 9,894
Restricted stock issued	8,630								
Preferred stock accretion				$ 41,661		$ (41,661)			
Preferred stock dividend payments						(168,750)			(168,750)
Stock based compensation					12,000				12,000
Comprehensive income:									
							118,295	118,295	118,295

Net changes in unrealized gain on available-for-sale securities (net of income tax of $82,716)									
Reclassification of realized gains (net of income tax benefit of $10,651)							(15,233)	(15,233)	(15,233)
Net income						1,165,476	1,165,476		1,165,476
Comprehensive income							$ 1,268,538		
Balances, March 31, 2011	7,713,794	$ 24,013,443	13,500	$ 13,055,606	$ 2,092,218	$ 24,971,531		$ 1,646,616	$ 65,779,414

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

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE THREE-MONTH PERIODS ENDED MARCH 31, 2011 AND MARCH 31, 2010

	THREE MONTHS ENDED MARCH 31, 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 1,165,476	$ 947,641
Adjustments to reconcile net earnings to net cash from operating activities:		
Provision for loan losses	600,000	1,005,000
Depreciation	225,471	239,300
Amortization and accretion, net	532	(2,410)
Stock based compensation	12,000	21,670
OREO write downs and losses on sale	219,166	211,996
Gain on called available for sale securities	(25,884)	(55,838)
Increase in BOLI cash surrender value	(128,298)	(103,986)
Increase in interest payable and other liabilities	349,490	328,498
Increase in interest receivable	(84,647)	(16,173)
Decrease (increase) in other assets	107,756	(31,644)
Net cash from operating activities	2,441,062	2,544,054
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available for sale securities	(22,085,657)	(3,022,258)
Proceeds from maturities, calls, and principal paydowns of securities available for sale	1,881,943	2,702,998
Net decrease in loans	8,842,258	12,758,640
Proceeds from sale of OREO	0	9,816
Net purchases of premises and equipment	(78,384)	(525,965)
Net cash (used in) from investing activities	(11,439,840)	11,923,231
CASH FLOWS FROM FINANCING ACTIVITIES:		
FHLB advanced funds	0	480,000
FHLB payments	0	(480,000)
Federal funds advances	0	100,000
Federal funds payments	0	(8,000,000)
Preferred stock dividend payment	(168,750)	(168,750)
Net increase in demand deposits and savings accounts	16,102,250	5,888,075
Net decrease in time deposits	(7,200,472)	(3,474,262)
Proceeds from sale of common stock and exercise of stock options	9,894	0
Net cash from (used in) financing activities	8,742,922	(5,654,937)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(255,856)	8,812,348
CASH AND CASH EQUIVALENTS, beginning of period	68,936,916	21,648,548
CASH AND CASH EQUIVALENTS, end of period	$ 68,681,060	$ 30,460,896
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest	$ 477,548	$ 1,071,830
Income taxes	$ 221,119	$ 451,000

NON-CASH INVESTING ACTIVITIES:				
Real estate acquired through foreclosure	$	0	$	528,699
Change in unrealized gain (loss) on available-for-sale securities	$	175,125	$	(151,603)
NON-CASH FINANCING ACTIVITIES:				
Accretion of preferred stock	$	41,662	$	41,661

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

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OAK VALLEY BANCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1   BASIS OF PRESENTATION

On July 3, 2008 (the   Effective Date), a bank holding company reorganization was completed whereby Oak Valley Bancorp became the parent holding company for Oak Valley Community Bank (the   Bank). On the Effective Date, each outstanding share of the Bank was converted into one share of Oak Valley Bancorp and the Bank became a wholly-owned subsidiary of the holding company.

The accounting principles followed by the Company and the methods of applying these principles conform with accounting principles generally accepted in the United States of America (GAAP) and with general practices within the banking industry. In preparing financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts in the financial statements. Actual results could differ significantly from those estimates. Material estimates common to the banking industry that are particularly susceptible to significant change in the near term include, but are not limited to, the determination of the allowance for loan losses, the estimation of compensation expense related to stock options granted to employees and directors, and valuation allowances associated with deferred tax assets, the recognition of which are based on future taxable income.

The interim consolidated financial statements included in this report are unaudited but reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the interim periods presented. All such adjustments are of a normal recurring nature. The results of operations for the three month period ended March 31, 2011 are not necessarily indicative of the results of a full year s operations. For further information, refer to the audited financial statements and footnotes included in the Company s Form 10-K for the year ended December 31, 2010.

NOTE 2   RECENT ACCOUNTING PRONOUNCEMENTS

FASB ASC Topic 825   Fair Value Measurements and Disclosures.   In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements.* This ASU requires: (1) disclosure of the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurement categories and the reasons for the transfers; and (2) separate presentation of purchases, sales, issuances, and settlements in the reconciliation for fair value measurements using significant unobservable inputs (Level 3). In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures set forth in the Codification Subtopic 820-10: (1) For purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and (2) a reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and non-recurring fair value measurements. ASU 2010-06 is effective for interim and annual reporting periods beginning January 1, 2010, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, which are effective for fiscal years beginning January 1, 2011, and for interim periods within those fiscal years. As ASU 2010-06 is disclosure-related only, our adoption of this ASU in the first quarter of 2010 did not impact our financial condition or results of operations.

FASB ASC Topic 310 Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. In July 2010, FASB issued Accounting Standards Update 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (Topic 310)*. This standard expands disclosures about credit quality of financing receivables and the allowance for loan losses. The standard will require the Company to expand disclosures about the credit quality of our loans and the related reserves against them. The extra disclosures will include disaggregated matters related to our past due loans, credit quality indicators, and modifications of loans. The Company adopted the standard beginning with our December 31, 2010 financial statements. This standard did not have an impact on the Company s financial position or results of operations.

In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-02, *Receivables (Topic 310): A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. The ASU clarifies which loan modifications constitute troubled debt restructurings. It is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring (TDR), both for purposes of recording an impairment loss and for disclosure of a TDR. In evaluating whether a restructuring constitutes a TDR, a creditor must separately conclude that both of the following exist: (*a*) the restructuring constitutes a concession; and (*b*) the debtor is experiencing financial difficulties. The amendments to ASU Topic 310, *Receivables*, clarify the guidance on a creditor s evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. ASU No. 2011-02 is effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after the beginning of the fiscal year of adoption.

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NOTE 3 SECURITIES

The amortized cost and estimated fair values of debt securities as of March 31, 2011 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
Available-for-sale securities:				
U.S. agencies	$ 46,336,402	1,707,505	$ (40,939)	$ 48,002,968
Collateralized mortgage obligations	7,577,681	230,469		7,808,150
Municipalities	12,797,714	926,646		13,724,360
SBA Pools	1,499,226		(5,814)	1,493,412
Mutual Fund	2,662,690		(19,407)	2,643,283
	$ 70,873,713	$ 2,864,620	$ (66,160)	$ 73,672,173

The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at March 31, 2011.

	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. agencies	$ 5,605,519	$ (40,939)	$		$ 5,605,519	$ (40,939)
Collateralized mortgage obligations						
Municipalities						
SBA Pools			1,487,780	(5,814)	1,487,780	(5,814)
Mutual Fund	980,592	(19,407)			980,592	(19,407)
Total temporarily impaired securities	$ 6,586,111	$ (60,346)	$ 1,487,780	$ (5,814)	$ 8,073,891	$ (66,160)

At March 31, 2011, a total of two SBA pools make up the total amount of securities in an unrealized loss position for greater than 12 months. Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due solely to interest rate changes and the Bank does not intend to sell the securities and it is not likely that we will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

The amortized cost and estimated fair value of debt securities at March 31, 2011, by contractual maturity or call date, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Estimated

	Amortized Cost	Fair Value
Available-for-sale securities:		
Due in one year or less	$ 6,738,755	$ 6,746,022
Due after one year through five years	11,575,524	12,550,979
Due after five years through ten years	15,503,511	16,157,909
Due after ten years	37,055,923	38,217,263
	$ 70,873,713	$ 73,672,173

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The amortized cost and estimated fair values of debt securities as of December 31, 2010, are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Available-for-sale securities:				
U.S. agencies	$ 28,678,709	1,566,549	$ (54,870)	$ 30,190,388
Collateralized mortgage obligations	7,946,854	189,926		8,136,780
Municipalities	9,870,381	931,375	(2,257)	10,799,499
SBA Pools	1,517,332		(11,236)	1,506,096
Mutual Fund	2,631,371	14,063	(10,215)	2,635,219
	$ 50,644,647	$ 2,701,913	$ (78,578)	$ 53,267,982

The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2010.

	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. agencies	$ 3,101,384	$ (54,870)	$	$	$ 3,101,384	$ (54,870)
Collateralized mortgage obligations						
Municipalities	427,130	(2,257)			427,130	(2,257)
SBA Pools			1,499,228	(11,236)	1,499,228	(11,236)
Mutual Fund	989,786	(10,215)			989,786	(10,215)
Total temporarily impaired securities	$ 4,518,300	$ (67,342)	$ 1,499,228	$ (11,236)	$ 6,017,528	$ (78,578)

At December 31, 2010, two SBA pools make up the total amount of securities in an unrealized loss position for greater than 12 months. Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due solely to interest rate changes and the Bank does not intend to sell the securities and it is not likely that we will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

The Company recognized a gain of $25,884 for the three month period ended March 31, 2011, on certain available-for-sale securities that were partially called, which compares to $55,838 in the same period of 2010. There were no sales of available-for-sale securities during the first three months of 2011 and 2010.

Securities carried at $48,362,183 and $46,405,847 at March 31, 2011 and December 31, 2010, respectively, were pledged to secure deposits of public funds.

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NOTE 4 LOANS

The Bank s customers are primarily located in Stanislaus, San Joaquin, Tuolumne, Inyo, and Mono Counties. Approximately 83% of the Bank s loans are commercial real estate loans which includes construction loans. Approximately 7% of the Bank s loans are for general commercial uses including professional, retail, and small business. Additionally, 7% of the Bank s loans are for residential real estate and other consumer loans. The remaining 3% are agriculture loans.

