Oak Valley Bancorp
Form 10-Q
August 13, 2012
Table of Contents

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 June 30, 2012

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 **x** 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: 7,890,905 shares of common stock outstanding as of July 31, 2012.

Table of Contents

Oak Valley Bancorp

June 30, 2012

Table of Contents

		Page
PART I FINANCIAL INFORMATION		
Item 1.	**Consolidated Financial Statements**	
Condensed Consolidated Balance Sheets at June 30, 2012 (Unaudited), and December 31, 2011		
Condensed Consolidated Statements of Income (Unaudited) for the Three and Six Month Periods Ended June 30, 2012 and June 30, 2011		
Condensed Consolidated Statements of Comprehensive Income (Unaudited) for the Three and Six Month Periods Ended June 30, 2012 and June 30, 2011		
Condensed Consolidated Statements of Changes of Shareholders Equity for the Six-Month Period Ended June 30, 2012 (Unaudited) and the Year Ended December 31, 2011		
Condensed Consolidated Statements of Cash Flows (Unaudited) for the Six-Month Periods Ended June 30, 2012 and June 30, 2011		
Notes to Condensed Consolidated Financial Statements		
Item 2.	**Management s Discussion and Analysis of Financial Condition and Results of Operations**	
Item 3.	**Quantitative and Qualitative Disclosures About Market Risk**	
Item 4.	**Controls and Procedures**	
PART II OTHER INFORMATION		
Item 1.	**Legal Proceedings**	
Item 2.	**Unregistered Sales of Equity Securities and Use of Proceeds**	
Item 3.	**Defaults Upon Senior Securities**	
Item 4.	**Mine Safety Disclosures**	
Item 5.	**Other Information**	
Item 6.	**Exhibits**	

Table of Contents

PART I FINANCIAL STATEMENTS

Item 1. Consolidated Financial Statements (Unaudited)

OAK VALLEY BANCORP

CONDENSED CONSOLIDATED BALANCE SHEETS

AT JUNE 30, 2012 (UNAUDITED) AND DECEMBER 31, 2011 (AUDITED)

	June 30, 2012	December 31, 2011
ASSETS		
Cash and due from banks	$ 64,637,928	$ 73,189,775
Federal funds sold	7,240,000	27,895,000
Cash and cash equivalents	71,877,928	101,084,775
Securities available for sale	108,247,438	89,694,859
Loans, net of allowance for loan loss of $8,007,947 and $8,609,174 at June 30, 2012 and December 31, 2011, respectively	381,957,783	386,958,076
Bank premises and equipment, net	13,228,904	13,499,285
Other real estate owned	0	244,375
Interest receivable and other assets	21,105,037	20,690,288
	$ 596,417,090	$ 612,171,658
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits	$ 526,406,815	$ 536,204,003
Interest payable and other liabilities	3,074,865	2,565,649
Federal Home Loan Bank advances	0	3,000,000
Total liabilities	529,481,680	541,769,652
Commitments and contingencies		
Shareholders equity		
Series B Preferred stock, no par value; $1,000 per share liquidation preference, 10,000,000 shares authorized, 6,750 and 13,500 shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively	6,750,000	13,500,000
Common stock, no par value; 50,000,000 shares authorized, 7,890,905 and 7,718,469 shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively	23,603,460	23,453,443
Additional paid-in capital	2,242,906	2,128,700
Retained earnings	31,159,497	28,629,757
Accumulated other comprehensive income, net of tax	3,179,547	2,690,106
Total shareholders equity	66,935,410	70,402,006
	$ 596,417,090	$ 612,171,658

