TRICO BANCSHARES /
Form 10-K
March 01, 2019
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2018

Commission File Number 0-10661

TriCo Bancshares

(Exact name of Registrant as specified in its charter)

California **(State or other jurisdiction** **of incorporation or organization)**	**94-2792841** **(I.R.S. Employer** **Identification No.)**

63 Constitution Drive, Chico, California	**95973**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (530) 898-0300

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, without par value	**Nasdaq Global Select Market**
(Title of Class)	**(Name of each exchange on which registered)**

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark whether the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark whether the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer

Non-accelerated filer | Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The aggregate market value of the voting common stock held by non-affiliates of the Registrant, as of June 30, 2018, was approximately $748,354,000 (based on the closing sales price of the Registrant s common stock on the date).

The number of shares outstanding of Registrant s common stock, as of February 25, 2019, was 30,424,119.

DOCUMENTS INCORPORATED BY REFERENCE

The information required to be disclosed pursuant to Part III of this report either shall be (i) deemed to be incorporated by reference from selected portions of the Registrant s definitive proxy statement for the 2018 annual meeting of shareholders, if such proxy statement is filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the Registrants s most recently completed fiscal year, or (ii) included in an amendment to this report filed with the Commission on Form 10-K/A not later than the end of such 120 day period.

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FORWARD-LOOKING STATEMENTS

In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements about TriCo Bancshares (the Company, TriCo or we) and its subsidiaries for which it claims the protection of the safe harbor provisions contained in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on the current knowledge and belief of the Company s management (Management) and include information concerning the Company s possible or assumed future financial condition and results of operations. When you see any of the words believes , expects , anticipates , estimates , or similar expressions, these generally indicate th we are making forward-looking statements. A number of factors, some of which are beyond the Company s ability to predict or control, could cause future results to differ materially from those contemplated. These factors include those listed at Item 1A Risk Factors, in this report.

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.

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PART I

ITEM 1. BUSINESS
Information about TriCo Bancshares Business

TriCo Bancshares is a bank holding company incorporated in California in 1981 and registered under the Bank Holding Company Act of 1956, as amended (the BHC Act). The Company s principal subsidiary is Tri Counties Bank, a California-chartered commercial bank (the Bank) established in Chico, California in 1975. The Bank offers a unique brand of customer Service with Solutions® available in traditional stand-alone and in-store bank branches in communities throughout Northern and Central California and had total assets of approximately $6.4 billion at December 31, 2018. The Bank provides an extensive and competitive breadth of consumer, small business and commercial banking services easily accessed through its California communities branch network, advanced online and mobile banking, a shared nationwide network of over 32,000 ATMs, and bankers available by phone 7 days per week. The Bank s deposits are insured by the Federal Deposit Insurance Corporation (the FDIC) up to applicable limits. See Business of Tri Counties Bank . The Company and the Bank are headquartered in Chico, California.

As a bank holding company, TriCo is subject to the supervision of the Board of Governors of the Federal Reserve System (the FRB) under the BHC Act. The Bank is subject to the supervision of the California Department of Business Oversight (the DBO) and the FDIC. See Regulation and Supervision.

TriCo has five capital trusts, which are all wholly-owned trust subsidiaries formed for the purpose of issuing trust preferred securities (Trust Preferred Securities) and lending the proceeds to TriCo. For more information regarding the trust preferred securities please refer to Note 13 Junior Subordinated Debt to the financial statements at Item 8 of this report.

Additional information concerning the Company can be found on our website at www.tcbk.com. Copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports are available free of charge through the investors relations page of our website, www.tcbk.com, as soon as reasonably practicable after the Company files these reports with the U.S. Securities and Exchange Commission (SEC). The information on our website is not part this annual report.

Business of Tri Counties Bank

The Bank was incorporated as a California banking corporation on June 26, 1974, and received its certificate of authority to conduct banking operations on March 11, 1975. The Bank engages in the general commercial banking business in 29 counties in Northern and Central California.

The Bank provides a breadth of personal, small business and commercial financial services including accepting demand, savings and time deposits and making small business, commercial, real estate, and consumer loans, as well as a range of Treasury Management Services and other customary banking services including safe deposit boxes. Brokerage services are provided at the Bank s offices by the Bank s arrangement with Raymond James Financial Services, Inc., an independent financial services provider and broker-dealer.

Over 80% of the Bank s customers are personal banking customers. Less than 20% are business and commercial banking customers serving a diversity of industry types including manufacturing, real estate development, retail, wholesale, transportation, agriculture, commerce and professional services. The majority of the Bank s loans are direct loans made to individuals and businesses in Northern and Central California where its branches are located. At December 31, 2018, the Bank s consumer loans net of deferred fees outstanding was $418,982,000 (10.4%), commercial loans outstanding were $276,548,000 (6.9%), and real estate loans including construction loans of $183,384,000 were $3,326,484,000 (82.7%) of total loans. The Bank takes real estate, listed and unlisted securities, savings and time deposits, automobiles, machinery, equipment, inventory, accounts receivable and notes receivable secured by property as collateral for loans.

Most of the Bank s deposits are attracted from individuals and business-related sources. No single person or group of persons provides a material portion of the Bank s deposits, the loss of any one or more of which would have a materially adverse effect on the business of the Bank, nor is a material portion of the Bank s loans concentrated within a single industry or group of related industries.

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Merger with FNB Bancorp

On December 11, 2017, the Company and FNB Bancorp (FNBB), entered into an Agreement and Plan of Merger and Reorganization (the Merger Agreement) pursuant to which FNBB will be merged with and into TriCo, with TriCo as the surviving corporation (the Merger). The Merger Agreement provided that immediately after the Merger, FNBB s bank subsidiary, First National Bank of Northern California (First National Bank), will merge with and into TriCo s bank subsidiary, Tri Counties Bank, with Tri Counties Bank as the surviving bank (the Bank Merger). The Merger and Bank Merger are collectively referred to as the Merger Transaction.

The Merger Agreement provided that each share of FNBB common stock issued and outstanding immediately prior to the effective time of the Merger would be canceled and converted into the right to receive 0.98 shares of TriCo common stock (the Exchange Ratio), with cash paid in lieu of fractional shares of TriCo common stock.

Based on the closing price of TriCo common stock of $41.64 on December 8, 2017, the consideration value was $40.81 per share of FNBB common stock or approximately $315.3 million in aggregate. On July 6, 2018, the Merger Transaction was completed. Based on the closing price of TriCo s common stock of $38.41 on July 6, 2018, and based on the conversion of FNBB outstanding common shares to 7,405,277 shares of TCBK common shares, the share consideration value was approximately $284.4 million. The Company also paid cash of $6.7 million to settle and retire all FNBB stock options outstanding as of the acquisition date.

Employees

At December 31, 2018, the Company employed 1,174 persons, including six executive officers. Full time equivalent employees were 1,141. No employees of the Company are presently represented by a union or covered under a collective bargaining agreement. Management believes that its employee relations are good.

Competition

The banking business in California generally, and in the Bank s primary service area of Northern and Central California specifically, is highly competitive with respect to both loans and deposits. It is dominated by a relatively small number of national and regional banks with many offices operating over a wide geographic area. Among the advantages such major banks have over the Bank is their ability to finance wide ranging advertising campaigns and to allocate their investment assets to regions of high yield and demand. By virtue of their greater total capitalization such institutions have substantially higher lending limits than does the Bank.

In addition to competing with other banks, the Bank competes with savings institutions, credit unions and the financial markets for funds. Yields on corporate and government debt securities and other commercial paper may be higher than on deposits, and therefore affect the ability of commercial banks to attract and hold deposits. Commercial banks also compete for available funds with money market instruments and mutual funds. During past periods of high interest rates, money market funds have provided substantial competition to banks for deposits and they may continue to do so in the future. Mutual funds are also a major source of competition for savings dollars. The Bank relies substantially on local promotional activity, personal contacts by its officers, directors, employees and shareholders, extended hours, personalized service and its reputation in the communities it services to compete effectively.

Regulation and Supervision

General

The Company and the Bank are subject to extensive regulation under both federal and state law. This regulation is intended primarily for the protection of customers, depositors, the FDIC deposit insurance fund and the banking system as a whole, and not for the protection of shareholders of the Company. Set forth below is a summary description of the significant laws and regulations applicable to the Company and the Bank. The description is qualified in its entirety by reference to the applicable laws and regulations.

Regulatory Agencies

The Company is a legal entity separate and distinct from the Bank and its other subsidiaries. As a bank holding company, the Company is regulated under the BHC Act, and is subject to supervision, regulation and examination by the FRB. The Company is also under the jurisdiction of the SEC and is subject to the disclosure and regulatory requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934, each administered by the SEC. The Company s common stock is listed on the Nasdaq Global Select market (Nasdaq) under the trading symbol TCBK and the Company is, therefore, subject to the rules of Nasdaq for listed companies.

The Bank is subject to regulation, supervision and periodic examination by the FDIC, which is the bank s primary federal regulator because the bank is a state-chartered bank that is not a member of the Federal Reserve System and the DBO, because the bank is a California state chartered bank. This regulation is broad and extends to all of the Bank s operations.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) created the Consumer Financial Protection Bureau (the CFPB) as an independent entity with broad rulemaking, supervisory and enforcement authority over consumer financial products and services. The CFPB s functions include investigating consumer complaints, rulemaking, supervising and examining bank consumer transactions, and enforcing rules related to consumer financial products and services. CFPB regulations and guidance apply to all financial institutions, including the Bank. Banks with $10 billion or more in assets are subject to examination by the CFPB. Banks with less than $10 billion in assets, including the Bank, continue to be examined for compliance with federal consumer laws by their primary federal banking agency.

The Bank Holding Company Act

The Company is registered as a bank holding company under the BHC Act. In general, the BHC Act limits the business of bank holding companies to banking, managing or controlling banks and other activities that the FRB has determined to be so closely related to banking as to be a proper incident thereto. Qualified bank holding companies that elect to be financial holding companies may engage in any activity, or acquire and retain the shares of a company engaged in any activity, that is either (i) financial in nature or incidental to such financial activity or (ii) complementary to a financial activity, and that does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally (as determined solely by the FRB). Activities that are financial in nature include securities underwriting and dealing, insurance underwriting and agency, and making merchant banking investments. The Company currently has not elected to become a financial holding company.

As a bank holding company, TriCo is required to file reports with the FRB and the FRB periodically examines the Company. Under the Dodd-Frank Act, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary bank and, under appropriate circumstances, to commit resources to support the subsidiary bank.

The BHC Act, the Bank Merger Act, and other federal and state statutes regulate acquisitions of commercial banks. The BHC Act requires a bank holding company to obtain the approval of the FRB prior to directly or indirectly acquiring more than 5 percent of the voting shares of a commercial bank or its parent holding company. Under the Bank Merger Act, the prior approval of an acquiring bank s primary federal regulator is required before it may merge with another bank or purchase the assets or assume the deposits of another bank. In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory authorities will consider, among other things, the competitive effect and public benefits of the transactions, the capital position of the combined organization, the applicant s performance record under the Community Reinvestment Act, consumer compliance, fair housing laws and the effectiveness of the subject organizations in combating money laundering activities.

Safety and Soundness Standards

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) implemented certain specific restrictions on transactions and required the regulators to adopt overall safety and soundness standards for depository institutions related to internal control, loan underwriting and documentation, and asset growth. Among other things, FDICIA limits the interest rates paid on deposits by undercapitalized institutions, the use of brokered deposits and the aggregate extension of credit by a depository institution to an executive officer, director, principal stockholder or related interest, and reduces deposit insurance coverage for deposits offered by undercapitalized institutions for deposits by certain employee benefits accounts.

Under FDICIA, the federal ban regulatory agencies have establish safety and soundness standards for insured financial institutions covering:

- Internal controls, information systems and internal audit systems;
- Loan documentation;
- Credit underwriting;
- Interest rate exposure;
- Asset growth;

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Compensation, fees and benefits;

Asset quality, earnings and stock valuation; and

Excessive compensation for executive officers, directors or principal shareholders which could lead to material financial loss.

If an agency determines that an institution fails to meet any standard established by the guidelines, the agency may require the financial institution to submit to the agency an acceptable plan to achieve compliance with the standard. If the agency requires submission of a compliance plan and the institution fails to timely submit an acceptable plan or to implement an accepted plan, the agency must require the institution to correct the deficiency. An institution must file a compliance plan within 30 days of a request to do so from the institution s primary federal regulatory agency. The agencies may elect to initiate enforcement actions in certain cases rather than relying on a plan, particularly where failure to meet one or more of the standards could threaten the safe and sound operation of the institution.

Restrictions on Dividends and Distributions

A California corporation such as TriCo may make a distribution to its shareholders to the extent that either the corporation s retained earnings meet or exceed the amount of the proposed distribution or the value of the corporation s assets exceed the amount of its liabilities plus the amount of shareholders preferences, if any, and certain other conditions are met. It is the FRB s policy that bank holding companies should generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the organization s expected future needs and financial condition. In addition, a bank holding company may be unable to pay dividends on its common stock if it fails to maintain an adequate capital conservation buffer under the new capital rules. See Regulatory Capital Requirements.