Loan totals were as follows:

	March 31, 2011	December 31, 2010
Loans		
Commercial real estate:		
Commercial real estate- construction	$ 11,009,926	$ 13,669,527
Commercial real estate- mortgages	280,633,689	289,208,721
Land	19,537,992	18,975,637
Farmland	17,118,792	14,876,426
Commercial and industrial	28,646,662	30,755,651
Consumer	1,709,806	1,242,300
Consumer residential	26,524,138	21,843,935
Agriculture	10,061,988	13,621,952
Total loans	395,242,993	404,194,149
Less:		
Deferred loan fees and costs, net	(714,017)	(733,012)
Allowance for loan losses	(8,765,026)	(8,254,929)
Net loans	$ 385,763,950	$ 395,206,208

Loan Origination/Risk Management. The Corporation has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower s ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower s management possesses sound ethics and solid business acumen, the Bank s management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Bank s commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Bank s exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Bank avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Bank also utilizes third-party experts to

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provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. At March 31, 2011, approximately 37.6% of the outstanding principal balance of the Bank s commercial real estate loans were secured by owner-occupied properties.

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Bank may originate from time to time, the Bank generally requires the borrower to have had an existing relationship with the Bank and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Bank until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

The Bank originates consumer loans utilizing a computer-based credit scoring analysis to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans follow bank policy, which include, but are not limited to, a maximum loan-to-value percentage of 80%, a maximum housing and total debt ratio of 36% and 42%, respectively and other specified credit and documentation requirements.

The Bank maintains an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Bank s policies and procedures.

Non-Accrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management s opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Year-end non-accrual loans, segregated by class of loans, were as follows:

		March 31, 2011		**December 31, 2010**
Loans				
Commercial real estate:				
Commercial real estate- construction	$	2,476,284	$	3,252,081
Commercial real estate- mortgages		4,181,308		4,190,665
Land		3,787,472		3,810,473
Farmland		0		0

Commercial and industrial		217,822		221,723
Consumer		0		0
Consumer residential		0		0
Agriculture		0		0
Total non-accrual loans	$	10,662,886	$	11,474,942

Had non-accrual loans performed in accordance with their original contract terms, the Bank would have recognized additional interest income of approximately $181,000 and $163,000 in three month periods ended March 31, 2011 and 2010, respectively.

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The following table analyzes past due loans including the non-accrual loans in the above table, segregated by class of loans, as of March 31, 2011:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Greater Than 90 Days Past Due and Still Accruing
March 31, 2011						
Commercial real estate:						
Commercial R.E. - construction	$ 0	$ 0	$ 2,476,285	$ 2,476,285	$ 8,533,641	$ 0
Commercial R.E. - mortgages	3,162,836	0	4,345,620	7,508,456	273,125,233	164,312
Land	580,710	0	2,485,032	3,065,742	16,472,250	0
Farmland	0	0	0	0	17,118,792	0
Commercial and industrial	69,372	0	0	69,372	28,577,290	0
Consumer	0	0	0	0	1,709,806	0
Consumer residential	0	0	0	0	26,524,138	0
Agriculture	0	0	0	0	10,061,988	0
Total	$ 3,812,918	$ 0	$ 9,306,937	$ 13,119,855	$ 382,123,138	$ 164,312

The following table analyzes past due loans including the non-accrual loans in the above table, segregated by class of loans, as of December 31, 2010:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Greater Than 90 Days Past Due and Still Accruing
December 31, 2010						
Commercial real estate:						
Commercial R.E. - construction	$ 0	$ 0	$ 2,663,126	$ 2,663,126	$ 11,006,401	$ 0
Commercial R.E. - mortgages	1,473,940	2,865,492	1,325,173	5,664,605	283,544,116	0
Land	0	0	3,810,473	3,810,473	15,165,164	0
Farmland	0	0	0	0	14,876,426	0
Commercial and industrial	0	0	0	0	30,755,651	0
Consumer	0	0	0	0	1,242,300	0
Consumer residential	0	0	0	0	21,843,935	0
Agriculture	0	0	0	0	13,621,952	0
Total	$ 1,473,940	$ 2,865,492	$ 7,798,772	$ 12,138,204	$ 392,055,945	$ 0

Impaired Loans. Loans are considered impaired when, based on current information and events, it is probable the Bank will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectibility of the principal amount is reasonably assured, in which case interest is

recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

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Impaired loans as of March 31, 2011 and December 31, 2010 are set forth in the following table. No interest income was recognized on impaired loans subsequent to their classification as impaired.

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
March 31, 2011						
Commercial real estate:						
Commercial R.E. - construction	$ 2,628,587	$ 0	$ 2,476,284	$ 2,476,284	$ 296,126	$ 2,600,846
Commercial R.E. - mortgages	4,469,681	1,315,816	2,865,492	4,181,308	402,767	4,775,569
Land	7,707,585	721,731	3,065,741	3,787,472	562,353	3,795,807
Farmland	0	0	0	0	0	0
Commercial and industrial	219,023	217,822	0	217,822	0	219,123
Consumer	0	0	0	0	0	0
Consumer residential	0	0	0	0	0	0
Agriculture	0	0	0	0	0	0
Total	$ 15,024,876	$ 2,255,369	$ 8,407,517	$ 10,662,886	$ 1,261,246	$ 11,391,345
December 31, 2010						
Commercial real estate:						
Commercial R.E. - construction	$ 3,405,167	$ 1,427,776	$ 1,824,305	$ 3,252,081	$ 179,725	$ 4,430,245
Commercial R.E. - mortgages	4,469,681	4,190,665	0	4,190,665	0	1,900,081
Land	7,710,271	739,732	3,070,741	3,810,473	768,118	4,231,514
Farmland	0	0	0	0	0	0
Commercial and industrial	222,023	221,723	0	221,723	0	207,384
Consumer	0	0	0	0	0	0
Consumer residential	0	0	0	0	0	2,417
Agriculture	0	0	0	0	0	0
Total	$ 15,807,142	$ 6,579,896	$ 4,895,046	$ 11,474,942	$ 947,843	$ 10,771,641

Quality ratings (Risk Grades) are assigned to all commitments and stand-alone notes. Risk grades define the basic characteristics of commitments or stand-alone note in relation to their risk. All loans are graded using a system that maximizes the loan quality information contained in loan review grades, while ensuring that the system is compatible with the grades used by bank examiners.

We grade loans using the following letter system:

1 Exceptional Loan

2 Quality Loan

3A Better Than Acceptable Loan

3B Acceptable Loan

3C Marginally Acceptable Loan

4 (W) Watch Acceptable Loan

5 Other Loans Especially Mentioned

6 Substandard Loan

7 Doubtful Loan

8 Loss

1. Exceptional Loan - Loans with A+ credits that contain very little, if any, risk. To qualify for this rating, the following characteristics must be present:

-A high level of liquidity and whose debt-servicing capacity exceeds expected obligations by a substantial margin.

-Where leverage is below average for the industry and earnings are consistent or growing without severe vulnerability to economic cycles.

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-Also included in this rating (but not mandatory unless one or more of the preceding characteristics are missing) are loans that are fully secured and properly margined by our own time instruments or U.S. blue chip securities. To be properly margined cash collateral must be equal to, or greater than, 110% of the loan amount.

2. Quality Loan - Loans with excellent sources of repayment that conform in all respects to bank policy and regulatory requirements. These are also loans for which little repayment risk has been identified. No credit or collateral exceptions. Other factors include:

-Unquestionable debt-servicing capacity to cover all obligations in the ordinary course of business from well-defined primary and secondary sources.

-Consistent strong earnings.

-A solid equity base.

3A. Better than Acceptable Loan - In the interest of better delineating the loan portfolio s true credit risk for reserve allocation, further granularity has been sought by splitting the grade 3 category into three classifications. The distinction between the three are bank-defined guidelines and represent a further refinement of the regulatory definition of a pass, or grade 3 loan. Grade 3A is the stronger third of the pass category, but is not strong enough to be a grade 2 and is characterized by:

-Strong earnings with no loss in last three years and ample cash flow to service all debt well above policy guidelines.

-Long term experienced management with depth and defined management succession.

-The loan has no exceptions to policy.

-Loan-to-value on real estate secured transactions is 10% to 20% less than policy guidelines.

-Very liquid balance sheet that may have cash available to pay off our loan completely.

-Little to no debt on balance sheet.

3B. Acceptable Loan - 3B loans are simply defined as all loans that are less qualified than 3A loans and are stronger than 3C loans. These loans are characterized by acceptable sources of repayment that conform to bank policy and regulatory requirements. Repayment risks are acceptable for these loans. Credit or collateral exceptions are minimal, are in the process of correction, and do not represent repayment risk. These loans:

-Are those where the borrower has average financial strengths, a history of profitable operations and experienced management.

-Are those where the borrower can be expected to handle normal credit needs in a satisfactory manner.

3C. Marginally Acceptable - 3C loans have similar characteristics as that of 3Bs with the following additional characteristics:

Requires collateral. A credit facility where the borrower has average financial strengths, but usually lacks reliable secondary sources of repayment other than the subject collateral. Other common characteristics can include some or all of the following: minimal background

experience of management, lacking continuity of management, a start-up operation, erratic historical profitability (acceptable reasons-well identified), lack of or marginal sponsorship of guarantor, and government guaranteed loans.

4W *Watch Acceptable* - Watch grade will be assigned to any credit that is adequately secured and performing but monitored for a number of indicators. These characteristics may include any unexpected short-term adverse financial performance from budgeted projections or prior period s results (i.e., declining profits, sales, margins, cash flow, or increased reliance on leverage, including adverse balance sheet ratios, trade debt issues, etc.). Additionally, any managerial or personal problems of company management, decline in the entire industry or local economic conditions failure to provide financial information or other documentation as requested; issues regarding delinquency, overdrafts, or renewals; and any other issues that cause concern for the company. Loans to individuals or loans supported by guarantors with marginal net worth and/or marginal collateral. Weakness identified

in a Watch credit is short-term in nature. Loans in this category are usually accounts the bank would want to retain providing a positive turnaround can be expected within a reasonable time frame.

5 *Other Loans Especially Mentioned (OLEM)* - A special mention extension of credit is defined as having potential weaknesses that deserve management s close attention. If left uncorrected, these potential weaknesses may, at some future date result in the deterioration of the repayment prospects for the credit or the institution s credit position. Extensions of credit that might be detailed in this category include the following:

-The lending officer may be unable to properly supervise the credit because of an inadequate loan or credit agreement.

-Questions exist regarding the condition of and/or control over collateral.

-Economic or market conditions may unfavorably affect the obligor in the future.

-A declining trend in the obligor s operations or an imbalanced position in the balance sheet exists, but not to the point that repayment is jeopardized.