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

Table of Contents

OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2012 AND JUNE 30, 2011

	THREE MONTHS ENDED JUNE 30, 2012	THREE MONTHS ENDED JUNE 30, 2011	SIX MONTHS ENDED JUNE 30, 2012	SIX MONTHS ENDED JUNE 30, 2011
INTEREST INCOME				
Interest and fees on loans	$ 5,585,589	$ 5,922,684	$ 11,300,632	$ 11,864,362
Interest on securities available for sale	877,846	768,334	1,711,531	1,462,409
Interest on federal funds sold	4,557	11,604	9,624	26,822
Interest on deposits with banks	24,981	23,489	54,787	40,160
Total interest income	6,492,973	6,726,111	13,076,574	13,393,753
INTEREST EXPENSE				
Deposits	280,745	407,011	595,962	847,532
FHLB advances		18,815	4,707	40,488
Total interest expense	280,745	425,826	600,669	888,020
Net interest income	6,212,228	6,300,285	12,475,905	12,505,733
PROVISION FOR LOAN LOSSES	300,000	300,000	600,000	900,000
Net interest income after provision for loan losses	5,912,228	6,000,285	11,875,905	11,605,733
OTHER INCOME				
Service charges on deposits	300,498	282,041	581,576	540,136
Earnings on cash surrender value of life insurance	105,000	86,660	210,000	214,958
Mortgage commissions	60,378	16,947	107,787	26,820
Other	206,284	294,296	604,023	569,272
Total non-interest income	672,160	679,944	1,503,386	1,351,186
OTHER EXPENSES				
Salaries and employee benefits	2,514,183	2,379,400	5,089,746	4,713,390
Occupancy expenses	743,208	675,716	1,494,082	1,332,247
Data processing fees	278,003	239,891	555,864	498,526
OREO expenses (income), net	(1,716)	101,500	18,358	350,279
Regulatory assessments (FDIC & DFI)	116,000	198,000	233,000	396,000
Other operating expenses	962,341	806,477	1,817,733	1,636,380
Total non-interest expense	4,612,019	4,400,984	9,208,783	8,926,822
Net income before provision for income taxes	1,972,369	2,279,245	4,170,508	4,030,097
PROVISION FOR INCOME TAXES	620,409	829,984	1,357,643	1,415,360
NET INCOME	$ 1,351,960	$ 1,449,261	$ 2,812,865	$ 2,614,737
Preferred stock dividends and accretion	114,375	210,411	283,125	420,822
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$ 1,237,585	$ 1,238,850	$ 2,529,740	$ 2,193,915

NET INCOME PER COMMON SHARE	$	0.16	$	0.16	$	0.33	$	0.28
NET INCOME PER DILUTED COMMON SHARE	$	0.16	$	0.16	$	0.33	$	0.28

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

Table of Contents

OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2012 AND JUNE 30, 2011

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2012	**2011**	**2012**	**2011**
Net income	$ 1,351,960	$ 1,449,261	$ 2,812,865	$ 2,614,737
Available for sale securities:				
Gross unrealized gain arising during the year	1,300,708	968,115	866,676	1,169,124
Reclassification adjustment for gains realized in net income	(13,456)	(12,940)	(35,003)	(38,824)
Income tax expense	(529,704)	(393,055)	(342,232)	(465,118)
Other comprehensive income	757,548	562,120	489,441	665,182
Comprehensive income	$ 2,109,508	$ 2,011,381	$ 3,302,306	$ 3,279,919

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

Table of Contents

OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

FOR THE YEAR ENDED DECEMBER 31, 2011 AND THE SIX-MONTH PERIOD ENDED JUNE 30, 2012 (UNAUDITED)

	YEAR ENDED DECEMBER 31, 2011 AND SIX MONTHS ENDED JUNE 30, 2012							
	Common Stock		Preferred Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	Total Shareholders
	Shares	Amount	Shares	Amount	Capital	Earnings	Income	Equity
Balances, January 1, 2011	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	13,305							0
Repurchase of Series A preferred stock			(13,500)	$ (13,500,000)				(13,500,000)
Series B preferred stock issued			13,500	13,500,000				13,500,000
Preferred stock accretion				486,055		$ (486,055)		0
Preferred stock dividend payments						(761,249)		(761,249)
Payment to repurchase U.S. Treasury Warrant		(560,000)						(560,000)
Stock based compensation					48,482			48,482
Other comprehensive income							1,146,552	1,146,552
Net income						5,860,595		5,860,595
Balances, December 31, 2011	7,718,469	$ 23,453,443	13,500	$ 13,500,000	$ 2,128,700	$ 28,629,757	$ 2,690,106	$ 70,402,006
Stock options exercised	37,561	$ 150,017						$ 150,017
Tax benefit on stock options exercised					37,218			37,218
Restricted stock issued	134,875							0
Repurchase of Series B preferred stock			(6,750)	$ (6,750,000)				(6,750,000)
Preferred stock dividend payments						(283,125)		(283,125)
Stock based compensation					76,988			76,988
							489,441	489,441