The primary source of funds for payment of dividends by TriCo to its shareholders has been and will be the receipt of dividends and management fees from the Bank. TriCo s ability to receive dividends from the Bank is limited by applicable state and federal law. Under the California Financial Code, funds available for cash dividend payments by a bank are restricted to the lesser of: (i) retained earnings or (ii) the bank s net income for its last three fiscal years (less any distributions to shareholders made during such period). However, with the prior approval of the Commissioner of the DBO, a bank may pay cash dividends in an amount not to exceed the greatest of the: (1) retained earnings of the bank; (2) net income of the bank for its last fiscal year; or (3) net income of the bank for its current fiscal year. However, if the DBO finds that the shareholders equity of the bank is not adequate or that the payment of a dividend would be unsafe or unsound, the Commissioner may order the bank not to pay a dividend to shareholders.

The new Capital Rules may restrict dividends by the Bank if the additional capital conservation buffer is not achieved. See Regulatory Capital Requirements .

The FRB, FDIC and the DBO have authority to prohibit a bank holding company or a bank from engaging in practices which are considered to be unsafe and unsound. Depending on the financial condition of TriCo and the Bank and other factors, the FRB, FDIC or the DBO could determine that payment of dividends or other payments by TriCo or the Bank might constitute an unsafe or unsound practice.

The Community Reinvestment Act

The Community Reinvestment Act of 1977 (CRA) requires the federal banking regulatory agencies to periodically assess a bank s record of helping meet the credit needs of its entire community, including low- and moderate-income neighborhoods. The CRA also requires the agencies to consider a financial institution s record of meeting its community credit when evaluating applications for, among other things, domestic branches and mergers or acquisitions. The federal banking agencies rate depository institutions compliance with the CRA. The ratings range from a high of outstanding to a low of substantial noncompliance. A less than satisfactory rating could result in the suspension of any growth of the Bank through acquisitions or opening de novo branches until the rating is improved. As of its most recent CRA examination, the Bank s CRA rating was Satisfactory.

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Consumer Protection Laws

The Bank is subject to many federal consumer protection statues and regulations, some of which are discussed below.

The Equal Credit Opportunity Act generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

The Truth-in-Lending Act is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably.

The Fair Housing Act regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status.

The Home Mortgage Disclosure Act, which includes a fair lending aspect, requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

The Real Estate Settlement Procedures Act requires lenders to provide borrowers with disclosures regarding the nature and cost of real estate settlements and prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts.

In addition, the CFPB has taken a number of actions that may affect the Bank s operations and compliance costs, including the following:

The issuance of final rules for residential mortgage lending, which became effective January 10, 2013, including definitions for qualified mortgages and detailed standards by which lenders must satisfy themselves of the borrower s ability to repay the loan and revised forms of disclosure under the Truth in Lending Act and the Real Estate Settlement Procedures Act.

The issuance of a policy report on arbitration clauses which could result in the restriction or prohibition of lenders including arbitration clauses in consumer financial services contracts.

Actions taken to regulate and supervise credit bureaus and debt collections.

Positions taken by CFPB on fair lending, including applying the disparate impact theory in auto financing, which could make it harder for lenders, such as the Bank, to charge different rates or apply different terms to loans to different customers.

Penalties for violations of the above laws may include fines, reimbursements, injunctive relief and other penalties.

Data Privacy and Cyber Security Regulation

The Company is subject to many U.S. federal, state and international laws and regulations governing requirements for maintaining policies and procedures to protect the non-public confidential information of customers and employees. The privacy provisions of the Gramm-Leach-Bliley Act generally prohibit financial institutions, including the Company, from disclosing nonpublic personal financial information of consumer customers to third parties for certain purposes (primarily marketing) unless customers have the opportunity to opt out of the disclosure. Other laws and regulations, at the international, federal and state level, limit the Company s ability to share certain information with affiliates and non-affiliates for marketing and/or non-marketing purposes, or to contact customers with marketing offers. The Gramm-Leach-Bliley Act also requires banks to implement a comprehensive information security program that includes administrative, technical and physical safeguards to ensure the security and confidentiality of customer records and information.

Regulatory Capital Requirements

The Company and the Bank are subject to the minimum capital requirements of the FRB and FDIC, respectively. Capital requirements may have an effect on the Company s and the Bank s profitability and ability to pay dividends. If the Company or the Bank lacks adequate capital to increase its assets without violating the minimum capital requirements or if it forced to reduce the level of its assets in order to satisfy regulatory capital requirements, its ability to generate earnings would be reduced.

For a discussion of the regulatory capital requirements, see Note 25 Regulatory Matters to the consolidated financial statements at Part II, Item 8 of this report.

We believe that we were in compliance with the requirements of the new capital rules applicable to us as of December 31, 2018.

Prompt Corrective Action

Prompt Corrective Action regulations of the federal bank regulatory agencies establish five capital categories in descending order (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized), assignment to which depends upon the institution s total risk-based capital ratio, Tier 1 risk-based capital ratio, and leverage ratio. The new capital rules revised the prompt corrective action framework. Under the current prompt corrective action framework, insured depository institutions will be required to meet the following minimum capital level requirements in order to qualify as well capitalized: (i) a common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 capital ratio of 8%; (iii) a total capital ratio of 10%; and (iv) a Tier 1 leverage ratio of 5%. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. Institutions classified in one of the three undercapitalized categories are subject to certain mandatory and discretionary supervisory actions, which include increased monitoring and review, implementation of capital restoration plans, asset growth restrictions, limitations upon expansion and new business activities, requirements to augment capital, restrictions upon deposit gathering and interest rates, replacement of senior executive officers and directors, and requiring divestiture or sale of the institution. The Bank s capital levels have exceeded the minimums necessary to be considered well capitalized under the current regulatory framework for prompt corrective action since adoption.

Deposit Insurance

Deposit accounts in the Bank are insured by the FDIC, generally up to a maximum of $250,000 per separately insured depositor. The Bank is subject to deposit insurance assessments as determined by the FDIC. The amount of the deposit insurance assessment for institutions with less than $10.0 billion in assets, such as the Bank, is based on its risk category, with certain adjustments for any unsecured debt or brokered deposits held by the insured bank. Institutions assigned to higher risk categories (that is, institutions that pose a higher risk of loss to the FDIC s deposit insurance fund (the DIF)) pay assessments at higher rates than institutions that pose a lower risk. An institution s risk classification is assigned based on a combination of its financial ratios and supervisory ratings, reflecting, among other things, its capital levels and the level of supervisory concern that the institution poses to the regulators. In addition, the FDIC can impose special assessments in certain instances.

The Dodd-Frank Act changed the way that deposit insurance premiums are calculated. The assessment base is no longer the institution s deposit base, but rather its average consolidated total assets less its average tangible equity. The Dodd-Frank Act also increased the minimum designated reserve ratio of the DIF from 1.15% to 1.35% of the estimated amount of total insured deposits by 2020, eliminates the upper limit for the reserve ratio designated by the FDIC each year, and eliminates the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds. Continued action by the FDIC to replenish the DIF, as well as the changes contained in the Dodd-Frank Act, may result in higher assessment rates, which could reduce our profitability or otherwise negatively impact our operations.

The Bank is generally unable to control the amount of premiums that it is required to pay for FDIC insurance. If there are additional bank or financial institution failures or if the FDIC otherwise determines, the Bank may be required to pay even higher FDIC premiums than the recently increased levels. Increases in FDIC insurance premiums may have a material and adverse effect on the Company s earnings and could have a material adverse effect on the value of, or market for, the Company s common stock.

The FDIC may terminate a depository institution s deposit insurance upon a finding that the institution s financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices that pose a risk to the DIF or that may prejudice the interest of the bank s depositors. The termination of deposit insurance for the Bank would also result in the revocation of the Bank s charter by the DBO.

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Anti-Money Laundering Laws

A series of banking laws and regulations beginning with the Bank Secrecy Act in 1970 requires banks to prevent, detect, and report illicit or illegal financial activities to the federal government to prevent money laundering, international drug trafficking, and terrorism. Today, the Bank Secrecy Act requires that all banking institutions develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with certain recordkeeping and reporting requirements regarding both domestic and international currency transactions. These programs must, at a minimum, provide for a system of internal controls to assure ongoing compliance, provide for independent testing of such systems and compliance, designate individuals responsible for such compliance and provide appropriate personnel training.

Under the USA Patriot Act of 2001, financial institutions are subject to prohibitions against specified financial transactions and account relationships, requirements regarding the Customer Identification Program, as well as enhanced due diligence and know your customer standards in their dealings with high risk customers, foreign financial institutions, and foreign individuals and entities. The act also requires financial institutions, including banks, to establish anti-money laundering programs, including employee training and independent audit requirements, meet minimum standards specified by the act, follow minimum standards for customer identification and maintenance of customer identification records, and regularly compare customer lists against lists of suspected terrorists, terrorist organizations and money launderers.

Transactions with Affiliates

Banks are also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders (including the Company) or any related interest of such persons. Extensions of credit must be made on substantially the same terms, including interest rates and collateral as, and follow credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions with persons not affiliated with the bank, and must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to such persons. Regulation W requires that certain transactions between the Bank and its affiliates, including its holding company, be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving nonaffiliated companies or, in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to or would apply to nonaffiliated companies.

Impact of Monetary Policies

Banking is a business that depends on interest rate differentials. In general, the difference between the interest paid by a bank on its deposits and other borrowings, and the interest rate earned by banks on loans, securities and other interest-earning assets comprises the major source of banks earnings. Thus, the earnings and growth of banks are subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the FRB. The FRB implements national monetary policy, such as seeking to curb inflation and combat recession, by its open-market dealings in United States government securities, by adjusting the required level of reserves for financial institutions subject to reserve requirements and through adjustments to the discount rate applicable to borrowings by banks which are members of the FRB. The actions of the FRB in these areas influence the growth of bank loans, investments and deposits and also affect interest rates. The nature and timing of any future changes in such policies and their impact on the Company cannot be predicted. In addition, adverse economic conditions could make a higher provision for loan losses a prudent course and could cause higher loan loss charge-offs, thus adversely affecting the Company s net earnings.

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ITEM 1A. RISK FACTORS

There are a number of factors that may adversely affect the Company s business, financial results, or stock price. In analyzing whether to make or continue holding an investment in the Company, investors should consider, among other factors, the following:

Risks Related to the Nature and Geographic Area of Our Business

We are exposed to risks in connection with the loans we make.

As a lender, we face a significant risk that we will sustain losses because borrowers, guarantors or related parties may fail to perform in accordance with the terms of the loans we make or acquire. Our earnings are significantly affected by our ability to properly originate, underwrite and service loans. We have underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that we believe appropriately address this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying our respective loan portfolios. Such policies and procedures, however, may not prevent unexpected losses that could adversely affect our results of operations. We could sustain losses if we incorrectly assess the creditworthiness of our borrowers or fail to detect or respond to deterioration in asset quality in a timely manner.

Our allowance for loan losses may not be adequate to cover actual losses.

Like other financial institutions, we maintain an allowance for loan losses to provide for loan defaults and non-performance. Our allowance for loan losses may not be adequate to cover actual loan losses, and future provisions for loan losses would reduce our earnings and could materially and adversely affect our business, financial condition, results of operations and cash flows. The allowance for loan losses reflects our estimate of the probable incurred losses in our loan portfolio at the relevant balance sheet date. Our allowance for loan losses is based on prior experience, as well as an evaluation of the known risks in the current portfolio, composition and growth of the loan portfolio and economic factors. Determining an appropriate level of loan loss allowance is an inherently difficult process and is based on numerous assumptions. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, that may be beyond our control and these losses may exceed current estimates. Federal and state regulatory agencies, as an integral part of their examination process, review our loans and allowance for loan losses. While we believe that our allowance for loan losses is adequate to cover current losses, we cannot assure you that we will not increase the allowance for loan losses further or that the allowance will be adequate to absorb loan losses we actually incur. Either of these occurrences could have a material adverse effect on our business, financial condition and results of operations.

The Financial Accounting Standards Board has recently issued an accounting standard update that will result in a significant change in how we recognize credit losses and may have a material impact on our financial condition or results of operations.

In June 2016, the Financial Accounting Standards Board issued ASU 2016-13, Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 requires banking organizations to determine the adequacy of their ALLL with an expected loss model, which is referred to as the current expected credit loss (CECL) model. Under the CECL model, banking organizations will be required to present certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the incurred loss model required under current GAAP, which delays recognition until it is probable a loss has been incurred. ASU 2016-13 is expected to be effective for public business entities for fiscal years after December 15, 2019. CECL will change the manner in which we determine the adequacy of our allowance for loan losses. We are evaluating the impact the CECL model will have on our accounting, but we may recognize a one-time cumulative-effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective. We cannot yet determine the magnitude of any such one-time cumulative adjustment or of the overall impact of the new standard on our financial condition or results of operations. The federal banking regulators have adopted a rule that gives a banking organization the option to phase in over a three-year period the day-one adverse effects of CECL on its regulatory capital.