6 *Substandard Loan* - A substandard extension of credit is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Extensions of credit so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard credits, does not have to exist in individual extensions of credit classified substandard.

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7 *Doubtful Loan* - An extension of credit classified doubtful has all the weaknesses inherent in one classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high but because of certain important and reasonably specific pending factors that may work to the advantage of and strengthen the credit, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors may include a proposed merger or acquisition, liquidation proceedings, capital injection, perfecting liens on additional collateral or refinancing plans. The entire loan need not be classified doubtful when collection of a specific portion appears highly probable. An example of proper use of the doubtful category is the case of a company being liquidated, with the trustee-in-bankruptcy indicating a minimum disbursement of 40 percent and a maximum of 65 percent to unsecured creditors, including the bank. In this situation, estimates are based on liquidation value appraisals with actual values yet to be realized. By definition, the only portion of the credit that is doubtful is the 25 percent difference between 40 and 65 percent.

A proper classification of such a credit would show 40 percent substandard, 25 percent doubtful, and 35 percent loss. A credit classified as doubtful should be resolved within a reasonable period of time. Reasonable is generally defined as the period between examinations. In other words, a credit classified doubtful at an examination should be cleared up before the next exam. However, there may be situations that warrant continuation of the doubtful classification a while longer.

8. *Loss* - Extensions of credit classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the credit has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off, even though partial recovery may be affected in the future. It should not be the bank s practice to attempt long-term recoveries while the credit remains on the books. Losses should be taken in the period in which they surface as uncollectible.

The following table presents weighted average risk grades of our loan portfolio:

	March 31, 2011 Weighted Average Risk Grade	**December 31, 2010 Weighted Average Risk Grade**
Commercial real estate:		
Commercial real estate - construction	3.67	4.83
Commercial real estate - mortgages	3.33	3.27
Land	5.30	5.37
Farmland	3.39	3.45
Commercial and industrial	3.19	3.28
Consumer	2.79	2.77
Consumer residential	3.04	3.01
Agriculture	3.26	3.20
Total gross loans	3.41	3.42

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The following table presents risk grade totals by class of loans. Risk grades 1 through 4 have been aggregated in the Pass line. Classified loans include loans in risk grades 5, 6, and 7.

Dollars in thousands	Commercial R.E. Construction	Commercial R.E. Mortgages	Land	Farmland	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Total
March 31, 2011									
Pass	$ 8,533,641	$ 252,503,464	$ 4,683,417	$ 14,498,996	$ 27,062,342	$ 1,692,453	$ 26,125,958	$ 9,109,028	$ 344,209,299
Special mention		14,732,241		1,184,252	102,688			263,461	16,282,642
Substandard	2,476,285	13,397,984	14,854,575	1,435,544	1,481,632	17,353	398,180	689,499	34,751,052
Doubtful									
Total loans	$ 11,009,926	$ 280,633,689	$ 19,537,992	$ 17,118,792	$ 28,646,662	$ 1,709,806	$ 26,524,138	$ 10,061,988	$ 395,242,993
December 31, 2010									
Pass	$ 10,417,446	$ 265,361,186	$ 4,076,121	$ 12,225,807	$ 28,295,716	$ 1,225,072	$ 21,723,935	$ 12,593,405	$ 355,918,688
Special mention		10,352,335		1,190,402	1,573,044			278,548	13,394,329
Substandard	3,252,081	13,495,200	14,899,516	1,460,217	886,891	17,228	120,000	749,999	34,881,132
Doubtful									
Total loans	$ 13,669,527	$ 289,208,721	$ 18,975,637	$ 14,876,426	$ 30,755,651	$ 1,242,300	$ 21,843,935	$ 13,621,952	$ 404,194,149

Allowance for Loan Losses. The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management s best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Bank s allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, Receivables and allowance allocations calculated in accordance with ASC Topic 450, Contingencies. Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Bank s process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management s continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any

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credit that, in management s judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Bank s control, including, among other things, the performance of the Bank s loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Bank s allowance for loan losses consists of three elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other qualitative risk factors both internal and external to the Bank.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor s ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a calculated grade of 5 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower s ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower s industry, among other things.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. The Bank calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. The Bank s pools of similar loans include similarly risk-graded groups of commercial and industrial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Bank. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the bank s lending management and staff; (ii) the effectiveness of the Bank s loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, moderate or low degree of risk. The results are then input into a general allocation matrix to determine an appropriate general valuation allowance.

Included in the general valuation allowances are allocations for groups of similar loans with risk characteristics that exceed certain concentration limits established by management. Concentration risk limits have been established, among other things, for certain industry concentrations, large balance and highly leveraged credit relationships that exceed specified risk grades, and loans originated with policy exceptions that exceed specified risk grades.

Loans identified as losses by management, internal loan review and/or bank examiners are charged-off. Furthermore, consumer loan accounts are charged-off automatically based on regulatory requirements.

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The following table details activity in the allowance for loan losses by portfolio segment for the three months ended March 31, 2011 and year ended December 31, 2010. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Allowance for Loan Losses

For the Three Months Ended March 31, 2011 and Year Ended December 31, 2010

	Commercial Real Estate	**Commercial and industrial**	**Consumer**	**Consumer Residential**	**Agriculture**	**Unallocated**	**Total**
March 31, 2011							
Allowance for loan losses:							
Beginning balance	$ 6,577,011	$ 686,303	$ 61,115	$ 375,349	$ 152,526	$ 402,625	$ 8,254,929
Charge-offs	(55,039)	(35,000)	(1,865)				(91,904)
Recoveries			1,983	18			2,001
Provision	715,927	42,776	(9,591)	(100,508)	(26,303)	(22,301)	600,000
Ending balance	$ 7,237,899	$ 694,079	$ 51,642	$ 274,859	$ 126,223	$ 380,324	$ 8,765,026
Allowance for loan losses for loans:							
Individually evaluated for impairment	$ 1,261,246	$	$	$	$	$	$ 1,261,246
Collectively evaluated for impairment	5,976,653	694,079	51,642	274,859	126,223	380,324	7,503,780
	$ 7,237,899	$ 694,079	$ 51,642	$ 274,859	$ 126,223	$ 380,324	$ 8,765,026
Ending balances of loans:							
Individually evaluated for impairment	$ 10,445,064	$ 217,822	$	$	$	$	$ 10,662,886
Collectively evaluated for impairment	$ 317,855,335	$ 28,428,840	$ 1,709,806	$ 26,524,138	$ 10,061,988	$	$ 384,580,107
	$ 328,300,399	$ 28,646,662	$ 1,709,806	$ 26,524,138	$ 10,061,988	$ 0	$ 395,242,993
December 31, 2010							
Allowance for loan losses:							
Beginning balance	$ 5,844,793	$ 648,523	$ 43,822	$ 201,741	$ 142,009	$ 139,334	$ 7,020,222
Charge-offs	(2,695,836)	(52,382)	(569)	(43,399)			(2,792,186)
Recoveries		1,638	5,203	52			6,893
Provision	3,428,054	88,524	12,659	216,955	10,517	263,291	4,020,000
Ending balance	$ 6,577,011	$ 686,303	$ 61,115	$ 375,349	$ 152,526	$ 402,625	$ 8,254,929
Allowance for loan losses for loans:							
Individually evaluated for impairment	$ 947,843	$	$	$	$	$	$ 947,843
Collectively evaluated for impairment	$ 5,629,168	$ 686,303	$ 61,115	$ 375,349	$ 152,526	$ 402,625	$ 7,307,086
	$ 6,577,011	$ 686,303	$ 61,115	$ 375,349	$ 152,526	$ 402,625	$ 8,254,929
Ending balances of loans:							
Individually evaluated for impairment	$ 11,253,219	$ 221,723	$	$	$		$ 11,474,942
Collectively evaluated for impairment	$ 325,477,092	$ 30,533,928	$ 1,242,300	$ 21,843,935	$ 13,621,952		$ 392,719,207

$ 336,730,311	$ 30,755,651	$ 1,242,300	$ 21,843,935	$ 13,621,952	$ 0	$ 404,194,149

Changes in the allowance off-balance-sheet commitments were as follows:

	THREE MONTHS ENDED MARCH 31, 2011	2010
Balance, beginning of year	$ 157,001	171,900
Provision Charged to Operations for Off Balance Sheet	(36,231)	(18,030)
Balance, end of year	$ 120,770	$ 153,870

The method for calculating the allowance for off-balance-sheet loan commitments is based on an allowance percentage which is less than other outstanding loan types because they are at a lower risk level. This allowance percentage, based on many factors including historical losses and existing economic conditions, is evaluated by management periodically and is applied to the total undisbursed loan commitment balance to calculate the allowance for off-balance-sheet commitments.

At March 31, 2011 and December 31, 2010, loans carried at $322,207,330 and $331,288,636, respectively, were pledged as collateral on advances from the Federal Home Loan Bank.

NOTE 5 OTHER REAL ESTATE OWNED

As of March 31, 2011, the Bank owned three properties with balances of $559,008 that were classified as other

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real estate owned, as compared to three properties with outstanding balances of $778,174 as of December 31, 2010. Each of these properties was acquired through loan foreclosure.

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at the lower of carrying amount of the loan or fair value of the property at the date of foreclosure less selling costs. Subsequent to foreclosure, valuations are periodically performed and any subject revisions in the estimate of fair value are reported as adjustment to the carrying value of the real estate, provided the adjusted carrying amount does not exceed the original amount at foreclosure. Revenues and expenses from operations and changes in the valuation allowance are included in other operating expenses.

NOTE 6 OTHER POST-RETIREMENT BENEFIT PLANS

During January 2008, the Bank awarded certain officers a salary continuation plan (the Plan). Under the Plan, the participants will be provided with a fixed annual retirement benefit for twenty years after retirement. The Bank is also responsible for certain pre-retirement death benefits under the Plan. In connection with the implementation of the Plan, the Bank purchased single premium life insurance policies on the life of each of the officers covered under the Plan. The Bank is the owner and partial beneficiary of these life insurance policies. The assets of the Plan, under Internal Revenue Service regulations, are owned by the Bank and are available to satisfy the Bank s general creditors.