Other comprehensive income								
Net income						2,812,865		2,812,865
Balances, June 30, 2012	7,890,905	$ 23,603,460	6,750	$ 6,750,000	$ 2,242,906	$ 31,159,497	$ 3,179,547	$ 66,935,410

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

Table of Contents

OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE SIX MONTH PERIODS ENDED JUNE 30, 2012 AND JUNE 30, 2011

	SIX MONTHS ENDED JUNE 30, 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 2,812,865	$ 2,614,737
Adjustments to reconcile net earnings to net cash from operating activities:		
Provision for loan losses	600,000	900,000
(Decrease) increase in deferred fees/costs, net	(85,119)	2,995
Depreciation	564,615	455,581
Amortization of investment securities, net	93,116	2,660
Stock based compensation	76,988	24,000
Excess tax benefits from stock-based payment arrangements	(37,218)	0
Gain on sale of premises and equipment	(21,875)	0
OREO write downs and (gain)/losses on sale	(3,548)	290,609
Gain on called available for sale securities	(35,003)	(38,824)
Earnings on cash surrender value of life insurance	(210,000)	(214,958)
Increase (decrease) in interest payable and other liabilities	593,591	(583,658)
Increase in interest receivable	(86,512)	(74,607)
(Increase) decrease in other assets	(690,101)	1,981,625
Net cash from operating activities	3,571,799	5,360,160
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available for sale securities	(31,682,295)	(28,235,484)
Proceeds from maturities, calls, and principal paydowns of securities available for sale	13,903,276	3,808,274
Net decrease in loans	4,485,412	13,109,613
Purchase of FRB Stock	(1,450)	0
Redemption of FHLB stock	268,300	0
Proceeds from sale of OREO	247,923	243,190
Proceeds from sales of premises and equipment	21,875	0
Net purchases of premises and equipment	(294,234)	(3,077,387)
Net cash (used in) investing activities	(13,051,193)	(14,151,794)
CASH FLOWS FROM FINANCING ACTIVITIES:		
FHLB payments	(3,000,000)	(2,000,000)
Preferred stock dividend payment	(367,500)	(337,500)
Repurchase of Series B preferred stock	(6,750,000)	0
Net (decrease) increase in demand deposits and savings accounts	(8,258,458)	30,991,066
Net decrease in time deposits	(1,538,730)	(11,518,271)
Excess tax benefits from stock-based payment arrangements	37,218	0
Proceeds from sale of common stock and exercise of stock options	150,017	9,894
Net cash (used in) from financing activities	(19,727,453)	17,145,189
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(29,206,847)	8,353,555
CASH AND CASH EQUIVALENTS, beginning of period	101,084,775	68,936,916
CASH AND CASH EQUIVALENTS, end of period	$ 71,877,928	$ 77,290,471

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:				
Cash paid during the period for:				
Interest	$	659,147	$	923,490
Income taxes	$	885,000	$	2,561,119
NON-CASH INVESTING ACTIVITIES:				
Change in unrealized gain on available-for-sale securities	$	831,673	$	1,130,300
NON-CASH FINANCING ACTIVITIES:				
Accretion of preferred stock	$	0	$	83,323

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

Table of Contents

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 (the Company) 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 and six month periods ended June 30, 2012 are not necessarily indicative of the results of a full year s operations. Certain prior year amounts have been reclassified to conform to the current year presentation. There was no effect on net income or shareholders equity. For further information, refer to the audited consolidated financial statements and footnotes included in the Company s Form 10-K for the year ended December 31, 2011.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

In May 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-04 *Fair Value Measurement* (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The ASU improves the comparability of fair value measurements presented and disclosed in accordance with U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRSs) by changing the wording used to describe many of the requirements in U.S GAAP for measuring fair value and disclosure of information. The amendments to this ASU provide explanation on how to measure fair value but do not require any additional fair value measurements and does not establish valuation standards or affect valuation practices outside of financial reporting. The amendments clarify existing fair value measurements and disclosure requirements to include application of the highest and best use and valuation premises concepts; measuring fair value of an instrument classified in a reporting entity s shareholders equity; and disclosures requirements regarding quantitative information about unobservable inputs categorized within Level 3 of the fair value hierarchy. In addition, clarification is provided for measuring the fair value of financial instruments that are managed in a portfolio and the application of premiums and discounts in a fair value measurement. For public entities, ASU 2011-04 is effective during interim and annual periods beginning after December 15, 2011. There was no significant impact on the Company s financial position or results of operations as a result of adopting this ASU.