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Our business may be adversely affected by business conditions in northern and central California.

We conduct most of our business in northern and central California. As a result of this geographic concentration, our financial results may be impacted by economic conditions in California. Deterioration in the economic conditions in California could result in the following consequences, any of which could have a material adverse effect on our business, financial condition, results of operations and cash flows:

- problem assets and foreclosures may increase,
- demand for our products and services may decline,
- low cost or non-interest bearing deposits may decrease, and
- collateral for loans made by us, especially real estate, may decline in value, in turn reducing customers borrowing power, and reducing the value of assets and collateral associated with our existing loans.

In view of the concentration of our operations and the collateral securing our loan portfolio in both northern and central California, we may be particularly susceptible to the adverse effects of any of these consequences, any of which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

A significant majority of the loans in our portfolio are secured by real estate and a downturn in our real estate markets could hurt our business.

A downturn in our real estate markets in which we conduct our business in California could hurt our business because most of our loans are secured by real estate. Real estate values and real estate markets are generally affected by changes in national, regional or local economic conditions, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies and acts of nature. As real estate prices decline, the value of real estate collateral securing our loans is reduced. As a result, our ability to recover on defaulted loans by foreclosing and selling the real estate collateral could then be diminished and we would be more likely to suffer losses on defaulted loans. As of December 31, 2018, approximately 91.7% of the book value of our loan portfolio consisted of loans collateralized by various types of real estate. Substantially all of our real estate collateral is located in California. So if there is a significant adverse decline in real estate values in California, the collateral for our loans will provide less security. Real estate values could also be affected by, among other things, earthquakes, drought and national disasters in our markets. Any such downturn could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We depend on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.

Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of, and experience in, the California community banking industry. The process of recruiting personnel with the combination of skills and attributes required to carry out our strategies is often lengthy. Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing and technical personnel and upon the continued contributions of our management and personnel. In particular, our success has been and continues to be highly dependent upon the abilities of our senior management team of Messrs. Smith, Bailey, Carney, Fleshood, O Sullivan and Wiese, who have expertise in banking and collective experience in the California markets we serve and have targeted for future expansion. We also depend upon a number of other key executives who are California natives or are long-time residents and who are integral to implementing our business plan. The loss of the services of any one of our senior executive management team or other key executives could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We are exposed to the risk of environmental liabilities with respect to properties to which we take title.

In the course of our business, we may foreclose and take title to real estate and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean-up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we become subject to significant environmental liabilities, our business, financial condition, results of operations and cash flows could be materially adversely affected.

Strong competition in California could hurt our profits.

Competition in the banking and financial services industry is intense. Our profitability depends upon our continued ability to successfully compete. We primarily compete in northern and central California for loans, deposits and customers with commercial banks, savings and loan associations, credit unions, finance companies, mutual funds, insurance companies, brokerage firms and Internet-based marketplace lending platforms. In particular, our competitors include major financial companies whose greater resources may afford them a marketplace advantage by enabling them to maintain numerous locations and mount extensive promotional and advertising campaigns. Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions may have larger lending limits which would allow them to serve the credit needs of larger customers. Areas of competition include interest rates for loans and deposits, efforts to obtain loan and deposit customers and a range in quality of products and services provided, including new technology-driven products and services. Technological innovation continues to contribute to greater competition in domestic and international financial services markets as technological advances enable more companies, such as Internet-based marketplace lenders, to provide financial services, often without many of regulatory and capital restrictions that we face. We also face competition from out-of-state financial intermediaries that have opened loan production offices or that solicit deposits in our market areas. If we are unable to attract and retain banking customers, we may be unable to continue our loan growth and level of deposits and our business, financial condition, results of operations and cash flows may be adversely affected.

Our previous results may not be indicative of our future results.

We may not be able to sustain our historical rate of growth and level of profitability or may not even be able to grow our business or continue to be profitable at all. Various factors, such as economic conditions, regulatory and legislative considerations and competition, may also impede or prohibit our ability to expand our market presence and financial performance. If we experience a significant decrease in our historical rate of growth, our results of operations and financial condition may be adversely affected due to a high percentage of our operating costs being fixed expenses.

We may be adversely affected by the soundness of other financial institutions.

Financial services institutions are interrelated as a result of clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by a counterparty or client. In addition, our credit risk may be exacerbated when the collateral that we hold cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to us. Any such losses could have a material adverse effect on our financial condition and results of operations.

Severe weather, natural disasters and other external events could adversely affect our business.

Our operations and our customer base are primarily located in northern and central California where natural and other disasters may occur. These regions are known for being vulnerable to natural disasters and other risks, such as earthquakes, fires, droughts and floods, the nature and severity of which may be impacted by climate change. These types of natural catastrophic events have at times disrupted the local economies, our business and customers in these regions. Such events could also affect the stability of the Bank s deposit base; impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans and cause significant property damage, result in losses of revenue and/or cause us to incur additional expenses. In addition, catastrophic events occurring in other regions of the world may have an impact on our customers and in turn, on us. Our business continuity and disaster recovery plans may not be successful upon the occurrence of one of these scenarios, and a significant catastrophic event anywhere in the world could materially adversely affect our operating results.

We may be adversely affected by recent changes in U.S. tax laws.

The enactment of the Tax Cuts and Jobs Act (the TCJA) on December 22, 2017 made significant changes to the Internal Revenue Code, many of which are highly complex and may require interpretations and implementing regulations. The TCJA includes a number of provisions that will have an impact on the banking industry, borrowers and the market for residential real estate. These changes include: (i) a lower limit on the deductibility of mortgage interest on single-family residential mortgage loans, (ii) the elimination of interest deductions for home equity loans, (iii) a limitation on the deductibility of business interest expense, and (iv) a limitation on the deductibility of property taxes and state and local income taxes. The TCJA may have an adverse effect on the market for and the valuation of residential properties, as well as on the demand for such loans in the future, and could make it harder for borrowers to make their loan payments. The value of the properties securing loans in our loan portfolio may be adversely impacted as a result of the changing economics of home ownership. Such an impact could require an increase in our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition and results of operations.

It is too early to evaluate all of the potential consequences of the tax reform bill, but such consequences could include lower commercial customer borrowings, either due to the increase in cash flows as a result of the reduction in the corporate statutory tax rate or the utilization by businesses in certain sectors of alternative non-debt financing and/or early retirement of existing debt. While the reform bill lowered the corporate federal statutory tax rate, it also eliminated or limited certain federal corporate deductions. There can be no assurance that any benefits realized by us as a result of the reduction in the corporate federal statutory tax rate will ultimately result in increased net income, whether due to decreased loan yields as a result of competition or to other factors. Uncertainty also exists related to state and other taxing jurisdictions response to federal tax reform.

Federal income tax treatment of corporations may be further clarified and modified by other legislative, administrative or judicial changes or interpretations at any time. Any such changes could adversely affect us.

Market and Interest Rate Risk

Fluctuations in interest rates could reduce our profitability and affect the value of our assets.

Like other financial institutions, we are subject to interest rate risk. Our primary source of income is net interest income, which is the difference between interest earned on loans and leases and investments, and interest paid on deposits and borrowings. We expect that we will periodically experience imbalances in the interest rate sensitivities of our assets and liabilities and the relationships of various interest rates to each other. Over any defined period of time, our interest-earning assets may be more sensitive to changes in market interest rates than our interest-bearing liabilities, or vice-versa. In addition, the individual market interest rates underlying our loan and lease and deposit products may not change to the same degree over a given time period. If market interest rates should move contrary to our position, earnings may be negatively affected. In addition, loan and lease volume and quality and deposit volume and mix can be affected by market interest rates as can the businesses of our clients. Changes in levels of market interest rates could have a material adverse effect on our net interest spread, asset quality, origination volume, the value of our loans and investment securities and overall profitability.

Market interest rates are beyond our control, and they fluctuate in response to general economic conditions and the policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, may negatively affect our ability to originate loans and leases, the value of our assets and our ability to realize gains from the sale of our assets, all of which ultimately could affect our earnings.

Our business is subject to interest rate risk and variations in interest rates may negatively affect our financial performance.

Because of the differences in the maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. Accordingly, fluctuations in interest rates could adversely affect our interest rate spread and, in turn, our profitability. In addition, loan origination volumes are affected by market interest rates. Rising interest rates, generally, are associated with a lower volume of loan originations while lower interest rates are usually associated with higher loan originations. Conversely, in rising interest rate environments, loan repayment rates may decline and in falling interest rate environments, loan repayment rates may increase. Although we were successful in generating new loans during 2018, the continuation of historically low long-term interest rate levels may cause additional refinancing of commercial real estate and 1-4 family residence loans, which may depress our loan volumes or cause rates on loans to decline. In addition, an increase in the general level of short-term interest rates on variable rate loans may adversely affect the ability of certain borrowers to pay the interest on and principal of their obligations or reduce the amount they wish to borrow. Additionally, if short-term market rates rise, in order to retain existing deposit customers and attract new deposit customers we may need to increase rates we pay on deposit accounts. Accordingly, changes in levels of market interest rates could materially and adversely affect our net interest spread, asset quality, loan origination volume, business, financial condition, results of operations and cash flows.

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Reduction in the value, or impairment of our investment securities, can impact our earnings and common shareholders equity.

We maintained a balance of $1.6 billion, or approximately 25% of our assets, in investment securities at December 31, 2018. Changes in market interest rates can affect the value of these investment securities, with increasing interest rates generally resulting in a reduction of value. Although the reduction in value from temporary increases in market rates does not affect our income until the security is sold, it does result in an unrealized loss recorded in other comprehensive income that can reduce our common stockholders equity. Further, we must periodically test our investment securities for other-than-temporary impairment in value. In assessing whether the impairment of investment securities is other-than-temporary, we consider the length of time and extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability to retain our investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value in the near term.

Regulatory Risks

Recently enacted financial reform legislation has, among other things, created a new Consumer Financial Protection Bureau, tightened capital standards and resulted in new laws and regulations that are expected to increase our costs of operations.

The Dodd-Frank Act, which was enacted in 2010, significantly changed the current bank regulatory structure and affects the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. Among other things, the Dodd-Frank Act created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit unfair, deceptive or abusive acts and practices. The CFPB has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks with $10 billion or less in assets, such as the Bank, are subject to the CFPB s rules but continue to be examined for compliance with the consumer laws by their primary bank regulators. In addition, the Dodd-Frank Act required the FDIC and FRB to adopt new, more stringent capital rules that apply to us. The Dodd-Frank Act also weakens the federal preemption rules that have been applicable for national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws.

It is difficult to predict the continuing impact that the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on community banks. However, it is expected that at a minimum they will increase our operating and compliance costs and could increase our interest expense.

We operate in a highly regulated environment and we may be adversely affected by new laws and regulations or changes in existing laws and regulations. Regulations may prevent or impair our ability to pay dividends, engage in acquisitions or operate in other ways.

We are subject to extensive regulation, supervision and examination by the DBO, FDIC, and the FRB. See Item 1 Regulation and Supervision of this report for information on the regulation and supervision which governs our activities. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, the classification of our assets and determination of the level of our allowance for loan losses. Banking regulations, designed primarily for the protection of depositors, may limit our growth and the return to our shareholders by restricting certain of our activities, such as:

- the payment of dividends to our shareholders,
- possible mergers with or acquisitions of or by other institutions,
- desired investments,
- loans and interest rates on loans,
- interest rates paid on deposits,
- service charges on deposit account transactions,
- the possible expansion of branch offices, and
- the ability to provide securities or trust services.

We also are subject to regulatory capital requirements. We could be subject to regulatory enforcement actions if, any of our regulators determines for example, that we have violated a law of regulation, engaged in unsafe or unsound banking practice or lack adequate capital. Federal and state governments and regulators could pass legislation and adopt policies responsive to current credit conditions that would have an adverse effect on the Company and its financial performance. We cannot predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that such changes may have on our future business and earnings prospects. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material adverse impact on our operations.

Compliance with changing regulation of corporate governance and public disclosure may result in additional risks and expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Dodd-Frank Act, the Sarbanes-Oxley Act of 2002 and new SEC regulations, are creating additional expense for publicly-traded companies such as the Company. The application of these laws, regulations and standards may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased expenses and a diversion of management time and attention. In particular, our efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding management s required assessment of its internal control over financial reporting and its external auditors audit of our internal control over financial reporting requires, and will continue to require, the commitment of significant financial and managerial resources. Further, the members of our board of directors, members of our audit or compensation and management succession committees, our chief executive officer, our chief financial officer and certain other executive officers could face an increased risk of personal liability in connection with the performance of their duties. It may also become more difficult and more expensive to obtain director and officer liability insurance. As a result, our ability to attract and retain executive officers and qualified board and committee members could be more difficult.