During January 2008 the Bank awarded two of its directors a director retirement plan (DRP). Under the DRP, the participants will be provided with a fixed annual retirement benefit for ten years after retirement. The Bank is also responsible for certain pre-retirement death benefits under the DRP. In connection with the implementation of the DRP, the Bank purchased single premium life insurance policies on the life of each director covered under the DRP. The Bank is the owner and partial beneficiary of these life insurance policies. The assets of the DRP, under Internal Revenue Service regulations, are the property of the Bank and are available to satisfy the Bank s general creditors.

Future compensation under both plans is earned for services rendered through retirement. The Bank accrues for the salary continuation liability based on anticipated years of service and vesting schedules provided under the plans. The Bank s current benefit liability is determined based on vesting and the present value of the benefits at a corresponding discount rate. The discount rate used is an equivalent rate for investment-grade bonds with lives matching those of the service periods remaining for the salary continuation contracts, which average approximately 20 years. The salary continuation liability as of March 31, 2011 and December 31, 2010 was $1,364,228 and $1,300,062, respectively, and is reported in interest payable and other liabilities in the consolidated balance sheet.

During January 2008, the Bank purchased $4.7 million in bank owned life insurance policies and entered into split-dollar life insurance agreements with certain officers and directors. In connection with the implementation of the split-dollar agreements, the Bank purchased single premium life insurance policies on the life of each of the officers and directors covered by the split-dollar life insurance agreements. The Bank is the owner of the policies and the partial beneficiary in an amount equal to the cash surrender value of the policies.

The combined cash surrender value of all Bank-owned life insurance policies recorded in other assets on the consolidated balance sheet was $11,226,934 and $11,098,636 at March 31, 2011 and December 31, 2010, respectively.

NOTE 7 FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Fair values of financial instruments The financial statements include various estimated fair value information as of March 31, 2011 and December 31, 2010. Such information, which pertains to the Bank s financial instruments, does not purport to represent the aggregate net fair value of the Bank. Further, the fair value estimates are based on various assumptions, methodologies, and subjective considerations, which vary widely among different financial institutions and which are subject to change. The following methods and assumptions are used by the Bank.

Cash and cash equivalents The carrying amounts of cash and cash equivalents approximate their fair value.

Securities (including mortgage-backed securities) Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Loans receivable The fair values for variable rate loans and all other loans (e.g., real estate construction and mortgage, commercial, and installment loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The allowance for loan losses is considered to be a reasonable estimate of loan discount for credit quality concerns.

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Deposit liabilities The fair values estimated for demand deposits (interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). The carrying amounts for variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of the aggregate expected monthly maturities on time deposits.

Federal Home Loan Bank (FHLB) advances Rates currently available to the Bank for borrowings with similar terms and remaining maturities are used to estimate the fair value of the existing debt.

Interest payable and receivable The carrying amounts of interest payable and receivable approximate their fair value.

Off-balance-sheet instruments Fair values for the Bank s off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the credit standing of the counterparties.

The estimated fair values of the Bank s financial instruments at March 31, 2011 are as follows:

	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash and cash equivalents	$ 68,681,060	$ 68,681,060
Securities available for sale	73,672,173	73,672,173
Loans, net	385,763,950	391,769,157
Interest receivable	1,726,509	1,726,509
Financial liabilities:		
Deposits	(485,640,628)	(486,148,512)
FHLB advance	(8,000,000)	(8,032,332)
Interest payable	(151,923)	(151,923)
Off-balance-sheet assets (liabilities):		
Commitments and standby letters of credit		(454,450)

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The estimated fair values of the Bank s financial instruments at December 31, 2010 are as follows:

	Carrying Amount	Fair Value
Financial assets:		
Cash and cash equivalents	$ 68,936,916	$ 68,936,916
Securities available for sale	53,267,982	53,267,982
Loans, net	395,206,208	400,399,726
Interest receivable	1,641,862	1,641,862
Financial liabilities:		
Deposits	(476,738,850)	(477,261,566)
FHLB advance	(8,000,000)	(8,028,835)
Interest payable	(167,277)	(167,277)
Off-balance-sheet assets (liabilities):		
Commitments and standby letters of credit		(599,443)

Fair value measurements defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follow:

Level 1: Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstance that caused the transfer, which generally corresponds with the Bank s quarterly valuation process.

Assets and liabilities measured at fair value on a recurring and non-recurring basis are summarized below:

		Fair Value Measurements at March 31, 2011		
	March 31, 2011	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs (Level 3)

				(Level 1)		(Level 2)		
Assets and liabilities measured on a recurring basis:								
Available-for-sale securities:								
U.S. agencies	$	48,002,968	$		$	48,002,968	$	
Collateralized mortgage obligations	$	7,808,150	$		$	7,808,150	$	
Municipalities	$	13,724,360	$		$	13,724,360	$	
SBA Pools	$	1,493,412	$		$	1,493,412	$	
Mutual Fund	$	2,643,283	$	2,643,283	$		$	
Assets and liabilities measured on a non-recurring basis:								
Impaired loans	$	7,146,271	$		$		$	7,146,271
Other real estate owned	$	559,008	$		$		$	559,008

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	December 31, 2010	Fair Value Measurements at December 31, 2010 Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities				
U.S. agencies	$ 30,190,388	$	$ 30,190,388	$
Collateralized mortgage obligations	8,136,780		8,136,780	
Municipalities	10,799,499		10,799,499	
SBA Pools	1,506,096		1,506,096	
Mutual Fund	2,635,219	2,635,219		
Assets and liabilities measured on a non-recurring basis:				
Impaired Loans	$ 3,947,203	$	$	$ 3,947,203
Other real estate owned	$ 778,174	$	$	$ 778,174

Losses recognized from non-recurring fair value adjustments for the three month period ended March 31, 2011 and 2010 are presented on the following table:

	THREE MONTHS ENDED MARCH 31, 2011	2010
Impaired loans	$ 90,039	$ 1,081,758
Other real estate owned	219,166	216,092
Total loss from non-recurring fair value adjustments	$ 309,205	$ 1,297,850

The fair value of securities available for sale equals quoted market price, if available. If quoted market prices are not available, fair value is determined using quoted market prices for similar securities. Changes in fair market value are recorded in other comprehensive income net of tax.

The fair value measurement applies to impaired loans, which includes impaired loans measured at an observable market price (if available), or at the fair value of the loan s collateral (if the loan is collateral dependent). Fair value of the loan s collateral, when the loan is dependent on collateral, is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the collateral. At March 31, 2011, impaired loans that had a specific loan loss reserve had a principal balance of $8,407,517 with a valuation allowance of $1,261,246. Upon being classified as impaired, either a charge off or a specific reserve or both may be taken to reduce the balance of each loan to an estimate of the collateral fair market value less cost to dispose. This estimate was a level 3 valuation. There was no direct impact on the statement of income. The charge-offs were recorded as a debit to the allowance for loan losses.

Fair value of other real estate owned is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the property. Total fair market value at March 31, 2011 was $559,008 which was a level 3 valuation. There is a direct impact to the statement of income as any market value write downs are charged directly to operating expenses. The Bank is required by internal bank policies to order real estate appraisals on OREO properties every six months. In addition, management evaluates the book values on a quarterly basis for reasonableness and makes fair value adjustments as necessary.

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NOTE 8 EARNINGS (LOSS) PER SHARE

Earnings per share (EPS) is calculated based on the weighted average common shares outstanding during the period. Basic EPS excludes dilution and is calculated by dividing net income available to common shareholders by the weighted average common shares outstanding. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

In thousands (except share and per share amounts)	THREE MONTHS ENDED MARCH 31, 2011		2010	
BASIC EARNINGS PER SHARE				
Net income available to common shareholders	$	955,065	$	737,230
Weighted average shares outstanding		7,711,401		7,681,877
Net income per common share	$	0.12	$	0.10
DILUTED EARNINGS PER SHARE				
Net income available to common shareholders	$	955,065	$	737,230
Weighted average shares outstanding		7,711,401		7,681,877
Effect of dilutive stock options		19,679		23,611
Effect of dilutive warrants		11,150		
Weighted average shares of common stock and common stock equivalents		7,742,230		7,705,488
Net income per diluted common share	$	0.12	$	0.10

During the three month period ended March 31, 2011, anti-dilutive weighted average options to purchase 219,625 shares of common stock, were outstanding with prices ranging from $7.05 to $15.67. Anti-dilutive weighted average stock options of 240,187 were outstanding during the same three month period of 2010, with prices ranging from $4.58 to $15.67. These options were not included in the computation of diluted EPS because the options exercise price was greater than the average market price of the common shares. These options begin to expire in 2013. Weighted average warrants of 350,346 issued to the U.S. Treasury Capital Purchase Program were dilutive for the three month period of 2011, as the exercise price of $5.78 was less than the average market price of common shares. These warrants were anti-dilutive for the three month period of 2010, as the exercise price was more than the average market price of common shares.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion explains the significant factors affecting our operations and financial position for the periods presented. The discussion should be read in conjunction with our financial statements and the notes related thereto which appear or that are referenced to elsewhere in this report, and with the audited consolidated financial statements and accompanying notes included in our 2010 Annual Report on Form 10-K, as amended. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

The discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions. This discussion and analysis includes executive management s (Management) insight of the Company s financial condition and results of operations of Oak Valley Bancorp and its subsidiary. Unless otherwise stated, the Company refers to the consolidated entity, Oak Valley Bancorp, while the Bank refers to Oak Valley Community Bank

Forward-Looking Statements

Some matters discussed in this Form 10-Q may be forward-looking statements within the meaning of the Private Litigation Reform Act of 1995 and therefore may involve risks, uncertainties and other factors which may cause our actual results to be materially different from the results expressed or implied by our forward-looking statements. These statements generally appear with words such as anticipate, believe, estimate, may, intend, and expect. Although management believes that the assumptions and expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to be correct. Factors that could cause actual results to differ from results discussed in forward-looking statements include, but are not limited to: economic conditions (both generally and in the markets where the Bank operates); competition from other providers of financial services offered by the Bank; changes in government regulation and legislation; changes in interest rates; material unforeseen changes in the financial stability and liquidity of the Bank s credit customers; risks associated with concentrations in real estate related loans; changes in accounting standards and interpretations; and other risks as may be detailed from time to time in the Company s filings with the Securities and Exchange Commission, all of which are difficult to predict and which may be beyond the control of the Company or the Bank. The Company undertakes no obligation to revise forward-looking statements to reflect events or changes after the date of this discussion or to reflect the occurrence of unanticipated events.

Forward-looking statements speak only as of the date they are made, and the Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made, whether as a result of new information, future developments or otherwise, except as may be required by law.