In June 2011, the FASB issued ASU No. 2011-05 *Comprehensive Income* (Topic 220) Presentation of Comprehensive Income. The ASU improves the comparability, consistency, and transparency of financial reporting and increases the prominence of items reported in other comprehensive income. The amendments to Topic 220, Comprehensive Income, require entities to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Entities are no longer permitted to present components of other comprehensive income as part of the statement of changes in stockholders equity. Any adjustments for items are that reclassified from other comprehensive income to net income are to be presented on the face of the entities financial statement regardless the method of presentation for comprehensive income. The amendments do not change items to be reported in comprehensive income or when an item of other comprehensive income must be reclassified to net income, nor do the amendments change the option to present the components of other comprehensive income either net of related tax effects or before related tax effects. ASU 2011-05 is effective for fiscal years, and interim periods beginning on or after December 15, 2011. In December 2011, the FASB issued ASU No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. The ASU defers indefinitely the requirement to present reclassification adjustments and the effect of those reclassification adjustments on the face of the financial statements where net income is presented, by component of net income, and on the face of the financial statements where other comprehensive income is presented, by component of other comprehensive income. The adoption of the ASUs did not have a material impact on the Company s consolidated financial statements.

Table of Contents

In December 2011, the FASB issued ASU No. 2011-11, *Disclosures about Offsetting Assets and Liabilities.* The update requires an entity to offset, and present as a single net amount, a recognized eligible asset and a recognized eligible liability when it has an unconditional and legally enforceable right of setoff and intends either to settle the asset and liability on a net basis or to realize the asset and settle the liability simultaneously. The ASU requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The amendments are effective for annual and interim reporting periods beginning on or after January 1, 2013. The Company is currently in the process of evaluating the ASU but does not expect it will have a material impact on the Company s consolidated financial statements.

NOTE 3 PREFERRED STOCK REPURCHASE AND WARRANT REDEMPTION

In August 2011, The Company repurchased the $13,500,000 of Series A Preferred Stock originally issued to the U.S. Treasury in December 2008 in connection with the Company s participation in the Capital Purchase Program (CPP). The Company simultaneously issued $13,500,000 in Series B Preferred Stock to the U.S. Treasury under the Small Business Lending Funding (SBLF) program. Subsequently, the Company fully redeemed a warrant to purchase 350,346 shares of its Common Stock, at the exercise price of $5.78 per share that the Company had granted to the U.S. Treasury pursuant to the CPP, for a purchase price of $560,000, which settled in September 2011. So long as the preferred stock remains outstanding under SBLF, it will pay quarterly cumulative dividends at a variable rate between 1% and 5% per year for the first 2.5 years depending on growth of our small business loan portfolio. If there is no loan growth after 2.5 years, the dividend rate could increase to 7% and if the preferred stock remains outstanding after 4.5 years, the rate increases to 9%, regardless of loan growth.

In May 2012, the Company repurchased from the U.S. Treasury 6,750 shares of Series B Preferred Stock for aggregate consideration of $6.75 million.

NOTE 4 SECURITIES

The amortized cost and estimated fair values of debt securities as of June 30, 2012 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Available-for-sale securities:				
U.S. agencies	$ 58,933,241	$ 3,306,392	$	$ 62,239,633
Collateralized mortgage obligations	12,604,932	893,313		13,498,245
Municipalities	23,373,947	1,526,205	(139,303)	24,760,849
SBA Pools	1,207,347		(563)	1,206,784
Corporate debt	3,905,769	11,502	(200,708)	3,716,563
Mutual Fund	2,818,932	15,625	(9,193)	2,825,364
	$ 102,844,168	$ 5,753,037	$ (349,767)	$ 108,247,438

Table of Contents

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 June 30, 2012.