Risks Related to Growth and Expansion

Goodwill resulting from acquisitions may adversely affect our results of operations.

Goodwill and other intangible assets have increased substantially as a result of our acquisitions of FNB Bancorp in 2018 and North Valley Bancorp in 2014. Potential impairment of goodwill and amortization of other intangible assets could adversely affect our financial condition and results of operations. We assess our goodwill and other intangible assets and long-lived assets for impairment annually and more frequently when required by U.S. GAAP. We are required to record an impairment charge if circumstances indicate that the asset carrying values exceed their fair values. Our assessment of goodwill, other intangible assets, or long-lived assets could indicate that an impairment of the carrying value of such assets may have occurred that could result in a material, non-cash write-down of such assets, which could have a material adverse effect on our results of operations and future earnings.

If we cannot attract deposits, our growth may be inhibited.

We plan to increase the level of our assets, including our loan portfolio. Our ability to increase our assets depends in large part on our ability to attract additional deposits at favorable rates. We intend to seek additional deposits by offering deposit products that are competitive with those offered by other financial institutions in our markets and by establishing personal relationships with our customers. We cannot assure that these efforts will be successful. Our inability to attract additional deposits at competitive rates could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Potential acquisitions create risks and may disrupt our business and dilute shareholder value.

We intend to continue to explore opportunities for growth through mergers and acquisitions. Acquiring other banks, businesses, or branches involves various risks commonly associated with acquisitions, including, among other things:

incurring substantial expenses in pursuing potential acquisitions without completing such acquisitions,

exposure to potential asset quality issues of the target company,

losing key clients as a result of the change of ownership,

the acquired business not performing in accordance with our expectations,

difficulties and expenses arising in connection with the integration of the operations of the acquired business with our operations,

difficulty in estimating the value of the target company,

potential exposure to unknown or contingent liabilities of the target company,

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- management needing to divert attention from other aspects of our business,
- potentially losing key employees of the acquired business,
- incurring unanticipated costs which could reduce our earnings per share,
- assuming potential liabilities of the acquired company as a result of the acquisition,
- potential changes in banking or tax laws or regulations that may affect the target company,
- potential disruption to our business, and
- an acquisition may dilute our earnings per share, in both the short and long term, or it may reduce our tangible capital ratios

Our growth and expansion may strain our ability to manage our operations and our financial resources.

Our financial performance and profitability depend on our ability to execute our corporate growth strategy. In addition to seeking deposit and loan and lease growth in our existing markets, we may pursue expansion opportunities in new markets. Continued growth, however, may present operating and other problems that could adversely affect our business, financial condition, results of operations and cash flows. Accordingly, there can be no assurance that we will be able to execute our growth strategy or maintain the level of profitability that we have recently experienced.

Our growth may place a strain on our administrative, operational and financial resources and increase demands on our systems and controls. This business growth may require continued enhancements to and expansion of our operating and financial systems and controls and may strain or significantly challenge them. In addition, our existing operating and financial control systems and infrastructure may not be adequate to maintain and effectively monitor future growth. Our continued growth may also increase our need for qualified personnel. We cannot assure you that we will be successful in attracting, integrating and retaining such personnel.

Risks Relating to Dividends and Our Common Stock

Our future ability to pay dividends is subject to restrictions.

Our ability to pay dividends to our shareholders is limited by California law and the policies and regulations of the FRB. The FRB has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the FRB s view that a bank holding company should pay cash dividends only to the extent that its net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company s capital needs, asset quality and overall financial condition. See Regulation and Supervision Restrictions on Dividends and Distributions.

As a holding company with no significant assets other than the Bank, our ability to continue to pay dividends depends in large part upon the Bank s ability to pay dividends to us. The Bank s ability to pay dividends or make other capital distributions to us is subject to the restrictions in the California Financial Code.

Our ability to pay dividends to our shareholder and the ability of the Bank to pay in dividends to us are by the requirements that the we and the Bank maintain a certain minimum amount of capital to be considered a well capitalized institution as well as a separate capital conservation buffer, as further described under Item 1 Supervision and Regulation Regulatory Capital Requirements in this report.

From time to time, we may become a party to financing agreements or other contractual arrangements that have the effect of limiting or prohibiting us or the Bank from declaring or paying dividends. Our holding company expenses and obligations with respect to our trust preferred securities and corresponding junior subordinated deferrable interest debentures issued by us may limit or impair our ability to declare or pay dividends.

Anti-takeover provisions and federal law may limit the ability of another party to acquire us, which could cause our stock price to decline.

Various provisions of our articles of incorporation and bylaws could delay or prevent a third party from acquiring us, even if doing so might be beneficial to our shareholders. These provisions provide for, among other things, specified actions that the Board of Directors shall or may take when an offer to merge, an offer to acquire all assets or a tender offer is received and the authority to issue preferred stock by action of the board of directors acting alone, without obtaining shareholder approval.

The BHC Act and the Change in Bank Control Act of 1978, as amended, together with federal regulations, require that, depending on the particular circumstances, either FRB approval must be obtained or notice must be furnished to the FRB and not disapproved prior to any person or entity acquiring control of a bank holding company such as TriCo. These provisions may prevent a merger or acquisition that would be attractive to shareholders and could limit the price investors would be willing to pay in the future for our common stock.

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The amount of common stock owned by, and other compensation arrangements with, our officers and directors may make it more difficult to obtain shareholder approval of potential takeovers that they oppose.

As of December 31, 2018, directors and executive officers beneficially owned approximately 10.37% of our common stock and our Employee Stock Ownership Plan (ESOP) owned approximately 3.9%. Agreements with our senior management also provide for significant payments under certain circumstances following a change in control. These compensation arrangements, together with the common stock beneficially owned by our board of directors, management, and the ESOP, could make it difficult or expensive to obtain majority support for shareholder proposals or potential acquisition proposals of us that our directors and officers oppose.

We may issue additional common stock or other equity securities in the future which could dilute the ownership interest of existing shareholders.

In order to maintain our capital at desired or regulatory-required levels, or to fund future growth, our board of directors may decide from time to time to issue additional shares of common stock, or securities convertible into, exchangeable for or representing rights to acquire shares of our common stock. The sale of these shares may significantly dilute your ownership interest as a shareholder. New investors in the future may also have rights, preferences and privileges senior to our current shareholders which may adversely impact our current shareholders.

Holders of our junior subordinated debentures have rights that are senior to those of our common stockholders.

We have supported our continued growth through the issuance of trust preferred securities from special purpose trusts and accompanying junior subordinated debentures. At December 31, 2018, we had outstanding trust preferred securities and accompanying junior subordinated debentures with face value of $62,889,000. Payments of the principal and interest on the trust preferred securities are conditionally guaranteed by us. Further, the accompanying junior subordinated debentures we issued to the trusts are senior to our shares of common stock. As a result, we must make payments on the junior subordinated debentures before we can pay any dividends on our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the junior subordinated debentures must be satisfied before any distributions can be made on our common stock.

Risks Relating to Systems, Accounting and Internal Controls

If we fail to maintain an effective system of internal and disclosure controls, we may not be able to accurately report our financial results or prevent fraud. As a result, current and potential shareholders could lose confidence in our financial reporting, which would harm our business and the trading price of our securities.

Effective internal control over financial reporting and disclosure controls and procedures are necessary for us to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. We continually review and analyze our internal control over financial reporting for Sarbanes-Oxley Section 404 compliance. As part of that process we may discover material weaknesses or significant deficiencies in our internal control as defined under standards adopted by the Public Company Accounting Oversight Board that require remediation. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company s annual or interim financial statements will not be prevented or detected in a timely basis. A significant deficiency is a deficiency or combination of deficiencies, in internal control over financial reporting that is less severe than material weakness, yet important enough to merit attention by those responsible for the oversight of the Company s financial reporting.

As a result of weaknesses that may be identified in our internal controls, we may also identify certain deficiencies in some of our disclosure controls and procedures that we believe require remediation. If we discover weaknesses, we will make efforts to improve our internal and disclosure controls. However, there is no assurance that we will be successful. Any failure to maintain effective controls or timely effect any necessary improvement of our internal and disclosure controls could harm operating results or cause us to fail to meet our reporting obligations, which could affect our ability to remain listed with Nasdaq. Ineffective internal and disclosure controls could also cause investors to lose confidence in our reported financial information, which would likely have a negative effect on the trading price of our securities.

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We rely on communications, information, operating and financial control systems technology and we may suffer an interruption in or breach of the security of those systems.

We rely heavily on our communications, information, operating and financial control systems technology to conduct our business. We rely on third party services providers to provide many of these systems. Any failure, interruption or breach in security of these systems could result in failures or interruptions in our customer relationship management, general ledger, deposit, servicing and loan origination systems. We cannot assure you that such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed by us or the third parties service providers on which we rely. The occurrence of any failures, interruptions or security breaches could damage our reputation, result in a loss of customers, expose us to possible financial liability, lead to additional regulatory scrutiny or require that we make expenditures for remediation or prevention. Any of these circumstances could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We rely on certain third-party vendors.

We are reliant upon certain third-party vendors to provide products and services necessary to maintain our day-to-day operations. Accordingly, our operations are exposed to risk that these vendors will not perform in accordance with applicable contractual arrangements or service level agreements. We maintain a system of policies and procedures designed to monitor vendor risks including, among other things, (i) changes in the vendor s organizational structure, (ii) changes in the vendor s financial condition, (iii) changes in existing products and services or the introduction of new products and services, and (iv) changes in the vendor s support for existing products and services. While we believe these policies and procedures help to mitigate risk, the failure of an external vendor to perform in accordance with applicable contractual arrangements or the service level agreements could be disruptive to our operations, which could have a material adverse effect on our business and our financial condition and results of operations.

Our business is highly reliant on technology and our ability and our third party service providers to manage the operational risks associated with technology.

Our business involves storing and processing sensitive consumer and business customer data. We depend on internal systems, third party service providers, and outsourced technology to support these data storage and processing operations. Despite our efforts to ensure the security and integrity of our systems, we may not be able to anticipate, detect or recognize threats to our systems or those of third party service providers or to implement effective preventive measures against all cyber security breaches. Cyberattack techniques change regularly and can originate from a wide variety of sources, including third parties who are or may be involved in organized crime or linked to terrorist organizations or hostile foreign governments, and such third parties may seek to gain access to systems directly or using equipment or security passwords belonging to employees, customers, third-party service providers or other users of our systems. These risks may increase in the future as we continue to increase our mobile and other internet-based product offerings and expands our internal usage of web-based products and applications. A cyber security breach or cyberattack could persist for a long time before being detected and could result in theft of sensitive data or disruption of our transaction processing systems.

Our inability to use or access these information systems at critical points in time could unfavorably impact the timeliness and efficiency of our business operations. A material breach of customer data security may negatively impact our business reputation and cause a loss of customers, result in increased expense to contain the event and/or require that we provide credit monitoring services for affected customers, result in regulatory fines and sanctions and/or result in litigation. Cyber security risk management programs are expensive to maintain and will not protect us from all risks associated with maintaining the security of customer data and our proprietary data from external and internal intrusions, disaster recovery and failures in the controls used by our vendors. In addition, Congress and the legislatures of states in which we operate regularly consider legislation that would impose more stringent data privacy requirements, resulting in increased compliance costs.

A failure to implement technological advances could negatively impact our business.

The banking industry is undergoing technological changes with frequent introductions of new technology-driven products and services. In addition to improving customer services, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, on our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources than we do to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or successfully market such products and services to our customers.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company is engaged in the banking business through 69 traditional branches, 9 in-store branches and 2 loan production offices in 29 counties in northern and central California including the counties of Butte, Colusa, Contra Costa, Del Norte, Fresno, Glenn, Humboldt, Kern, Lake, Lassen, Madera, Mendocino, Merced, Nevada, Placer, Sacramento, San Francisco, San Mateo, Santa Clara, Shasta, Siskiyou, Sonoma, Stanislaus, Sutter, Tehama, Trinity, Tulare, Yolo and Yuba. All offices are constructed and equipped to meet prescribed security requirements.

As of December 31, 2018, the Company owned 35 branch office locations, two administrative buildings that include branch locations, and seven other buildings that are used as either administrative, operational, or loan production offices. The Company leased 32 branch office locations, two loan production offices, and two administrative locations. Most of the leases contain multiple renewal options and provisions for rental increases, principally for changes in the cost of living index, property taxes and maintenance. All of the Company s existing facilities are considered to be adequate for the Company s present and future use. In the opinion of management, all properties are adequately covered by insurance. See Note 7 Premises and Equipment to the consolidated financial statements at Part II, Item 8 of this report.