Critical Accounting Estimates

Management has determined the following five accounting policies to be critical:

Asset Impairment Judgments

Certain of our assets are carried in our statements of financial condition at fair value or at the lower of cost or fair value. Valuation allowances are established when necessary to recognize impairment of such assets. We periodically perform analyses to test for impairment of various assets. In addition to our impairment analyses related to loans, another significant impairment analysis relates to other than temporary declines in the value of our securities.

Our available for sale portfolio is carried at estimated fair value, with any unrealized gains and losses, net of taxes, reported as accumulated other comprehensive income in stockholders equity. We conduct a periodic review and evaluation of the securities portfolio to determine if the value of any security has declined below its carrying value and whether such decline is other than temporary. If such decline is deemed other than temporary, we would adjust the carrying amount of the security by writing down the security to fair market value through a charge to current period income. The market values of our securities are significantly affected by changes in interest rates.

In general, as interest rates rise, the market value of fixed-rate securities will decrease; as interest rates fall, the market value of fixed-rate securities will increase. With significant changes in interest rates, we evaluate our intent and ability to hold the security for a sufficient time to recover the recorded principal balance. Estimated fair values for securities are based on published or securities dealers market values. Market volatility is unpredictable and may impact such values.

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Allowance for Loan Losses

Accounting for allowance for loan losses involves significant judgment and assumptions by management and is based on historical data and management s view of the current economic environment. At least on a quarterly basis, our management reviews the methodology and adequacy of allowance for loan losses and reports its assessment to the Board of Directors for its review and approval.

We base our allowance for loan losses on an estimation of probable losses inherent in our loan portfolio. Our methodology for assessing loan loss allowances are intended to reduce the differences between estimated and actual losses and involves a detailed analysis of our loan portfolio in three phases:

• the specific review of individual loans,

• the segmenting and review of loan pools with similar characteristics and,

• our judgmental estimate based on various subjective factors.

The first phase of our methodology involves the specific review of individual loans to identify and measure impairment. We evaluate each loan by use of a risk rating system, except for homogeneous loans, such as automobile loans and home mortgages. Specific risk rated loans are deemed impaired if all amounts, including principal and interest, will likely not be collected in accordance with the contractual terms of the related loan agreement. Impairment for commercial and real estate loans is measured either based on the present value of the loan s expected future cash flows or, if collection on the loan is collateral dependent, the estimated fair value of the collateral, less selling and holding costs.

The second phase involves the segmenting of the remainder of the risk rated loan portfolio into groups or pools of loans, together with loans with similar characteristics, for evaluation. We determine the calculated loss ratio to each loan pool based on its historical net losses and benchmark it against the levels of other peer banks.

In the third phase, we consider relevant internal and external factors that may affect the collectibility of loan portfolio and each group of loan pool. The factors considered are, but are not limited to:

• concentration of credits,

• nature and volume of the loan portfolio,

• delinquency trends,

• non-accrual loan trend,

• problem loan trend,

• loss and recovery trend,

• quality of loan review,

• lending and management staff,

• lending policies and procedures,

• economic and business conditions, and

• other external factors including regulatory review.

Our management estimates the probable effect of such conditions based on our judgment, experience and known or anticipated trends. Such estimation may be reflected as an additional allowance to each group of loans, if necessary. Management reviews these conditions with our senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management s estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specific, identifiable problem credit or portfolio segment as of the evaluation date, management s evaluation of the inherent loss related to such condition is reflected in the unallocated allowance.

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Central to our credit risk management and our assessment of appropriate loss allowance is our loan risk rating system. Under this system, the originating credit officer assigns borrowers an initial risk rating based on a thorough analysis of each borrower s financial capacity in conjunction with industry and economic trends. Approvals are made based upon the amount of inherent credit risk specific to the transaction and are reviewed for appropriateness by senior line and credit administration personnel. Credits are monitored by line and credit administration personnel for deterioration in a borrower s financial condition which may impact the ability of the borrower to perform under the contract. Although management has allocated a portion of the allowance to specific loans, specific loan pools, and off-balance sheet credit exposures (which are reported separately as part of other liabilities), the adequacy of the allowance is considered in its entirety.

Non-Accrual Loan Policy

Interest on loans is credited to income as earned and is accrued only if deemed collectible. Accrual of interest is discontinued when a loan is over 90 days delinquent or if management believes that collection is highly uncertain. Generally, payments received on nonaccrual loans are recorded as principal reductions. Interest income is recognized after all principal has been repaid or an improvement in the condition of the loan has occurred that would warrant resumption of interest accruals. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due.

Stock-Based Compensation

The Company recognizes in the statement of income the grant-date fair value of stock options and other equity-based forms of compensation issued to employees over the employees requisite service period (generally the vesting period). The Bank uses the straight-line recognition of expenses for awards with graded vesting. The Bank utilizes a binomial pricing model for all grants. Expected volatility is based on the historical volatility of the price of the Bank s stock for the period equal to the contractual stock option term. The Bank uses historical data to estimate option exercise and stock option forfeiture rates within the valuation model. The expected term of options granted for the binomial model is derived from applying a historical suboptimal exercise factor to the contractual term of the grant. For binomial pricing, the risk-free rate for periods is equal to the U.S. Treasury yield at the time of grant and commensurate with the contractual term of the grant.

Other Real Estate Owned

Other real estate owned, which represents real estate acquired through foreclosure, or deed in lieu of foreclosure in satisfaction of commercial and real estate loans, is carried at the lower of cost or estimated fair value less the estimated selling costs of the real estate. The fair value of the property is based upon a current appraisal. The difference between the fair value of the real estate collateral and the loan balance at the time of transfer is recorded as a loan charge off if fair value is lower. Subsequent to foreclosure, management periodically performs valuations and the OREO property is carried at the lower of carrying value or fair value, less costs to sell. The determination of a property s estimated fair value incorporates (1) revenues projected to be realized from disposal of the property, (2) construction and renovation costs, (3) marketing and transaction costs, and (4) holding costs (e.g., property taxes, insurance and homeowners association dues). Any subsequent declines in the fair value of the OREO property after the date of transfer are recorded through a write-down of the asset. Any subsequent operating expenses or income, reduction in estimated fair values, and gains or losses on disposition of such properties are charged or credited to current operations.

Introduction

Oak Valley Community Bank commenced operations in May 1991. We are an insured bank under the Federal Deposit Insurance Act and are a member of the Federal Reserve. Since its formation, the Bank has provided basic banking services to individuals and business enterprises in Oakdale, California and the surrounding areas. The focus of the Bank is to offer a range of commercial banking services designed for both individuals and small to medium-sized businesses in the two main areas of service of the Bank: the Central Valley and the Eastern Sierras.

The Bank offers a complement of business checking and savings accounts for its business customers. The Bank also offers commercial and real estate loans, as well as lines of credit. Real estate loans are generally of a short-term nature for both residential and commercial purposes. Longer-term real estate loans are generally made with adjustable interest rates and contain normal provisions for acceleration. In addition, the Bank offers traditional residential mortgages through a third party.

The Bank also offers other services for both individuals and businesses including online banking, remote deposit capture, merchant services, night depository, extended hours, traveler s checks, wire transfer of funds, note collection, and automated teller machines in a national network. The Bank does not currently offer international banking or trust services although the Bank may make such services available to the Bank s customers through financial institutions with which the Bank has correspondent banking relationships. The Bank does not offer stock transfer services nor does it directly issue credit cards.

Effective July 3, 2008, Oak Valley Community Bank became a subsidiary of Oak Valley Bancorp, a newly established bank holding company. Oak Valley Bancorp operates Oak Valley Community Bank as a community bank in the general commercial banking

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business, with our primary market encompassing the California Central Valley around Oakdale and Modesto, and the Eastern Sierras. As such, unless otherwise noted, all references are about Oak Valley Bancorp.

Overview of Results of Operations and Financial Condition

The purpose of this summary is to provide an overview of the items management focuses on when evaluating the condition of the Company and its success in implementing its business and shareholder value strategies. The Company s business strategy is to operate the Bank as a well-capitalized, profitable and independent community oriented bank. The Company s shareholders value strategy has three major themes: (1) enhancing shareholders value; (2) making its retail banking franchise more valuable; and (3) efficiently utilizing its capital.

Management believes the following were important factors in the Company s performance during the three month period ended March 31, 2011:

- Thanks to our deep roots in the communities that we serve, our focus on customer care and our selectivity in lending, during the first three months of 2011, our performance has been better than most institutions of our size that compete in our market. Despite the severity of the recession affecting our primary market areas, we have been able to increase our core deposits to $445.8 million and have posted net income available to common shareholders of $0.12 per diluted share for the three month period of 2011.

- While recently published economic data indicate that the current downturn may be easing, it is not clear when or at what speed the recession will end. To the extent that the recession continues, it will affect the market areas that we serve and our results accordingly.

- The Company recognized net income available to common shareholders of $955,000 for the three month period ended March 31, 2011, as compared to $737,000 for the same period in 2010. The Company recognized net income before preferred stock dividends and accretion of $1,165,000, for the first quarter of 2011. The factors contributing to these results will be discussed below.

- The Company recognized $210,000 in the first quarter of 2011 and 2010 associated with the accrual for preferred stock dividends and accretion of the preferred stock discount in connection with the 13,500 shares of Series A Preferred Stock that the U.S. Treasury purchased from the Company in December 2008 under the TARP Program. So long as such preferred stock remains outstanding, it will pay quarterly cumulative dividends at a rate of 5% per year for the first five years and thereafter at a rate of 9% per year.

- The Company has taken significant steps to reduce the risk of loan losses. In the three month period ended March 31, 2011, the provision for loan loss was $600,000, which was a decrease of $405,000 compared to the same period in 2010. The decrease was mainly due to management s assessment of the appropriate level for the allowance for loan losses and a decrease in the level of non-accrual loans. The Company continues to monitor its loan portfolio with the objective of avoiding defaults or write-downs. Despite these actions, the possibility of additional losses cannot be eliminated, but the Board of Directors and all employees continue to work hard to make the best of these continuing challenging conditions.

- Net interest income increased $145,000 or 2.4% for the three month period ended March 31, 2011, compared to the same period in 2010. This increase was primarily due to the increase in average earning assets of $39.5 million, for the three month period ended March 31, 2011, as compared to the same period of 2010.