	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	$	$	$	$	$	$
Collateralized mortgage obligations						
Municipalities	5,420,039	(139,303)			5,420,039	(139,303)
SBA Pools	1,206,784	(563)			1,206,784	(563)
Corporate debt	1,799,292	(200,708)			1,799,292	(200,708)
Mutual Fund	990,807	(9,193)			990,807	(9,193)
Total temporarily impaired securities	$ 9,416,922	$ (349,767)	$	$	$ 9,416,922	$ (349,767)

At June 30, 2012, there were no 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 Company 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 June 30, 2012, 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.

	Amortized Cost	**Fair Value**
Available-for-sale securities:		
Due in one year or less	$ 11,467,180	$ 11,561,930
Due after one year through five years	12,900,164	14,200,327
Due after five years through ten years	29,849,567	31,530,485
Due after ten years	48,627,257	50,954,696
	$ 102,844,168	$ 108,247,438

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

	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Market Value**
Available-for-sale securities:				
U.S. agencies	$ 52,101,177	2,722,817	$ (14,686)	$ 54,809,308
Collateralized mortgage obligations	11,366,368	728,104		12,094,472

Municipalities		15,660,035		1,312,377		(370)		16,972,042
SBA Pools		1,236,366		55				1,236,421
Corporate debt		2,000,000		0		(185,716)		1,814,284
Mutual Fund		2,759,316		17,188		(8,172)		2,768,332
	$	85,123,262	$	4,780,541	$	(208,944)	$	89,694,859

Table of Contents

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, 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	$ 2,985,314	$ (14,686)	$		$ 2,985,314	$ (14,686)
Collateralized mortgage obligations						
Municipalities	561,580	(370)			561,580	(370)
SBA Pools						
Corporate debt	1,814,284	(185,716)			1,814,284	(185,716)
Mutual Fund	991,828	(8,172)			991,828	(8,172)
Total temporarily impaired securities	$ 6,353,006	$ (208,944)	$	$	$ 6,353,006	$ (208,944)

At December 31, 2011, there were no 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 Company 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 $13,456 and $35,003 for the three and six month periods ended June 30, 2012, respectively, on certain available-for-sale securities that were partially called, which compares to $12,940 and $38,824 in the same periods of 2011. There were no sales of available-for-sale securities during the first six months of 2012 and 2011.

Securities carried at $49,056,082 and $53,419,019 at June 30, 2012 and December 31, 2011, respectively, were pledged to secure deposits of public funds.

NOTE 5   LOANS

The Company s customers are primarily located in Stanislaus, San Joaquin, Tuolumne, Inyo, and Mono Counties. As of June 30, 2012, approximately 83% of the Company s loans are commercial real estate loans which includes construction loans. Approximately 8% of the Company s loans are for general commercial uses including professional, retail, and small business. Additionally, 7% of the Company s loans are for residential real estate and other consumer loans. The remaining 2% are agriculture loans.

Loan totals were as follows:

	June 30, 2012	December 31, 2011

Commercial real estate:		
Commercial real estate- construction	$ 14,540,491	$ 14,595,324
Commercial real estate- mortgages	278,869,972	284,263,685
Land	8,934,895	10,635,954
Farmland	21,477,448	20,549,849
Commercial and industrial	32,701,817	32,017,744
Consumer	1,143,304	1,212,986
Consumer residential	27,369,395	23,870,519
Agriculture	5,477,722	9,055,622
Total loans	390,515,044	396,201,683
Less:		
Deferred loan fees and costs, net	(549,314)	(634,433)
Allowance for loan losses	(8,007,947)	(8,609,174)
Net loans	$ 381,957,783	$ 386,958,076

Table of Contents

Loan Origination/Risk Management. The Company 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 Company 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 Company s commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Company 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 Company avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Company also utilizes third-party experts to 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 June 30, 2012, approximately 37.4% of the outstanding principal balance of the Company 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 Company may originate from time to time, the Company generally requires the borrower to have had an existing relationship with the Company 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 Company 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 Company 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 Company 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 Company s policies and procedures.

Table of Contents

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.

Non-accrual loans, segregated by class of loans, were as follows:

	June 30, 2012	December 31, 2011
Commercial real estate:		
Commercial real estate- construction	$ 333,763	$ 179,262
Commercial real estate- mortgages	2,912,460	3,671,693
Land	2,725,022	3,277,463
Farmland	0	0
Commercial and industrial	23,111	104,481
Consumer	0	0
Consumer residential	1,190,525	0
Agriculture	0	0
Total non-accrual loans	$ 7,184,881	$ 7,232,899

Had non-accrual loans performed in accordance with their original contract terms, the Company would have recognized additional interest income of approximately $173,000 and $334,000 in three and six month periods ended June 30, 2012, respectively, as compared to $180,000 and $366,000 in the same periods of 2011.