ITEM 3. LEGAL PROCEEDINGS

Neither the Company nor its subsidiaries are a party to any pending legal proceedings that are material, nor is their property the subject of any other material pending legal proceeding at this time. All other legal proceedings are routine and arise out of the ordinary course of the Bank s business. None of those proceedings are currently expected to have a material adverse impact upon the Company s and the Bank s business, their consolidated financial position nor their operations in any material amount not already accrued, after taking into consideration any applicable insurance.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Common Stock Market Prices and Dividends

The Company s common stock is traded on the Nasdaq under the symbol TCBK. The following table shows the high and the low closing sale prices for the common stock for each quarter in the past two years, as reported by Nasdaq:

2018	High	Low
Fourth quarter	$ 38.45	$ 31.96
Third quarter	$ 39.63	$ 36.98
Second quarter	$ 40.22	$ 36.65
First quarter	$ 39.75	$ 36.35
2017		
Fourth quarter	$ 43.42	$ 37.86
Third quarter	$ 40.75	$ 33.60
Second quarter	$ 36.77	$ 33.05
First quarter	$ 37.38	$ 32.84

As of February 25, 2019 there were approximately 1,665 shareholders of record of the Company s common stock. On February 25, 2019, the closing market price was $40.11 per share.

The Company has paid cash dividends on its common stock in every quarter since March 1990, and it is currently the intention of the Board of Directors of the Company to continue payment of cash dividends on a quarterly basis. There is no assurance, however, that any dividends will be paid since they are dependent upon earnings, financial condition and capital requirements of the Company and the Bank. As of December 31, 2018 $98,438,000 was available for payment of dividends by the Bank to the Company, under applicable laws and regulations. See Note 26 Summary of Quarterly Results of Operations (unaudited) for the quarterly cash dividends paid by the Company in 2018 and 2017.

Issuer Repurchases of Common Stock

The Company has one previously announced stock repurchase plan under which it is currently authorized to purchase shares of its common stock. The table that follows provides additional information regarding this plan.

Announcement Date	Total shares approved for purchase	Total shares repurchased under the plan	Expiration date
8/21/2007	500,000	193,566	none

The following table shows the repurchases made by the Company or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Exchange Act) during the fourth quarter of 2018:

Period	(a) Total number of shares purchased [1]	(b) Average price paid per share	(c) Total number of shares purchased as of part of publicly announced plans or programs	(d) Maximum number of shares that may yet be purchased under the plans or programs [2]
October 1-31, 2018		$		333,400
November 1-30, 2018	49,173	$ 38.24		333,400
December 1-31, 2018	54,865	$ 35.87	26,966	306,434
Total	104,038	$ 38.37	26,966	306,434

(1) Includes shares purchased by the Company s Employee Stock Ownership Plan and pursuant to various other equity incentive plans. See Note 15 to the consolidated financial statements at Item 8 of Part II of this report, for a discussion of the Company s stock repurchased under equity compensation plans.

(2) Does not include shares that may be purchased by the Company s Employee Stock Ownership Plan and pursuant to various other equity incentive plans.

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The following graph presents the cumulative total yearly shareholder return from investing $100 on December 31, 2013, in each of TriCo common stock, the Russell 3000 Index, and the SNL Western Bank Index. The SNL Western Bank Index compiled by SNL Financial includes banks located in California, Oregon, Washington, Montana, Hawaii and Alaska with market capitalization similar to that of TriCo s. The amounts shown assume that any dividends were reinvested.

TriCo Bancshares

	Period Ending					
Index	**12/31/13**	**12/31/14**	**12/31/15**	**12/31/16**	**12/31/17**	**12/31/18**
TriCo Bancshares	100.00	88.68	100.55	127.93	144.27	131.15
Russell 3000 Index	100.00	112.56	113.10	127.50	154.44	146.34
SNL Western Bank Index	100.00	120.01	124.35	137.85	153.70	121.69

Equity Compensation Plans

The following table shows shares reserved for issuance for outstanding options, stock appreciation rights and warrants granted under our equity compensation plans as of December 31, 2018. All of our equity compensation plans have been approved by shareholders.

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, options, warrants and rights	(b) Weighted average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans not approved by shareholders		$	
Equity compensation plans approved by shareholders	343,000	$ 16.67	380,958
Total	343,000	$ 16.67	380,958

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ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data are derived from our consolidated financial statements. This data should be read in connection with our consolidated financial statements and the related notes located at Item 8 of this report.

TRICO BANCSHARES

Financial Summary

(In thousands, except per share amounts; unaudited)

Year ended December 31,	2018	2017	2016	2015	2014
Interest income	$ 228,218	$ 181,402	$ 173,708	$ 161,414	$ 121,115
Interest expense	(12,872)	(6,798)	(5,721)	(5,416)	(4,681)
Net interest income	215,346	174,604	167,987	155,998	116,434
(Provision for) benefit from loan losses	(2,583)	(89)	5,970	2,210	4,045
Noninterest income	49,284	50,021	44,563	45,347	34,516
Noninterest expense	(168,695)	(147,024)	(145,997)	(130,841)	(110,379)
Income before income taxes	93,352	77,512	72,523	72,714	44,616
Provision for income taxes	(25,032)	(36,958)	(27,712)	(28,896)	(18,508)
Net income	$ 68,320	$ 40,554	$ 44,811	$ 43,818	$ 26,108
Share Data					
Earnings per share:					
Basic	$ 2.57	$ 1.77	$ 1.96	$ 1.93	$ 1.47
Diluted	$ 2.54	$ 1.74	$ 1.94	$ 1.91	$ 1.46
Per share:					
Dividends paid	$ 0.70	$ 0.66	$ 0.60	$ 0.52	$ 0.44
Book value at period end	$ 27.20	$ 22.03	$ 20.87	$ 19.85	$ 18.41
Tangible book value at period end	$ 18.97	$ 19.01	$ 17.77	$ 16.81	$ 15.31
Average common shares outstanding	26,593	22,912	22,814	22,750	17,716
Average diluted common shares outstanding	26,880	23,250	23,087	22,998	17,923
Shares outstanding at period end	30,417	22,956	22,868	22,775	22,715
Financial Ratios					
During the period:					
Return on average assets	1.24%	0.89%	1.02%	1.11%	0.87%
Return on average equity	10.75%	8.10%	9.46%	10.04%	8.67%
Net interest margin(1)	4.30%	4.22%	4.23%	4.32%	4.17%
Efficiency ratio	60.79%	63.53%	66.89%	63.28%	70.92%
Average equity to average assets	11.52%	10.99%	10.84%	11.01%	10.00%
Dividend payout ratio	27.24%	37.30%	30.60%	27.20%	30.10%

At period end:					
Equity to assets	13.02%	10.62%	10.57%	10.71%	10.68%
Total capital to risk-adjusted assets	14.40%	14.07%	14.65%	15.09%	15.63%
Balance Sheet Data					
Total investments	$ 1,562,846	$ 1,245,727	$ 1,152,769	$ 1,131,415	$ 759,631
Total loans	4,022,014	3,015,165	2,759,593	2,522,937	2,282,524
Total assets	6,352,441	4,761,315	4,517,968	4,220,722	3,916,458
Total non-interest bearing deposits	1,760,580	1,368,218	1,275,745	1,155,695	1,083,900
Total deposits	5,366,466	4,009,131	3,895,560	3,631,266	3,380,423
Total other borrowings	15,839	122,166	17,493	12,328	9,276
Total junior subordinated debt	57,042	56,858	56,667	56,470	56,272
Total shareholders equity	827,373	505,808	477,347	452,116	418,172
Total tangible equity [2]	$ 577,121	$ 436,323	$ 406,473	$ 382,760	$ 347,659

(1) Fully taxable equivalent (FTE)

(2) Tangible equity is calculated by subtracting Goodwill and Other intangible assets from Total shareholders equity. Management believes that tangible equity is meaningful because it is a measure that the Company and investors commonly use to assess capital adequacy.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

As TriCo Bancshares has not commenced any business operations independent of the Bank, the following discussion pertains primarily to the Bank. Average balances, including such balances used in calculating certain financial ratios, are generally comprised of average daily balances for the Company. Within Management s Discussion and Analysis of Financial Condition and Results of Operations, interest income and net interest income are generally presented on a fully tax-equivalent (FTE) basis. The presentation of interest income and net interest income on a FTE basis is a common practice within the banking industry. Interest income and net interest income are shown on a non-FTE basis within Item 7 of this report, and a reconciliation of the FTE and non-FTE presentations is provided below in the discussion of net interest income.

Critical Accounting Policies and Estimates

The Company s discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP). The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those that materially affect the financial statements and are related to the adequacy of the allowance for loan losses, investments, mortgage servicing rights, fair value measurements, retirement plans, intangible assets and the fair value of acquired assets and liabilities. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The Company s policies related to estimates on the allowance for loan losses, other than temporary impairment of investments and impairment of intangible assets, can be found in Note 1 in the financial statements at Item 8 of this report.

Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances for the Company. Within Management s Discussion and Analysis of Financial Condition and Results of Operations, certain performance measures including interest income, net interest income, net interest yield, and efficiency ratio are generally presented on a fully tax-equivalent (FTE) basis. The Company believes the use of these non-generally accepted accounting principles (non-GAAP) measures provides additional clarity in assessing its results.

On July 6, 2018 the Bank completed its acquisition of FNBB originally announced on December 11, 2017 for an aggregate transaction value of $291,132,000. Through this business combination assets acquired, including core deposit intangibles of $27,605,000, totaled $1,306,539,000 and liabilities assumed totaled $1,172,068. Goodwill recognized totaled $156,661,000 and the merger expenses incurred during the year ended December 31, 2018 totaled $5,227,000.

From time to time the Bank may be presented with the opportunity to purchase individual or pools of loans in whole or in part outside of a transaction that would be considered a business combination. As of December 31, 2018 and 2017 the outstanding carrying value of purchased loans that were not acquired in a business combination totaled $56,023,000 and $69,599,000, respectively.

The Company refers to loans purchased or obtained in a business combination as purchased credit impaired (PCI) loans, or purchased not credit impaired (PNCI) loans. The Company refers to loans that it originates as originated loans. Additional information regarding the FNB Bancorp (FNBB) acquisition can be found in Note 2 in the financial statements at Item 8 of this report. Additional information regarding the definitions and accounting for originated, PNCI and PCI loans can be found in Notes 1, 2, 4 and 5 in the financial statements at Item 8 of this report, and under the heading *Asset Quality and Non-Performing Assets* below.

Geographical Descriptions

For the purpose of describing the geographical location of the Company s operations, the Company has defined northern California as that area of California north of, and including, Stockton to the east and San Jose to the west; central California as that area of the state south of Stockton and San Jose, to and including, Bakersfield to the east and San Luis Obispo to the west; and southern California as that area of the state south of Bakersfield and San Luis Obispo.

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Results of Operations

Overview

The following discussion and analysis is designed to provide a better understanding of the significant changes and trends related to the Company and the Bank s financial condition, operating results, asset and liability management, liquidity and capital resources and should be read in conjunction with the consolidated financial statements of the Company and the related notes at Item 8 of this report. Following is a summary of the components of net income for the periods indicated (dollars in thousands):

	Year ended December 31,		
	2018	2017	2016
Net interest income	$ 215,346	$ 174,604	$ 167,987
(Provision for) benefit from loan losses	(2,583)	(89)	5,970
Noninterest income	49,284	50,021	44,563
Noninterest expense	(168,695)	(147,024)	(145,997)
Provision for income taxes	(25,032)	(36,958)	(27,712)
Net income	$ 68,320	$ 40,554	$ 44,811
Net income per average fully-diluted share	$ 2.54	$ 1.74	$ 1.94
Net income as a percentage of average shareholders equity (ROAE)	10.75%	8.10%	9.46%
Net income as a percentage of average total assets (ROAA)	1.24%	0.89%	1.02%

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Net Interest Income

The Company s primary source of revenue is net interest income, which is the difference between interest income on earning assets and interest expense on interest-bearing liabilities. Following is a summary of the Company s net interest income for the periods indicated (dollars in thousands):

	Year ended December 31,		
	2018	2017	2016
Interest income	$ 228,218	$ 181,402	$ 173,708
Interest expense	(12,872)	(6,798)	(5,721)
Net interest income (not FTE)	215,346	174,604	167,987
FTE adjustment	1,304	2,499	2,329
Net interest income (FTE)	$ 216,650	$ 177,103	$ 170,316
Net interest margin (FTE)	4.30%	4.22%	4.23%
Acquired loans discount accretion:			
Purchased loan discount accretion	$ 5,271	$ 6,564	$ 7,399
Effect on average loan yield	0.14%	0.23%	0.29%
Effect of purchased loan discount accretion on net interest margin (FTE)	0.10%	0.16%	0.18%

Net interest income (FTE) for the year ended December 31, 2018 increased $39,547,000 (22.3%) to $216,650,000 from $177,103,000 during the year ended December 31, 2017. The increase in net interest income (FTE) was due primarily to a $705,839,000 (24.8%) increase in the average balance of loans to $3,548,498,000 and a $160,433,000 (13.1%) increase in the average balance of investment securities to $1,383,975,000. Increases in average yields for earnings assets from 4.39% during 2017 to 4.55% during 2018 were offset by increases in the average rates paid on interest-bearing liabilities, primarily time deposits and other borrowings. The average rate paid on time deposits increased by 38 basis points from 0.48% during 2017 to 0.86% during 2018. Additionally, the average rate paid on other borrowings increased by 104 basis points, from 0.74% during 2017 to 1.78% during 2018. Also offsetting increases in net interest income was an increase in the average balance of other borrowings, which increased by $113,120,000 (274%) from $41,252,000 during the year ended December 31, 2017 to $154,372,000 during the year ended December 31, 2018. Despite the increase in average balance of other borrowings during the 2018 year as compared to 2017, the outstanding balance of other borrowings decreased to $15,839,000 at December 31, 2018 as compared to $122,166,000 at December 31, 2017. The decrease in other borrowings of $106,327,000 was primarily made possible through deposit growth. See *Deposit Portfolio Composition* below. The $705,839,000 increase in average loan balances compared to the prior year was due primarily to the merger of FNBB during the third quarter of 2018. The increase in the average yield on loans and investments-taxable was due to increases in the prime lending rate and market rates on investment purchased.