- Non-interest income increased by $25,000 or 3.8% for the first quarter of 2011 as compared to the same period in 2010. The increase was primarily due to an increase in earnings on cash surrender value of life insurance, which was partially offset by a decrease in mortgage commissions as described below.

- Non-interest expense increased by $81,000 or 1.8% for the three month period ended March 31, 2011, as compared to the same period in 2010. The primary reason for the increase was an increase in salaries and benefits, which was offset in part by the reduction in the write downs of OREO property values as described below.

- Total assets increased $10.4 million or 1.9% from December 31, 2010. Total net loans decreased by $9.4 million or 2.4% and investment securities increased by $20.4 million or 38.3% from December 31, 2010 to March 31, 2011, while deposits increased by $8.9 million or 1.9% for the same period.

Income Summary

For the three month period ended March 31, 2011, the Company recorded net income available to common shareholders of $955,000, an increase of $218,000 for the quarter, as compared to $737,000 for the same period in 2010. Return on average assets (annualized) was

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0.85% for the first quarter of 2011, as compared with 0.75% for the same period in 2010. Annualized return on average common equity was 7.48% for the first quarter of 2011, as compared to 6.22% for the same period of 2010.

Net income before provisions for income taxes and preferred stock dividends and accretion was up $494,000 for the first quarter of 2011 from the comparable 2010 period. The income statement components of these variances are as follows:

Pre-Tax Income Variance Summary:

(In thousands)		**Effect on Pre-Tax Income Increase (Decrease) Three Months**
Change from 2010 to 2011 in:		
Net interest income	$	145
Provision for loan losses		405
Non-interest income		25
Non-interest expense		(81)
Change in income before income taxes	$	494

These variances will be explained in the discussion below.

Net Interest Income

Net interest income is the largest source of the Bank s operating income. For the three month period ended March 31, 2011, net interest income was $6.21 million, which represented an increase of $145,000 or 2.4%, from the comparable period in 2010.

The net interest margin (net interest income as a percentage of average interest earning assets) was 4.92% for the three month period ended March 31, 2011, a decrease of 30 basis points, as compared to 5.22% for the same period in 2010. The decrease in the net interest margin in the first quarter of 2011 was primarily attributable to the increased average cash and cash equivalent balances of $46.1 million which are earning 0.23% and thus driving down the overall yield on earning assets.

Offsetting these low yielding cash balances, is the impact that the historically low market interest rate environment had on our liability sensitive balance sheet which caused interest-bearing liabilities to decrease faster than the yields on loans. The total cost of funds decreased 54 basis points in the first quarter of 2011, compared to 2010 due to a shift from high cost CDs and FHLB borrowed funds into demand deposit and money market accounts. In addition, average non-interest-bearing demand deposit balances increased by $26.4 million for the three month period of 2011, as compared to the same period of 2010. Compared to cost of funds, the decrease in our loan yield was not as significant at only 17 basis points for the three month period of 2011, compared to the same period of 2010. The yield on loans remained relatively flat at 6.07% for the first quarter 2011 versus 6.24% in the first quarter of 2010, partly as a result of the significant portion of our loans that are at their contractual rate floors.

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The following tables shows the relative impact of changes in average balances of interest earning assets and interest bearing liabilities, and interest rates earned and paid by the Company on those assets and liabilities for the three month period ended March 31, 2011 and 2010:

Net Interest Analysis

(Dollars in thousands)

	Three Months Ended March 31, 2011			Three Months Ended March 31, 2010		
	Average Balance	Interest Income / Expense	Avg Rate/ Yield	Average Balance	Interest Income / Expense	Avg Rate/ Yield
Assets:						
Earning assets:						
Gross loans (1) (2)	$ 397,337	$ 5,944	6.07%	$ 419,029	$ 6,452	6.24%
Investment securities (2)	62,203	759	4.95%	47,055	651	5.61%
Federal funds sold	26,466	15	0.23%	2,936	2	0.22%
Interest-earning deposits	30,609	17	0.23%	8,066	4	0.22%
Total interest-earning assets	516,615	6,735	5.29%	477,086	7,109	6.04%
Total noninterest earning assets	37,519			38,237		
Total Assets	554,134			515,323		
Liabilities and Shareholders Equity:						
Interest-bearing liabilities:						
Money market deposits	232,790	211	0.37%	208,710	453	0.88%
NOW deposits	63,351	35	0.22%	57,817	48	0.34%
Savings deposits	18,380	19	0.42%	14,429	16	0.46%
Time certificates of deposit $100,000 or more	33,687	104	1.25%	30,247	172	2.30%
Other time deposits	36,332	71	0.79%	48,528	181	1.51%
Other borrowings	8,000	22	1.12%	24,599	98	1.62%
Total interest-bearing liabilities	392,540	462	0.48%	384,330	968	1.02%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	93,101			66,706		
Other liabilities	3,225			2,734		
Total noninterest-bearing liabilities	96,326			69,440		
Shareholders equity	65,268			61,553		
Total liabilities and shareholders equity	$ 554,134			$ 515,323		
Net interest income		$ 6,273			$ 6,141	
Net interest spread (3)			4.81%			5.02%
Net interest margin (4)			4.92%			5.22%

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(1) Loan fees have been included in the calculation of interest income.

(2) Yields on municipal securities and loans have been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 34.0%.

(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(4) Represents net interest income as a percentage of average interest-earning assets.

Shown in the following tables are the relative impacts on net interest income of changes in the average outstanding balances (volume) of earning assets and interest bearing liabilities and the rates earned and paid by the Company on those assets and liabilities for the three month period ended March 31, 2011 and 2010. Changes in interest income and expense that are not attributable specifically to either rate or volume are allocated to the rate column below.

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Rate / Volume Variance Analysis

(In thousands)

	For the Three Months Ended March 31 2011 vs 2010 Increase (Decrease) in interest income and expense due to changes in:		
	Volume	**Rate**	**Total**
Interest income:			
Gross loans (1)	$ (334)	$ (174)	$ (508)
Investment securities	210	(102)	108
Federal funds sold	12	1	13
Interest-earning deposits	12	1	13
Total interest income	$ **(100)**	$ **(274)**	$ **(374)**
Interest expense:			
Money market deposits	52	(294)	(242)
NOW deposits	5	(18)	(13)
Savings deposits	4	(1)	3
Time CD $100K or more	20	(88)	(68)
Other time deposits	(45)	(65)	(110)
Other borrowings	(66)	(10)	(76)
Total interest expense	$ **(30)**	$ **(476)**	$ **(506)**
Change in net interest income	$ **(70)**	$ **202**	$ **132**

(1) Loan fees have been included in the calculation of interest income.

The table above reflects the market interest rate decline has impacted liabilities more than assets as indicated by the increase of $202,000 in net interest income due to the rate change for the three month period of 2011. The decreased loan volume and the overall change in mix of balances resulted in a decrease of $70,000 to net interest income over the same period.

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Non-Interest Income

Non-interest income represents service charges on deposit accounts and other non-interest related charges and fees, including fees from mortgage commissions and investment service fee income. For the three month period ended March 31, 2011, non-interest income was $671,000, an increase of $25,000 or 3.8%, compared to the same period in 2010.

The following tables show the major components of non-interest income:

	For the Three Months Ended March 31,			
	2011	2010	$ change	% change
Service charges on deposits	$ 258,095	$ 255,640	$ 2,455	1.0%
Earnings on cash surrender value of life insurance	128,298	103,986	24,312	23.4%
Mortgage commissions	9,873	19,127	(9,254)	(48.4)%
Other income	274,975	267,847	7,128	2.7%
Total non-interest income	$ 671,241	$ 646,600	$ 24,641	3.8%

The increase to total non-interest income for the quarter is due primarily to an increase in earnings on cash surrender value of life insurance of $24,000 or 23.4%, an increase in bank debit card fees of $30,000 or 38.9% and an increase of $2,000 or 1.0% in service charges on deposits as compared to the first quarter of 2010. Offsetting these increases was a decrease from the gain on called securities of $30,000 or 53.6% and a decrease of $9,000 or 48.4% in mortgage commissions compared to the first quarter of 2010. Gain on called securities and bank debit card fees are all included in the other income line item in the above table.

Non-Interest Expense

Non-interest expense represents salaries and benefits, occupancy expenses, professional expenses, outside services, and other miscellaneous expenses necessary to conduct business.

The following tables show the major components of non-interest expenses:

	For the Three Months Ended March 31,			
	2011	2010	$ change	% change
Salaries and employee benefits	$ 2,333,990	$ 2,190,328	$ 143,662	6.6%
Occupancy expenses	656,530	681,508	(24,978)	(3.7)%
Data processing fees	258,635	236,533	22,102	9.3%
OREO write downs and expenses	248,778	347,800	(99,022)	(28.5)%
Regulatory assessments	198,000	258,000	(60,000)	(23.3)%
Other	829,904	731,090	98,814	13.5%

Total non-interest expense	$	4,525,837	$	4,445,259	$	80,578	1.8%

Non-interest expenses increased by $81,000 or 1.8% for the three months ended March 31, 2011, as compared to the same period of 2010. Salaries and employee benefits increased $144,000 for the three months ended March 31, 2011, as compared to the same period of 2010 primarily as a result of hiring new positions to support the growth of our branch operations and additional bonus accruals corresponding to the Company s performance metrics. Data processing fees increased by $22,000 for the three month period of 2011 as a result of an increased number of transaction accounts.

Other operating expenses increased by $99,000 primarily as a result of impaired loan expenses of $73,000 in the first three months of 2011. These expenses were incurred as a result of an agreement with a borrower to fund overhead costs on an impaired residential development loan. No impaired loan expenses were recorded in the first three months of 2010.

OREO fair market value write downs and expenses were $249,000 in the first quarter of 2011, compared to $348,000 for the comparable period of 2010. These expenses resulted from various overhead costs of $30,000 and $136,000 and OREO write downs of $219,000 and $212,000 for the first three months of 2011 and 2010, respectively, associated with the properties classified as other real estate owned. There have been multiple sales of the OREO properties which has reduced our OREO inventory from eight properties as

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of March 31, 2010 to three properties as of March 31, 2011. No sales of OREO properties were recorded in the first quarter of 2011.