The following table analyzes past due loans including the non-accrual loans in the above table, segregated by class of loans, as of June 30, 2012:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total	Greater Than 90 Days Past Due and Still Accruing
June 30, 2012							
Commercial real estate:							
Commercial R.E. - construction	$ 0	$ 0	$ 333,763	$ 333,763	$ 14,206,728	$ 14,540,491	$ 0
Commercial R.E. - mortgages	404,896	3,011,033	2,507,564	5,923,493	272,946,479	278,869,972	0
Land	679,732	2,918,104	2,045,290	5,643,126	3,291,769	8,934,895	0
Farmland	0	0	0	0	21,477,448	21,477,448	0
Commercial and industrial	0	348,924	0	348,924	32,352,893	32,701,817	0
Consumer	0	0	0	0	1,143,304	1,143,304	0
Consumer residential	0	1,190,525	0	1,190,525	26,178,870	27,369,395	0
Agriculture	0	0	0	0	5,477,722	5,477,722	0
Total	$ 1,084,628	$ 7,468,586	$ 4,886,617	$ 13,439,831	$ 377,075,213	$ 390,515,044	$ 0

13

Table of Contents

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, 2011:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total	Greater Than 90 Days Past Due and Still Accruing
December 31, 2011							
Commercial real estate:							
Commercial R.E. - construction	$ 0	$ 0	$ 179,263	$ 179,263	$ 14,416,061	$ 14,595,324	$ 0
Commercial R.E. - mortgages	424,683	0	3,671,693	4,096,376	280,167,309	284,263,685	0
Land	0	0	2,580,231	2,580,231	8,055,723	10,635,954	0
Farmland	0	0	0	0	20,549,849	20,549,849	0
Commercial and industrial	0	79,059	0	79,059	31,938,685	32,017,744	0
Consumer	16,419	0	0	16,419	1,196,567	1,212,986	0
Consumer residential	0	0	0	0	23,870,519	23,870,519	0
Agriculture	0	0	0	0	9,055,622	9,055,622	0
Total	$ 441,102	$ 79,059	$ 6,431,187	$ 6,951,348	$ 389,250,335	$ 396,201,683	$ 0

Impaired Loans. Loans are considered impaired when, based on current information and events, it is probable the Company 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 collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. There was no interest income realized on impaired loans for the three and six months ended June 30, 2012 and 2011. Average recorded investment in impaired loans was $6,325,000 and $6,641,000 for the three and six months ended June 30, 2012, respectively, as compared to $10,196,000 and $10,500,000 for the same periods of 2011. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Table of Contents

Impaired loans as of June 30, 2012 and December 31, 2011 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
June 30, 2012						
Commercial real estate:						
Commercial R.E. - construction	$ 400,363	$ 0	$ 333,763	$ 333,763	$ 3,797	$ 273,690
Commercial R.E. - mortgages	4,880,454	1,215,413	1,697,047	2,912,460	253,605	3,143,437
Land	7,124,435	679,732	2,045,290	2,725,022	157,078	3,134,102
Farmland	0	0	0	0	0	0
Commercial and Industrial	28,281	23,111	0	23,111	0	83,483
Consumer	0	0	0	0	0	0
Consumer residential	1,190,525	1,040,628	149,897	1,190,525	149,897	6,541
Agriculture	0	0	0	0	0	0
Total	$ 13,624,058	$ 2,958,884	$ 4,225,997	$ 7,184,881	$ 564,377	$ 6,641,253
December 31, 2011						
Commercial real estate:						
Commercial R.E. - construction	$ 245,862	$ 0	$ 179,262	$ 179,262	$ 5,984	$ 1,177,407
Commercial R.E. - mortgages	4,469,681	3,671,693	0	3,671,693	0	4,111,549
Land	7,659,990	697,232	2,580,231	3,277,463	544,630	3,329,784
Farmland	0	0	0	0	0	0
Commercial and Industrial	116,867	104,481	0	104,481	0	36,655
Consumer	0	0	0	0	0	0
Consumer residential	0	0	0	0	0	0
Agriculture	0	0	0	0	0	0
Total	$ 12,492,400	$ 4,473,406	$ 2,759,493	$ 7,232,899	$ 550,614	$ 8,655,395

Troubled Debt Restructurings In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company s internal underwriting policy.