Net interest income (FTE) for the year ended December 31, 2017 increased $6,787,000 (4.0%) to $177,103,000 from $170,316,000 during the year ended December 31, 2016. The increase in net interest income (FTE) was due primarily to a $212,930,000 (8.1%) increase in the average balance of loans to $2,842,659,000, and a 9 basis point increase in the average yield on investments taxable that were partially offset by a 21 basis point decrease in the average yield on loans, and a 3 basis point increase in the average rate paid on interest bearing liabilities. The $212,930,000 increase in average loan balances compared to the prior year was due primarily to net organic (i.e., not purchased) loan growth that was funded by deposit growth and the use of interest bearing cash at banks and other borrowings. The 9 basis point increase in the average yield on investments-taxable was due to increased market rates on investment securities purchased, and slower prepay speeds on the Company s mortgage backed securities (MBS) investments in 2017 compared to 2016. Slower prepay speeds for MBS investments with net purchase premiums result in higher yields, as was the case for the Company s MBS investments during 2017 compared to 2016. Accounting for 12 basis points of the 21 point decrease in the average yield on loans from 2016 to 2017 was the recovery of $2,311,000 of loan interest income from the sale of loans in 2016. A decrease in purchased loan discounts accretion accounted for 5 basis points of the 21 point decrease in average loan yield, and the remaining 4 basis point decrease in average loan yield was due primarily to lower average yields on new loans compared to existing loans, primarily during the first half of 2017 that was somewhat alleviated in the second half of 2017 and included the effects of 25 basis point increases in the Federal Funds Rate and the Prime Lending Rate during each of December 2016, and March, June, and December 2017. The 3 basis point increase in the average rate paid on interest-bearing liabilities was due primarily to increased rates paid on time deposits, other borrowings, and junior subordinated debt.

For more information related to loan interest income, including loan purchase discount accretion, see the *Summary of Average Balances, Yields/Rates and Interest Differential* and Note 26 to the consolidated financial statements at Part II, Item 8 of this report. The Yield and Volume/Rate tables shown below are useful in illustrating and quantifying the developments that affected net interest income during 2018 and 2017.

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Summary of Average Balances, Yields/Rates and Interest Differential   Yield Tables

The following tables present, for the periods indicated, information regarding the Company s consolidated average assets, liabilities and shareholders   equity, the amounts of interest income from average earning assets and resulting yields, and the amount of interest expense paid on interest-bearing liabilities. Average loan balances include nonperforming loans. Interest income includes proceeds from loans on nonaccrual loans only to the extent cash payments have been received and applied to interest income. Yields on securities and certain loans have been adjusted upward to reflect the effect of income thereon exempt from federal income taxation at the statutory tax rate applicable during the period presented (dollars in thousands):

	Year ended December 31,								
	2018			2017			2016		
	Average Balance	Interest Income/ Expense	Rates Earned /Paid	Average Balance	Interest Income/ Expense	Rates Earned /Paid	Average Balance	Interest Income/ Expense	Rate Earne /Paic
ets:									
ns	$ 3,548,498	$ 186,117	5.24%	$ 2,842,659	$ 146,794	5.16%	$ 2,629,729	$ 141,086	5.3
estment securities taxable	1,241,829	35,702	2.87%	1,087,302	29,096	2.68%	1,064,410	27,578	2.5
estment securities nontaxable(1)	142,146	5,649	3.97%	136,240	6,664	4.89%	126,099	6,210	4.9
al investments	1,383,975	41,351	2.99%	1,223,542	35,760	2.92%	1,190,509	33,788	2.8
h at Federal Reserve and other ks	109,352	2,054	1.88%	126,432	1,347	1.07%	205,263	1,163	0.5
al interest-earning assets	5,041,825	229,522	4.55%	4,192,633	183,901	4.39%	4,025,501	176,037	4.3
er assets	474,301			361,872			347,521		
al assets	$ 5,516,126			$ 4,554,505			$ 4,373,022		
bilities and shareholders equity:									
erest-bearing demand deposits	$ 1,075,331	945	0.09%	$ 939,516	744	0.08%	$ 878,436	441	0.0
ings deposits	1,610,202	2,803	0.17%	1,368,705	1,683	0.12%	1,344,304	1,685	0.1
ne deposits	378,058	3,248	0.86%	317,724	1,531	0.48%	342,511	1,357	0.4
al interest-bearing deposits	3,063,591	6,996	0.23%	2,625,945	3,958	0.15%	2,565,251	3,483	0.1
er borrowings	154,372	2,745	1.78%	41,252	305	0.74%	18,873	9	0.0
ior subordinated debt	56,950	3,131	5.50%	56,762	2,535	4.47%	56,566	2,229	3.9
al interest-bearing liabilities	3,274,913	12,872	0.39%	2,723,959	6,798	0.25%	2,640,690	5,721	0.2
ninterest-bearing deposits	1,531,383			12,62,592			11,93,297		
er liabilities	74,113			67,301			65,206		
reholders equity	635,717			500,653			473,829		
al liabilities and shareholders ity	$ 5,516,126			$ 4,554,505			$ 4,373,022		

interest spread (2)		4.16%		4.14%		4.1
interest income and interest rgin (3)	$ 216,650	4.30%	$ 177,103	4.22%	$ 170,316	4.2

(1) The fully-taxable equivalent (FTE) adjustment for interest income of non-taxable investment securities was $1,304, $2,499 and $2,329 for the years ended December 31, 2018, 2017 and 2016, respectively.

(2) Net interest spread represents the average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(3) Net interest margin is computed by dividing net interest income by total average earning assets.

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Summary of Changes in Interest Income and Expense due to Changes in Average Asset and Liability Balances and Yields Earned and Rates Paid Volume/Rate Tables

The following table sets forth a summary of the changes in the Company s interest income and interest expense from changes in average asset and liability balances (volume) and changes in average interest rates for the periods indicated. Changes applicable to both rate and volume have been included in the rate variance. Amounts are calculated on a fully taxable equivalent basis:

	2018 over 2017			2017 over 2016		
	Volume	Rate	Total	Volume	Rate	Total
Increase in interest income:						
Loans	$ 36,421	$ 2,902	$ 39,323	$ 11,434	$ (5,726)	$ 5,708
Investment securities taxable	4,141	2,465	6,606	593	925	1,518
Investment securities nontaxable	289	(1,304)	(1,015)	499	(45)	454
Cash at Federal Reserve and other banks	(183)	890	707	(449)	633	184
Total interest-earning assets	40,668	4,953	45,621	12,077	(4,213)	7,864
Increase in interest expense:						
Interest-bearing demand deposits	109	92	201	31	272	303
Savings deposits	290	830	1,120	32	(34)	(2)
Time deposits	290	1,427	1,717	(99)	273	174
Other borrowings	837	1,603	2,440	11	285	296
Junior subordinated debt	8	588	596	8	298	306
Total interest-bearing liabilities	1,534	4,540	6,074	(17)	1,094	1,077
Increase in net interest income	$ 39,134	$ 413	$ 39,547	$ 12,094	$ (5,307)	$ 6,787

The change in volume of interest earning assets and interest bearing liabilities during the year ended December 31, 2018 was significantly impacted by the acquisition of FNBB which was completed on July 6, 2018. The following is a summary of the certain consolidated assets and deposits as of the dates indicated:

Ending balances	As of December 31,			Acquired	Organic	Organic
($ s in thousands)	2018	2017	$ Change	Balances	$ Change	% Change
Total assets	$ 6,352,441	$ 4,761,315	$ 1,591,126	$ 1,463,200	$ 127,926	2.69%
Total loans	4,022,014	3,015,165	1,006,849	834,683	172,166	5.71%
Total investments	1,580,096	1,262,683	317,413	335,667	(18,254)	(1.45%)
Total deposits	$ 5,366,466	$ 4,009,131	$ 1,357,335	$ 991,935	$ 365,400	9.11%

Annual average balances	As of December 31,			Average Acquired	Organic	Organic %
($ s in thousands)	2018	2017	$ Change	Balances *	$ Change	Change
Total assets	$ 5,516,126	$ 4,554,505	$ 961,621	$ 713,561	$ 248,060	5.45%

Total loans	3,548,498	2,842,659	705,839	407,051	298,788	10.51%
Total investments	1,383,975	1,223,542	160,433	163,695	(3,262)	(0.27%)
Total deposits	$ 4,594,974	$ 3,888,537	$ 706,437	$ 483,738	$ 222,699	5.73%

* Average acquired amounts calculated by computing the annualized balance outstanding during the year based on the acquisition date of July 6, 2018 and a 365 day calendar year.

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Provision for Loan Losses

The provision for loan losses during any period is the sum of the allowance for loan losses required at the end of the period and any loan charge offs during the period, less the allowance for loan losses required at the beginning of the period, and less any loan recoveries during the period. See the Tables labeled *Allowance for loan losses year ended December 31, 2018 and 2017* at Note 5 in Item 8 of Part II of this report for the components that make up the provision for loan losses for the years ended December 31, 2018 and 2017.

The Company provided $2,583,000 for loan losses during the year ended December 31, 2018 versus an $89,000 provision for loan losses during the year ended December 31, 2017. The increase in provision for loan losses for the year ended December 31, 2018 compared to the year ended December 31, 2017 was due primarily to estimated losses related to the Camp Fire that occurred in the 4th quarter of 2018. As of December 31, 2018, the Company had established reserves totaling $3,250,000 related to the Camp Fire. As shown in the Table labeled *Allowance for Loan Losses year ended December 31, 2018* at Note 5 in Item 8 of Part II of this report residential and commercial real estate loans, other consumer loans, commercial, and construction loans experienced provision for loan losses during the year ended December 31, 2018. The level of provision for loan losses of each loan category during the year ended December 31, 2018 was due primarily to increases in the required allowance for loan losses as of December 31, 2018 when compared to the required allowance for loan losses as of December 31, 2017 less net charge-offs during the year ended December 31, 2018. All categories of loans except consumer home equity lines of credit and commercial loans experienced an increase in the required allowance for loan losses during the year ended December 31, 2018. These increases in required allowance for loan losses were due primarily to the estimated losses related to the Camp Fire, as mentioned above, which were offset by improvements in historical loss factors and decreases in nonperforming loans as a total percentage of loans. Total net charge-offs for the year ended December 31, 2018 were $324,000 as compared to total net charge offs for the year ended December 31, 2017 of $2,269,000. Total nonperforming loans decreased from 0.81% of total loans at December 31, 2017 to 0.68% of total loans at December 31, 2018. For details of the change in nonperforming loans during the year ended December 31, 2017 see the Tables, and associated narratives, labeled *Changes in nonperforming assets during the year ended December 31, 2018* and *Changes in nonperforming assets during the three months ended December 31, 2018* under the heading *Asset Quality and Non-Performing Assets* below.