FDIC and DFI (California Department of Financial Institutions) regulatory assessments decreased by $60,000 to $198,000 in the first quarter of 2011 compared to $258,000 in the comparable period of 2010. The initial base assessment rate for financial institutions varies based on the overall risk profile of the institution as defined by the FDIC. The decrease in the first quarter of 2011is due to a lower base assessment rate as the bank has improved its overall risk ratings. The decrease in expense was in spite of a higher deposit base in 2011 as compared to 2010, as the FDIC assessment rates are applied to average quarterly deposits.

Management anticipates that noninterest expense will continue to increase as we continue to grow. However, management remains committed to cost-control and efficiency, and we expect to keep these increases to a minimum relative to growth.

Income Taxes

We reported a provision for income taxes of $585,000, and $309,000 for the first three months of 2011 and 2010 respectively. The effective income tax rate on income from continuing operations was 33.4% for the first quarter of 2011 compared to 24.6% for the comparable period of 2010. These provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income, and adjusted for the effects of all permanent differences between income for tax and financial reporting purposes (such as earnings on qualified municipal securities, BOLI and certain tax-exempt loans). The disparity between the effective tax rates in 2011 as compared to 2010 is primarily due to tax credits from California Enterprise Zones and low income housing projects as well as tax free-income on loans within these enterprise zones and municipal securities and loans that comprise a larger proportion of pre-tax income in 2010 as compared to 2011.

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Asset Quality

Nonperforming assets consist of loans on non-accrual status, loans 90 days or more past due and still accruing interest, loans restructured, where the terms of repayment have been renegotiated resulting in a reduction or deferral of interest or principal, and other real estate owned (OREO).

Loans are generally placed on non-accrual status when they become 90 days past due, unless management believes the loan is adequately collateralized and in the process of collection. The past due loans may or may not be adequately collateralized, but collection efforts are continuously pursued. Loans may be restructured by management when a borrower has experienced some changes in financial status, causing an inability to meet the original repayment terms, and where we believe the borrower will eventually overcome those circumstances and repay the loan in full. OREO consists of properties acquired by foreclosure or similar means and which management intends to offer for sale.

Non-accrual loans totaled $10.7 million at March 31, 2011, as compared to $11.5 million at December 31, 2010. The non-accrual loans as of March 31, 2011 are loans made to eight borrowers primarily for purposes of real estate construction and commercial real estate. As of March 31, 2011, we had five loans considered troubled debt restructurings totaling $2.1 million, four of which are included in nonaccrual loans and the other was placed back on accrual status in the first quarter of 2011.

OREO totaled $559,000 as of March 31, 2011 and consists of three properties that were acquired through foreclosure including residential land lots and a commercial real estate property.

The following table presents information about the Company s non-performing loans, including asset quality ratios as of March 31, 2011 and December 31, 2010:

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Non-Performing Assets

(in thousands)		March 31, 2011		December 31, 2010
Loans in nonaccrual status	$	10,663	$	11,475
Loans past due 90 days or more and accruing		164		
Restructured loans				
Total nonperforming loans		10,827		11,475
Other real estate owned		559		778
Total nonperforming assets	$	11,386	$	12,253
Allowance for loan losses	$	8,765	$	8,255
Asset quality ratios:				
Non-performing assets to total assets		2.02%		2.22%
Non-performing loans to total loans		2.74%		2.84%
Allowance for loan losses to total loans		2.22%		2.04%
Allowance for loan losses to total non-performing loans		80.96%		71.94%

Allowance for Loan and Lease Losses (ALLL)

In anticipation of credit risk inherent in our lending business, we routinely set aside allowances through charges to earnings. Such charges are not only made for the outstanding loan portfolio, but also for off-balance sheet items, such as commitments to extend credits or letters of credit. Charges made for the outstanding loan portfolio have been credited to the allowance for loan losses, whereas charges for off-balance sheet items have been credited to the reserve for off-balance sheet items, which is presented as a component of other liabilities. The Bank recorded loan loss provisions of $600,000 for the three month period in 2011, which represented a $405,000 decrease, as compared to the provisions recorded in the same period of 2010.

The allowance for loan losses increased by $510,000 or 6.2%, to $8.8 million at March 31, 2011, as compared with $8.3 million at December 31, 2010. The Bank recognized the increase in the allowance for loan losses during the first three months of the year due to the loan loss provision of $600,000 which was partially offset by net loan charge-offs of $90,000. The weak business climate has continued to adversely impact the financial conditions of certain Bank clients in addition to decrease collateral values. The increase to the allowance for loan losses combined with the decrease in our loan portfolio resulted in an increase in the allowance for loan losses as a percentage of total loans to 2.22% at March 31, 2011, as compared to 2.04% at December 31, 2010.

The Bank will continue to monitor the adequacy of the allowance for loan losses and make additions to the allowance in accordance with the analysis referred to above. Because of uncertainties inherent in estimating the appropriate level of the allowance for loan losses, actual results may differ from management s estimate of credit losses and the related allowance.

The following table provides an analysis of the changes in the ALLL for the three month periods ended March 31, 2011 and 2010:

(dollars in thousands)	Three Months Ended March 31, 2011	2010
Balance at beginning of period	$ 8,255	$ 7,020
Provision for loan losses	600	1,005
Loans charged off	(92)	(1,264)
Recoveries of previous charge-offs	2	1
Net charge-offs	(90)	(1,263)
Balance at end of period	$ 8,765	$ 6,762
Allowance for loan losses to total loans	2.22%	1.65%
Net charge-offs to average loans (annualized)	0.09%	1.22%
Provision for loan losses to average loans (annualized)	0.61%	0.97%

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The Bank makes provisions for loan losses when required to bring the total allowance for loan and lease losses to a level deemed appropriate for the level of risk in the loan portfolio. At least quarterly, management conducts an assessment of the overall quality of the loan portfolio and general economic trends in the local market. The determination of the appropriate level for the allowance is based on that review, considering such factors as historical experience, the volume and type of lending conducted, the amount of and identified potential loss associated with specific nonperforming loans, regulatory policies, general economic conditions, and other factors related to the collectibility of loans in the portfolio.

Although management believes the allowance at March 31, 2011 was adequate to absorb probable losses from any known and inherent risks in the portfolio, no assurance can be given that the adverse effect of current and future economic conditions on our service areas, or other variables, will not result in increased losses in the loan portfolio in the future.

Investment Activities

Investments are a key source of interest income. Management of our investment portfolio is set in accordance with strategies developed and overseen by our Investment Committee. Investment balances, including cash equivalents and interest-bearing deposits in other financial institutions, are subject to change over time based on our asset/liability funding needs and interest rate risk management objectives. Our liquidity levels take into consideration anticipated future cash flows and all available sources of credits, and are maintained at levels management believes are appropriate to assure future flexibility in meeting anticipated funding needs.

Cash Equivalents and Interest-bearing Deposits in other Financial Institutions

The Bank holds federal funds sold, unpledged available-for-sale securities and salable government guaranteed loans to help meet liquidity requirements and provide temporary holdings until the funds can be otherwise deployed or invested. As of March 31, 2011, and December 31, 2010, we had $68.7 million and $68.9 million, respectively, in cash and cash equivalents.

Investment Securities

Management of our investment securities portfolio focuses on providing an adequate level of liquidity and establishing an interest rate-sensitive position, while earning an adequate level of investment income without taking undue risk. Investment securities that we intend to hold until maturity are classified as held-to-maturity securities, and all other investment securities are classified as available-for-sale. Currently, all of our investment securities are classified as available-for-sale. The carrying values of available-for-sale investment securities are adjusted for unrealized gains or losses as a valuation allowance and any gain or loss is reported on an after-tax basis as a component of other comprehensive income.

Management has evaluated the investment securities portfolio to determine if the impairment of any security in an unrealized loss position is temporary or other than temporary. We conduct a periodic review and evaluation of the securities portfolio to determine if the value of any security has declined below its carrying value. If such decline is deemed other than temporary, we would adjust the carrying amount of the

security by writing down the security to fair value through a charge to current period income or a charge to accumulated other comprehensive income depending on the nature of the impairment and managements intent or requirement to sell the security. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due solely to interest rate changes.

Deposits

Total deposits at March 31, 2011 were $485.6 million, an $8.9 million or 1.9% increase from the deposit total of $476.7 million at December 31, 2010. Average deposits increased $51.2 million to $477.6 million for the three month period ended March 31, 2011 as compared to the same period in 2010. We attracted deposits due to the safety and soundness of the Bank and our focus on customer service.

(in thousands)	March 31, 2011	December 31, 2010	Three months change $	Three months change %
Demand	$ 97,114	$ 102,422	$ (5,308)	(5.2)%
NOW	67,613	60,992	6,621	10.9%
MMDA	235,515	221,814	13,701	6.2%
Savings	19,395	18,306	1,089	5.9%
Time < $100K	26,033	28,054	(2,021)	(7.2)%
Time > $100K	39,971	45,151	(5,180)	(11.5)%
	$ 485,641	$ 476,739	$ 8,902	1.9%

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Because our client base is comprised primarily of commercial and industrial accounts, individual account balances are generally higher than those of consumer-oriented banks. Five of our clients carry deposit balances of more than 1% of our total deposits, one of which had a deposit balance of more than 3% of total deposits at March 31, 2011.

Since our deposit growth strategy emphasizes core deposit growth we have avoided relying on brokered deposits as a consistent source of funds. The only brokered deposits the Bank holds are from CDARS, a certificate of deposit program that exchanges funds with other network banks to offer full FDIC insurance coverage to the customer. The Bank had $2.2 million in brokered deposits as of March 31, 2011 as compared to $3.8 million at December 31, 2010.

Borrowings

Although deposits are the primary source of funds for our lending and investment activities and for general business purposes, we may obtain advances from the Federal Home Loan Bank of San Francisco (FHLB) as an alternative to retail deposit funds. Our outstanding FHLB advances remained at $8.0 million at December 31, 2010 and for the entire three month period ended March 31, 2011 as these are term advances that do not begin to mature until the second quarter of 2011. The $8.0 million in FHLB advances have a weighted average interest rate of 1.10% and are all considered short-term as they have remaining maturities of less than one year as of March 31, 2011. See Liquidity Management below for the details on the FHLB borrowings program.