At June 30, 2012, there were 5 loans and leases that were considered to be troubled debt restructurings, all of which are considered nonaccrual totaling $3,024,000. At June 30, 2012 and December 31, 2011 there were unfunded commitments of $1,650,000 and $1,644,000, respectively, on one loan classified as a troubled debt restructure because of an agreement with a borrower to continue advancing funds and covering overhead costs on a residential development project. The Company will receive proceeds to pay down the principal as the residential properties sell. The Company has allocated $158,000 and $551,000 of specific reserves to loans whose terms have been modified in troubled debt restructurings as of June 30, 2012 and December 31, 2011, respectively.

During the three and six month periods ended June 30, 2012, there were no loans modified as troubled debt restructurings. If a loan modification is granted, the modification of the terms of such loans typically includes one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date; or a temporary payment modification in which the payment amount allocated towards principal was reduced. In some cases, a permanent reduction of the accrued interest on the loan is conceded.

Since there was no troubled debt restructurings during the three and six month periods ended June 30, 2012, there was no increase in the allowance for loan losses as a result of loan modifications and there were no charge offs as a result of loan modifications.

Table of Contents

The following table presents loans by class modified as troubled debt restructurings within the previous twelve months and for which there was a payment default during the three and six month periods ended June 30, 2012.

	Three Months Ended June 30, 2012		Six Months Ended June 30, 2012	
	Number of Loans	**Recorded Investment**	**Number of Loans**	**Recorded Investment**
Commercial real estate:				
Commercial R.E. - construction	1	$ 275,502	1	$ 275,502
Commercial R.E. - mortgages	0	0	0	0
Land	1	1,473,696	1	1,473,696
Farmland	0	0	0	0
Commercial and Industrial	0	0	0	0
Consumer	0	0	0	0
Consumer residential	0	0	0	0
Agriculture	0	0	0	0
Total	2	$ 1,749,198	2	$ 1,749,198

A loan is considered to be in payment default once it is ninety days contractually past due under the modified terms.

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. Grade 1 loans are considered Pass. 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.

•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. Grade 2 loans are considered Pass. 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.

Table of Contents

- 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 Company would want to retain providing a positive turnaround can be expected within a reasonable time frame. Grade 4 loans are considered Pass.

5 Other Loans Especially Mentioned (Special Mention) - 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 Company 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.

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 Company. 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 Company 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.

Table of Contents

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

	June 30, 2012 Weighted Average Risk Grade	December 31, 2011 Weighted Average Risk Grade
Commercial real estate:		
Commercial real estate - construction	3.56	3.52
Commercial real estate - mortgages	3.25	3.26
Land	4.89	4.75
Farmland	3.36	3.40
Commercial and Industrial	3.20	3.21
Consumer	2.53	2.76
Consumer residential	3.19	3.10
Agriculture	3.49	3.23
Total gross loans	3.30	3.30

The following table presents risk grade totals by class of loans as of June 30, 2012 and December 31, 2011. Risk grades 1 through 4 have been aggregated in the Pass line.

Dollars in thousands	Commercial R.E. Construction	Commercial R.E. Mortgages	Land	Farmland	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Total
June 30, 2012									
Pass	$ 14,206,728	$ 260,210,211	$ 3,291,769	$ 20,165,266	$ 31,546,724	$ 1,127,417	$ 25,663,062	$ 4,119,900	$ 360,331,077
Special mention		10,430,916			314,793				10,745,709
Substandard	333,763	8,228,845	5,643,126	1,312,182	840,300	15,887	1,706,333	1,357,822	19,438,258
Doubtful									
Total loans	$ 14,540,491	$ 278,869,972	$ 8,934,895	$ 21,477,448	$ 32,701,817	$ 1,143,304	$ 27,369,395	$ 5,477,722	$ 390,515,044
December 31, 2011									
Pass	$ 14,416,062	$ 264,913,517	$ 4,419,659	$ 19,188,322	$ 31,000,530	$ 1,179,624	$ 23,475,447	$ 8,357,801	$ 366,950,962