The Company provided $89,000 for loan losses during the year ended December 31, 2017 versus a $5,970,000 reversal of provision for loan losses during the year ended December 31, 2016. The increase in provision for loan losses for the year ended December 31, 2017 compared to the year ended December 31, 2016 was due primarily to an increase of $4,266,000 (21.2%) in nonperforming loans during 2017 compared to a $16,991,000 (45.8%) decrease in nonperforming loans during 2016, and net charge-offs of $2,269,000 during 2017 compared to net recoveries of $2,462,000 during 2016. As shown in the Table labeled *Allowance for Loan Losses year ended December 31, 2017* at Note 5 in Item 8 of Part II of this report residential and commercial real estate loans, home equity lines of credit, home equity loans, and commercial construction loans experienced a reversal of provision for loan losses during the year ended December 31, 2017. The level of provision, or reversal of provision, for loan losses of each loan category during the year ended December 31, 2017 was due primarily to a decrease in the required allowance for loan losses as of December 31, 2017 when compared to the required allowance for loan losses as of December 31, 2016 less net charge-offs during the year ended December 31, 2017. All categories of loans except C & I loans experienced a decrease in the required allowance for loan losses during the year ended December 31, 2017. These decreases in required allowance for loan losses were due primarily to improvements in estimated cash flows and collateral values for impaired loans, and reductions in historical loss factors that were offset by increases in loan balances and nonperforming loans in some loan categories. For details of the change in nonperforming loans during the year ended December 31, 2017 see the Tables, and associated narratives, labeled *Changes in nonperforming assets during the year ended December 31, 2017* and *Changes in nonperforming assets during the three months ended December 31,* *2017* under the heading *Asset Quality and Non-Performing Assets* below.

The provision for loan losses related to Originated and PNCI loans is based on management s evaluation of inherent risks in these loan portfolios and a corresponding analysis of the allowance for loan losses. The provision for loan losses related to PCI loan portfolio is based on changes in estimated cash flows expected to be collected on PCI loans. Additional discussion on loan quality, our procedures to measure loan impairment, and the allowance for loan losses is provided under the heading *Asset Quality and Non-Performing Assets* below.

Management re-evaluates the loss ratios and other assumptions used in its calculation of the allowance for loan losses for its Originated and PNCI loan portfolios on a quarterly basis and makes changes as appropriate based upon, among other things, changes in loss rates experienced, collateral support for underlying loans, changes and trends in the economy, and changes in the loan mix. Management also re-evaluates expected cash flows used in its accounting for its PCI loan portfolio, including any required allowance for loan losses, on a quarterly basis and makes changes as appropriate based upon, among other things, changes in loan repayment experience, changes in loss rates experienced, and collateral support for underlying loans.

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Noninterest Income

The following table summarizes the Company s noninterest income for the periods indicated (dollars in thousands):

	Year Ended December 31,		
	2018	2017	2016
ATM and interchange fees	$ 18,249	$ 16,727	$ 15,859
Service charges on deposit accounts	15,467	16,056	14,365
Other service fees	2,852	3,282	3,121
Mortgage banking service fees	2,038	2,076	2,065
Change in value of mortgage loan servicing rights	(146)	(718)	(2,184)
Total service charges and fees	38,460	37,423	33,226
Commissions on sale of non-deposit investment products	3,151	2,729	2,329
Increase in cash value of life insurance	2,718	2,685	2,717
Gain on sale of loans	2,371	3,109	4,037
Lease brokerage income	678	782	711
Sale of customer checks	449	372	408
Gain on sale of foreclosed assets	408	711	262
Gain on sale of investment securities	207	961	
Loss on disposal of fixed assets	(185)	(142)	(147)
Loss on marketable equity securities	(64)		
Other	1,091	1,391	1,020
Total other noninterest income	10,824	12,598	11,337
Total noninterest income	$ 49,284	$ 50,021	$ 44,563

Noninterest income decreased $737,000 (1.5%) to $49,284,000 in 2018 compared to $50,021,000 in 2017. The decrease in noninterest income was due primarily to an decrease in service charges on deposit accounts and other service fees of $1,019,000 (5.3%) to $18,319,000, a decrease in gain on sale of loans of $738,000 (23.7%) to $2,371,000, a decrease in gain on sale of investment securities of $754,000 (78.5%), which were partially offset by an increase of $1,522,000 (9.1%) increase in ATM fees and interchange revenue, and a $422,000 (15.5%) increase in commissions on non-depository products. The $1,522,000 increase in ATM fees and interchange revenue was due primarily to the Company s continued focus in this area, and growth in electronic payments volume. The $738,000 decrease in gain on sale of loans was due primarily to reduced residential mortgage refinance activity in 2018 compared to 2017.

Noninterest income increased $5,458,000 (12.2%) to $50,021,000 in 2017 compared to 2016. The increase in noninterest income was due primarily to an increase in service charges on deposit accounts of $1,691,000 (11.8%) to $16,056,000, an increase in ATM fees and interchange revenue of $868,000 (5.5%) to $16,727,000, an increase of $1,466,000 in change in value of mortgage servicing rights, a $961,000 increase in gain on sale of investments, which were partially offset by a $928,000 (23.0%) decrease in gain on sale of loans, and a $371,000 (36.4%) decrease in other noninterest income. The $1,691,000 increase in service charges on deposit accounts was due primarily to increased fee generation from both consumer and business checking customers. The $868,000 increase in ATM fees and interchange revenue was due primarily to the Company s continued focus in this area, and growth in electronic payments volume. The $1,466,000 improvement in change in value of mortgage servicing rights (MSRs) was due primarily to a decrease in the market rate of return for such servicing rights thus increasing their value at December 31, 2017 compared to December 31, 2016. The $961,000 gain on sale of investment securities was due to the Company s decision to sell $24,796,000 of investment securities during the three months ended September 30, 2017 while no investment sales were made during 2016. The $983,000 increase in change in indemnification agreement was the result of the termination of its indemnification agreements with the FDIC during 2017. The $928,000 decrease in gain on sale of loans was due primarily to reduced residential mortgage refinance activity in 2017 compared to 2016.

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Noninterest Expense

The following table summarizes the Company s other noninterest expense for the periods indicated (dollars in thousands):

	Year Ended December 31,		
	2018	2017	2016
Base salaries, net of deferred loan origination costs	$ 62,422	$ 54,589	$ 53,169
Incentive compensation	11,147	9,227	8,872
Benefits and other compensation costs	20,373	19,114	18,683
Total salaries and benefits expense	93,942	82,930	80,724
Occupancy	12,139	10,894	10,139
Data processing and software	11,021	10,448	8,846
Equipment	6,651	7,141	6,597
ATM and POS network charges	5,271	4,752	4,999
Merger and acquisition expense	5,227	530	784
Advertising	4,578	4,101	3,829
Professional fees	3,546	3,745	5,409
Intangible amortization	3,499	1,389	1,377
Telecommunications	3,023	2,713	2,749
Regulatory assessments and insurance	1,906	1,676	2,105
Courier service	1,287	1,035	998
Operational losses	1,260	1,394	1,564
Postage	1,154	1,296	1,603
Legal settlement			1,450
Foreclosed assets expense	382	231	266
Provision for foreclosed asset losses	89	162	140
Other miscellaneous expense	13,720	12,587	12,418
Total other noninterest expense	74,753	64,094	65,273
Total noninterest expense	$ 168,695	$ 147,024	$ 145,997
Average full-time equivalent staff	1,071	1,000	999

Salary and benefit expenses increased $11,012,000 (13.3%) to $93,942,000 during the twelve months ended December 31, 2018 compared to $82,930,000 during the prior twelve months ended December 31, 2017. Base salaries, net of deferred loan origination costs increased $7,833,000 (14.3%) to $62,422,000.The increase in base salaries was due primarily to a 7.1% increase in average full time equivalent employees to 1,071 from 1,000 in the prior year-to-date period. Also affecting the increase in base salaries were annual merit increases and a higher wage base per employee resulting from the employees associated with the FNBB merger transaction due to the Bay Area region s higher cost of living. Commissions and incentive compensation increased $1,920,000 (20.8%) to $11,147,000 during 2018 compared to 2017 primarily due to organic growth of loans and deposits. Benefits & other compensation expense increased $1,259,000 (6.6%) to $20,373,000 during the year ended December 31, 2018 due primarily to increases in the average full time equivalent employees, as mentioned above, and to a lesser extent, annual increases in healthcare and benefits costs.

Other noninterest expense increased $10,659,000 (16.6%) to $74,753,000 during the year ended December 31, 2018 compared to the year ended December 31, 2017.The increase in other noninterest expense was due primarily to increased costs related to the merger of FNBB. Highlighting some of those increases were merger expenses, increases in intangible amortization, occupancy, data processing, and advertising, which increased by $4,697,000, $2,110,000, $1,245,000, $573,000, and $477,000, respectively, as compared to the prior year. The increases in noninterest expenses were partially offset by decreased equipment expenses and professional fees of $490,000 and $199,000, respectively.

Salary and benefit expenses increased $2,206,000 (2.7%) to $82,930,000 during the year ended December 31, 2017 compared to the year ended December 31, 2016. Base salaries, incentive compensation and benefits & other compensation expense increased $1,420,000 (2.7%), 355,000 (4.0%), and 431,000 (2.3%), respectively, to $54,589,000, $9,227,000 and $19,114,000, respectively, during the year ended December 31, 2017. The increases in these categories of salary and benefits expense are primarily due to annual merit increases. The average number of full-time equivalent staff increased 1 (0.1%) from 999 during the year ended December 31, 2016 to 1,000 for the year ended December 31, 2017.

Other noninterest expense decreased $1,179,000 (1.8%) to $64,094,000 during the year ended December 31, 2017 compared to the year ended December 31, 2016. The decrease in other noninterest expense was due primarily to a $1,664,000 (30.8%) decrease in professional fees, and a $1,450,000 decrease in litigation contingent liability expense, that were partially offset by a $1,602,000 (18.1%) increase in data processing and software expense, a $755,000 (7.4%) increase in occupancy expense, and a $544,000 (8.2%) increase in equipment expense. The $1,664,000 decrease in professional fees was due primarily to consulting fees related to system conversions during 2016. The $1,450,000 decrease in litigation contingent liability expense was due to a single specific liability incurred during 2016. The $1,602,000 increase in data processing and software expense was due primarily to data system outsourcing and enhancements that occurred throughout 2016, and early 2017. The $755,000 increase in occupancy expense was due primarily to increases in building maintenance and remodel, and lease expense. The $544,000 increase in equipment expense was due primarily to increased depreciation expense related to technology and other equipment, and furniture.

Income Taxes

The provisions for income taxes applicable to income before taxes for the years ended December 31, 2018, 2017 and 2016 differ from amounts computed by applying the statutory Federal income tax rates to income before taxes. The effective tax rate and the statutory federal income tax rate are reconciled as follows:

	Year Ended December 31,		
	2018	2017	2016
Federal statutory income tax rate	21.0%	35.0%	35.0%
State income taxes, net of federal tax benefit	8.6	6.9	6.8
Tax Cuts and Jobs Act impact of federal rate change		9.6	
Tax-exempt interest on municipal obligations	(1.0)	(1.9)	(1.8)
Tax-exempt life insurance related income	(0.6)	(1.3)	(1.3)
Low income housing tax credits	(2.2)	(2.3)	(1.3)
Low income housing tax credit amortization	2.0	2.1	0.8
Equity compensation	(0.5)	(1.2)	
Non-deductible joint beneficiary agreement expense	0.1	0.1	0.1
Non-deductible merger expenses	0.2	0.2	
Other	(0.8)	0.5	(0.1)
Effective Tax Rate	26.8%	47.7%	38.2%

On December 22, 2017, President Donald Trump signed into law H.R.1 , commonly known as the Tax Cuts and Jobs Act , which among other items reduces the Federal corporate tax rate from 35% to 21% effective January 1, 2018. This decrease in the Federal corporate tax rate had a positive impact on the Company s net income beginning January 1, 2018. However, the enactment of the law during 2017 required the Company to re-measure its deferred tax assets and liabilities as of December 31, 2017. The Company concluded that this caused the Company s net deferred tax asset to be reduced, and Federal income tax expense to be increased by $7,416,000 during the fourth quarter of 2017. Additionally, amortization expense of the low income housing tax credit investments was accelerated by $226,000.

The effective tax rate on income was 26.8%, 47.7%, and 38.2% in 2018, 2017, and 2016, respectively. The effective tax rate was greater than the Federal statutory rates of 21% in 2018 and 35% in 2017 and 2016 due to the combination of state tax expenses of 8.6% in 2018, 6.9% in 2017, and 6.8% in 2016. Tax provision expense for 2017 was increased further by $7,416,000 due to the remeasurement of the Company s net deferred tax asset resulting from the Federal tax law change. These increases in tax expense were partially offset by Federal tax-exempt investment income of $4,345,000, $4,165,000, and $3,881,000, respectively, Federal and State tax-exempt income of $2,718,000, $2,792,000, and $2,955,000, respectively, from increase in cash value and gain on death benefit of life insurance, low income housing tax credits and losses, net of amortization of $179,000, $142,000, and $197,000, respectively, and equity compensation excess tax benefits of $499,000, $916,000, and $0, respectively. The low income housing tax credits and the equity compensation excess tax benefits represent direct reductions in tax expense. The items noted above resulted in an effective combined Federal and State income tax rate that differed from the combined Federal and State statutory income tax rate of approximately 29.6% during 2018 and 42.0% during 2017 and 2016.