Capital Ratios

We are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can trigger regulatory actions that could have a material adverse effect on our financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that rely on quantitative measures of our assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

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The following table shows the Oak Valley Community Bank s and Oak Valley Bancorp s capital ratios, as calculated under regulatory guidelines, compared to the regulatory minimum capital ratios and the regulatory minimum capital ratios needed to qualify as a well-capitalized institution at March 31, 2011 and December 31, 2010:

Oak Valley Community Bank Capital Ratios

(dollars in thousands)

	Actual		Amount of Capital Required To Be Well-Capitalized		To Be Adequately Capitalized	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of March 31, 2011:						
Total Capital (to Risk-Weighted Assets)	$ 69,584	15.6%	$ 44,563	10%	$ 35,651	8%
Tier 1 Capital (to Risk-Weighted Assets)	$ 63,973	14.4%	$ 26,738	6%	$ 17,825	4%
Tier 1 Capital (to Average Assets)	$ 63,973	11.6%	$ 27,704	5%	$ 22,163	4%
As of December 31, 2010:						
Total Capital (to Risk-Weighted Assets)	$ 68,742	14.9%	$ 46,090	10%	$ 36,872	8%
Tier 1 Capital (to Risk-Weighted Assets)	$ 62,946	13.7%	$ 27,654	6%	$ 18,436	4%
Tier 1 Capital (to Average Assets)	$ 62,946	11.5%	$ 27,330	5%	$ 21,864	4%

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Oak Valley Bancorp Capital Ratios

(dollars in thousands)

	Actual		Amount of Capital Required To Be Well-Capitalized		To Be Adequately Capitalized	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of March 31, 2011 , 2009:						
Total Capital (to Risk-Weighted Assets)	$ 69,724	15.6%	N/A	N/A	$ 35,656	8%
Tier 1 Capital (to Risk-Weighted Assets)	$ 64,112	14.4%	N/A	N/A	$ 17,828	4%
Tier 1 Capital (to Average Assets)	$ 64,112	11.6%	N/A	N/A	$ 22,165	4%
As of December 31, 2010:						
Total Capital (to Risk-Weighted Assets)	$ 68,910	15.0%	N/A	N/A	$ 36,874	8%
Tier 1 Capital (to Risk-Weighted Assets)	$ 63,114	13.7%	N/A	N/A	$ 18,437	4%
Tier 1 Capital (to Average Assets)	$ 63,114	11.6%	N/A	N/A	$ 21,865	4%

Liquidity Management

Since the Company is a holding company and does not conduct regular banking operations, its primary sources of liquidity are dividends from the Bank. Under the California Financial Code, payment of a dividend from the Bank to the Company is restricted to the lesser of the Bank s retained earnings or the amount of the Bank s undistributed net profits from the previous three fiscal years. The primary uses of funds for the Company are stockholder dividends, investment in the Bank and ordinary operating expenses. Management anticipates that there will be sufficient earnings at the Bank level to provide dividends to the Company to meet its funding requirements for the foreseeable future.

Maintenance of adequate liquidity requires that sufficient resources be available at all times to meet our cash flow requirements. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of its customers and to take advantage of investment opportunities as they arise. Liquidity management involves our ability to convert assets into cash or cash equivalents without incurring significant loss, and to raise cash or maintain funds without incurring excessive additional cost. For this purpose, we maintain a portion of our funds in cash and cash equivalents, salable government guaranteed loans and securities available for sale. We obtain funds from the repayment and maturity of loans as well as deposit inflows, investment security maturities and paydowns, Federal funds purchased, FHLB advances, and other borrowings. Our primary uses of funds are the origination of loans, the purchase of investment securities, withdrawals of deposits, maturity of certificate of deposits, repayment of borrowings and dividends to common and preferred stockholders. Our liquid assets at March 31, 2011 were $149.1 million compared to $129.0 million at December 31, 2010. Our liquidity level measured as the percentage of liquid assets to total assets was 26.5% and 23.3% at March 31, 2011 and December 31, 2010, respectively. We anticipate that cash and cash equivalents on hand and other sources of funds will provide adequate liquidity for our operating, investing and financing needs and our regulatory liquidity requirements for the foreseeable future. Management monitors our liquidity position daily, balancing loan funding/payments with changes in deposit activity and overnight investments.

As a secondary source of liquidity, we rely on advances from the FHLB to supplement our supply of lendable funds and to meet deposit withdrawal requirements. Advances from the FHLB are typically secured by a portion of our loan portfolio. The FHLB determines limitations on the amount of advances by assigning a percentage to each eligible loan category that will count towards the borrowing capacity. As of March 31, 2011, our borrowing capacity from the FHLB was approximately $126.4 million and the

outstanding balance was $8.0 million, or approximately 6.3% of our borrowing capacity. We also maintain 2 lines of credit with correspondent banks to purchase up to $17.5 million in federal funds, for which there were no advances as of March 31, 2011.

Off-Balance-Sheet Arrangements

During the ordinary course of business, we provide various forms of credit lines to meet the financing needs of our customers. These commitments, which represent a credit risk to us, are not represented in any form on our balance sheets.

As of March 31, 2011 and December 31, 2010, we had commitments to extend credit of $45.5 million and $59.9 million, respectively, which includes obligations under letters of credit of $1.4 million and $1.4 million, respectively.

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The effect on our revenues, expenses, cash flows and liquidity from the unused portion of the commitments to provide credit cannot be reasonably predicted because there is no guarantee that the lines of credit will be used.

Recent Legislation and Other Regulatory Initiatives

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act), a landmark financial reform bill comprised of new rules and restrictions that will impact banks going forward. It includes key provisions aimed at preventing a repeat of the 2008 financial crisis and a new process for winding down failing, systemically important institutions in a manner as close to a controlled bankruptcy as possible. The Act includes other key provisions as follows:

(1) The Act establishes a new Financial Stability Oversight Council to monitor systemic financial risks. The Board of Governors of the Federal Reserve (Fed) is given extensive new authorities to impose strict controls on large bank holding companies with total consolidated assets equal to or in excess of $50 billion and systemically significant nonbank financial companies to limit the risk they might pose for the economy and to other large interconnected companies. The Fed can also take direct control of troubled financial companies that are considered systemically significant.

(2) The Act also establishes a new independent Federal regulatory body for consumer protection within the Federal Reserve System known as the Bureau of Consumer Financial Protection (the Bureau), which will assume responsibility for most consumer protection laws (except the Community Reinvestment Act). It will also be in charge of setting appropriate consumer banking fees and caps. The Office of Comptroller of the Currency will continue to have authority to preempt state banking and consumer protection laws if these laws prevent or significantly interfere with the business of banking.

(3) The Act restricts the amount of trust preferred securities (TPS) that may be considered as Tier 1 Capital. For depository institution holding companies below $15 billion in total assets, TPS issued before May 19, 2010 will be grandfathered, so their status as Tier 1 capital does not change. However going forward, TPS will be disallowed as Tier 1 capital. Beginning January 1, 2013, bank holding companies above $15 billion in assets will have a three-year phase-in period to fill the capital gap caused by the disallowance of the TPS issued before May 19, 2010.

(4) The Act effects changes in the FDIC assessment base with stricter oversight. A new council of regulators led by the U.S. Treasury will set higher requirements for the amount of cash banks must keep on hand. FDIC insurance coverage is made permanent at the $250 thousand level retroactive to January 1, 2008 and unlimited FDIC insurance is provided for noninterest-bearing transaction accounts in all banks effective December 31, 2010 through the end of 2012. Further, the Act removes the prohibition on payments of interest on demand deposit accounts as of July 21, 2011. Thus, if a depositor sweeps any amount in excess of $250 thousand from a noninterest-bearing transaction account to an interest bearing demand deposit, there is no FDIC insurance coverage on the portion that is over $250 thousand coverage limit.

(5) The Act places certain limitations on investment and other activities by depository institutions, holding companies and their affiliates.

The impact of the Act on our banking operations is still uncertain due to the large volume of new rules still subject to adoption and interpretation.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4. Controls and Procedures

The Company s Chief Executive Officer and its Chief Financial Officer, after evaluating the effectiveness of the Company s disclosure controls and procedures, as defined in Exchange Act Rules 13 a-15(e)and 15(d)-15(e) promulgated under the Exchange Act, as of the end of the period covered by this report (the Evaluation Date) have concluded that as of the Evaluation Date, the Company s disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company would be made known to them by others within the Company, particularly during the period in which this report was being prepared. Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no significant changes in our internal control over financial reporting during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting subsequent to the Evaluation Date, nor there were any significant deficiencies or material weaknesses in such controls requiring corrective actions.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

There are no pending, or to management s knowledge, any threatened, material legal proceedings to which we are a defendant, or to which any of our properties are subject. There are no material legal proceedings to which any director, any nominee for election as a director, any executive officer, or any associate of any such director, nominee or officer is a party adverse to us.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

We did not have any unregistered sales of our equity securities during the three months ended March 31, 2011.

Item 3. Defaults Upon Senior Securities

None.

Item 4. (Removed and Reserved)

None.

Item 5. Other Information

None.

Item 6. Exhibits

The following exhibits are filed as part of this report or hereby incorporated by reference to filings previously made with the SEC:

3.1	Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company s Registration Statement on Form 10-12B filed with the Securities and Exchange Commission on July 31, 2008).
3.2	First Amendment to Articles of Incorporation (incorporated by reference to Exhibit 3.2 to the Company s Registration Statement on Form 10-12B filed with the Securities and Exchange Commission on July 31, 2008).
3.3	Bylaws (incorporated by reference to Exhibit 3.3 to the Company s Registration Statement on Form 10-12B filed with the Securities and Exchange Commission on July 31, 2008).
3.4	Certificate of Amendment of Bylaws (incorporated by reference to Exhibit 3.5 to the Company s Registration Statement on Form 8-A12B filed with the Securities and Exchange Commission on January 14, 2009).
4.1	Certificate of Determination filed with the California Secretary of State for Fixed Rate Cumulative Perpetual Preferred Stock, Series A (incorporated by reference to Exhibit 3.4 to the Company s Registration Statement on Form 8-A12B filed with the Securities and Exchange Commission on January 14, 2009).
4.2	Warrant to Purchase Common Stock dated December 5, 2008 (incorporated by reference to Exhibit 3.4 to the Company s Registration Statement on Form 8-A12B filed with the Securities and Exchange Commission on January 14, 2009).
31.01	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.01	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	Oak Valley Bancorp	
Date: May 13, 2011	By:	/s/ RICHARD A. MCCARTY
		Richard A. McCarty
		Executive Vice President and Chief Financial Officer
		(Principal Financial Officer and duly authorized signatory)

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EXHIBIT INDEX

Exhibit	Description
31.01	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
31.02	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
32.01	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2003