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Financial Condition

Investment Securities

The following table presents the available for sale debt securities and marketable equity investment securities portfolio by major type as of the dates indicated:

	Year ended December 31,				
(dollars in thousands)	2018	2017	2016	2015	2014
Marketable equity securities	$ 2,874	$ 2,938	$ 2,938	$ 2,985	$ 3,002
Debt securities available for sale:					
Obligations of U.S. government and agencies	$ 629,981	$ 604,789	$ 429,678	$ 313,682	$ 75,120
Obligations of states and political subdivisions	126,072	123,156	117,617	88,218	3,175
Corporate bonds	4,478				1,908
Asset backed securities	354,505				
Total debt securities available for sale	$ 1,115,036	$ 727,945	$ 547,295	$ 401,900	$ 80,203
Debt securities held to maturity:					
Obligations of U.S. government agencies	$ 430,343	$ 500,271	$ 597,982	$ 711,994	$ 660,836
Obligations of states and political subdivisions	14,593	14,573	14,554	14,536	15,590
Total debt securities held to maturity	$ 444,936	514,844	$ 612,536	$ 726,530	$ 676,426

Debt securities available for sale increased $387,091,000 to $1,115,036,000 as of December 31, 2018, compared to December 31, 2017. This increase is attributable to purchases of $436,678,000 that were primarily funded with proceeds from sales of securities of $293,279,000 acquired in the FNBB merger, maturities and principal repayments of $73,014,000, a decrease in fair value of investments securities available for sale of $17,267,000 and amortization of net purchase price premiums of $1,541,000.

Debt securities held to maturity decreased $69,908,000 to $444,936,000 as of December 31, 2018, compared to December 31, 2017. This decrease is attributable to principal repayments of $68,937,000 and amortization of net purchase price discounts/premiums of $971,000.

Additional information about the investment portfolio is provided in Note 3 in the financial statements at Item 8 of Part II of this report.

Restricted Equity Securities

Restricted equity securities were $17,250,000 and $16,956,000 at December 31, 2018 and December 31, 2017, respectively. The entire balance of restricted equity securities at December 31, 2018 and 2017 represents the Bank s investment in the Federal Home Loan Bank of San Francisco (FHLB).

FHLB stock is carried at par and does not have a readily determinable fair value. While technically these are considered equity securities, there is no market for the FHLB stock. Therefore, the shares are considered as restricted investment securities. Management periodically evaluates FHLB stock for other-than-temporary impairment. Management s determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB.

As a member of the FHLB system, the Bank is required to maintain a minimum level of investment in FHLB stock based on specific percentages of its outstanding mortgages, total assets, or FHLB advances. The Bank may request redemption at par value of any stock in excess of the minimum required investment. Stock redemptions are at the discretion of the FHLB.

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Loans

The Bank concentrates its lending activities in four principal areas: real estate mortgage loans (residential and commercial loans), consumer loans, commercial loans (including agricultural loans), and real estate construction loans. The interest rates charged for the loans made by the Bank vary with the degree of risk, the size and maturity of the loans, the borrower s relationship with the Bank and prevailing money market rates indicative of the Bank s cost of funds.

The majority of the Bank s loans are direct loans made to individuals, farmers and local businesses. The Bank relies substantially on local promotional activity and personal contacts by bank officers, directors and employees to compete with other financial institutions. The Bank makes loans to borrowers whose applications include a sound purpose, a viable repayment source and a plan of repayment established at inception and generally backed by a secondary source of repayment.

Loan Portfolio Composition

The following table shows the Company s loan balances, including net deferred loan fees, at the dates indicated:

	Year ended December 31,				
(dollars in thousands)	2018	2017	2016	2015	2014
Real estate mortgage	$ 3,143,100	$ 2,300,322	$ 2,057,824	$ 1,811,832	$ 1,615,359
Consumer	418,982	356,874	362,303	395,283	417,084
Commercial	276,548	220,412	217,047	194,913	174,945
Real estate construction	183,384	137,557	122,419	120,909	75,136
Total loans	$ 4,022,014	$ 3,015,165	$ 2,759,593	$ 2,522,937	$ 2,282,524

The following table shows the Company s loan balances, including net deferred loan fees, as a percentage of total loans at the dates indicated:

	Year ended December 31,				
(dollars in thousands)	2018	2017	2016	2015	2014
Real estate mortgage	78.1%	76.3%	74.6%	71.8%	70.8%
Consumer	10.4%	11.8%	13.1%	15.7%	18.2%
Commercial	6.9%	7.3%	7.9%	7.7%	7.7%
Real estate construction	4.6%	4.6%	4.4%	4.8%	3.3%
Total loans	100%	100%	100%	100%	100%

At December 31, 2018 loans, including net deferred loan costs, totaled $4,022,014,000 which was a 33.4% ($1,006,849,000) increase over the balances at the end of 2017. Included in the increase in loans in 2018 is acquired loans, net of discount, of $834,683,000 from the acquisition of FNBB.

At December 31, 2017 loans, including net deferred loan costs, totaled $3,015,165,000 which was a 9.3% ($255,572,000) increase over the balances at the end of 2016.

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Asset Quality and Nonperforming Assets

Nonperforming Assets

The following tables set forth the amount of the Bank s nonperforming assets as of the dates indicated. Performing nonaccrual loans are loans that may be current for both principal and interest payments, or are less than 90 days past due, but for which payment in full of both principal and interest is not expected, and are not well secured and in the process of collection:

	December 31,				
(dollars in thousands)	2018	2017	2016	2015	2014
Performing nonaccrual loans	$ 22,689	$ 20,937	$ 17,677	$ 31,033	$ 45,072
Nonperforming nonaccrual loans	4,805	3,176	2,451	6,086	2,517
Total nonaccrual loans	27,494	24,113	20,128	37,119	47,589
Originated and PNCI loans 90 days past due and still accruing		281			
Total nonperforming loans	27,494	24,394	20,128	37,119	47,589
Foreclosed assets	2,280	3,226	3,986	5,369	4,894
Total nonperforming assets	$ 29,774	$ 27,620	$ 24,114	$ 42,488	$ 52,483
U.S. government, including its agencies and its government-sponsored agencies, guaranteed portion of nonperforming loans	$ 1,173	$ 358	$ 911	$ 28	$ 123
Nonperforming assets to total assets	0.47%	0.58%	0.53%	1.01%	1.34%
Nonperforming loans to total loans	0.68%	0.81%	0.73%	1.47%	2.08%
Allowance for loan losses to nonperforming loans	119%	124%	161%	97%	77%
Allowance for loan losses, unamortized loan fees, and discounts to loan principal balances owed	2.11%	1.77%	2.09%	2.69%	3.31%

	December 31, 2018			
(dollars in thousands)	Originated	PNCI	PCI	Total
Performing nonaccrual loans	$ 16,573	$ 1,269	$ 4,847	$ 22,689
Nonperforming nonaccrual loans	2,843	1,589	373	4,805
Total nonaccrual loans	19,416	2,858	5,220	27,494
Originated and PNCI loans 90 days past due and still accruing				
Total nonperforming loans	19,416	2,858	5,220	27,494
Foreclosed assets	1,490		790	2,280
Total nonperforming assets	$ 20,906	$ 2,858	$ 6,010	$ 29,774

U.S. government, including its agencies and its government-sponsored agencies, guaranteed portion of nonperforming loans	$ 800	$	$ 373	$ 1,173
Nonperforming assets to total assets	0.34%	0.04%	0.09%	0.47%
Nonperforming loans to total loans	0.65%	0.28%	36.70%	0.68%
Allowance for loan losses to nonperforming loans	164%	23.3%	2.34%	118.51%
Allowance for loan losses, unamortized loan fees, and discounts to loan principal balances owed	1.39%	3.48%	33.69%	2.11%

	December 31, 2017			
(dollars in thousands)	Originated	PNCI	PCI	Total
Performing nonaccrual loans	$ 12,942	$ 1,305	$ 6,690	$ 20,937
Nonperforming nonaccrual loans	2,520	158	498	3,176
Total nonaccrual loans	15,462	1,463	7,188	24,113
Originated loans 90 days past due and still accruing		281		281
Total nonperforming loans	15,462	1,744	7,188	24,394
Foreclosed assets	1,836		1,390	3,226
Total nonperforming assets	$ 17,298	$ 1,744	$ 8,578	$ 27,620
U.S. government, including its agencies and its government-sponsored agencies, guaranteed portion of nonperforming loans	$ 358	$	$	$ 358
Nonperforming assets to total assets	0.36%	0.04%	0.18%	0.58%
Nonperforming loans to total loans	0.57%	0.56%	46.20%	0.81%
Allowance for loan losses to nonperforming loans	188%	53.27%	3.78%	124%
Allowance for loan losses, unamortized loan fees, and discounts to loan principal balances owed	1.32%	2.22%	34.05%	1.77%

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Changes in nonperforming assets during the year ended December 31, 2018

The following table shows the activity in the balance of nonperforming assets for the year ended December 31, 2018:

(in thousands):	Balance at December 31, 2018	Additions	Advances/ Paydowns, net	Charge-offs/ Write-downs	Transfers to Foreclosed Assets	Category Changes	Balance at December 31, 2017
Real estate mortgage:							
Residential	$ 2,854	$ 2,007	$ (1,793)	$ (51)	$	$ (1,048)	$ 3,739
Commercial	15,046	6,204	(3,455)	(15)	(580)	1,072	11,820
Consumer							
Home equity lines	2,749	3,048	(3,401)	(104)	(49)	(227)	3,482
Home equity loans	2,963	2,434	(724)	(51)	(633)	301	1,636
Other consumer	7	114	(31)	(87)			11
Commercial	3,875	3,209	(1,975)	(967)		(98)	3,706
Construction:							
Residential							
Commercial							
Total nonperforming loans	27,494	17,016	(11,379)	(1,275)	(1,262)		24,394
Foreclosed assets	2,280		(2,119)	(89)	1,262		3,226
Total nonperforming assets	$ 29,774	$ 17,016	$ (13,498)	$ (1,364)	$	$	$ 27,620

The table above does not include deposit overdraft charge-offs.

Nonperforming assets increased by $2,154,000 (7.8%) to $29,774,000 at December 31, 2018 from $27,620,000 at December 31, 2017. The increase in nonperforming assets during 2018 was the result of new nonperforming loans of $17,016,000, that were partially offset by net paydowns, sales or upgrades of nonperforming loans to performing status totaling $11,379,000, dispositions of foreclosed assets totaling $2,119,000, and net charge-offs of $1,364,000.

Changes in nonperforming assets during the year ended December 31, 2017

The following table shows the activity in the balance of nonperforming assets for the year ended December 31, 2017:

(in thousands):	Balance at December 31, 2017	New NPA	Advances/ Paydowns, net	Charge-offs/ Write-downs	Transfers to Foreclosed Assets	Category Changes	Balance at December 31, 2016
Real estate mortgage:							
Residential	$ 3,739	$ 3,416	$ (122)	$ (60)	$ (127)	$ 183	$ 449
Commercial	11,820	11,715	(10,394)	(186)	(466)	258	10,893
Consumer							
Home equity lines	3,482	1,234	(1,715)	(98)	(550)	(326)	4,937
Home equity loans	1,636	1,701	(606)	(332)	(140)	143	870

Other consumer	11	653	(43)	(637)			38
Commercial	3,706	5,292	(2,670)	(1,444)	(144)	(258)	2,930
Construction:							
Residential		1,118	(25)	(1,104)			11
Commercial							
Total nonperforming loans	24,394	25,129	(15,575)	(3,861)	(1,427)		20,128
Foreclosed assets	3,226		(2,161)	(26)	1,427		3,986
Total nonperforming assets	$ 27,620	$ 25,129	$ (17,736)	$ (3,887)	$	$	$ 24,114

The table above does not include deposit overdraft charge-offs.

Nonperforming assets increased by $3,506,000 (14.5%) to $27,620,000 at December 31, 2018 from $24,114,000 at December 31, 2017. The increase in nonperforming assets during 2018 was the result of new nonperforming loans of $25,129,000, that were partially offset by net paydowns, sales or upgrades of nonperforming loans to performing status totaling $15,575,000, dispositions of foreclosed assets totaling $2,161000, and net charge-offs of $3,887,000.

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Changes in nonperforming assets during the three months ended December 31, 2018

The following table shows the activity in the balance of nonperforming assets for the quarter ended December 31, 2018:

(in thousands):	Balance at December 31, 2018	Additions	Advances/ Paydowns, net	Charge-offs/ Write-downs	Transfers to Foreclosed Assets	Category Changes	Balance at September 30, 2018
Real estate mortgage:							
Residential	$ 2,854	$ 1,104	$ (1,288)	$	$	$	$ 3,038
Commercial	15,046	1,947	(1,450)		(580)		15,129
Consumer							
Home equity lines	2,749	895	(230)		(49)		2,133
Home equity loans	2,963	461	(489)	(1)	(97)		3,089
Other consumer	7		(1)				8
Commercial	3,875	1,338	(990)	(224)			3,751
Construction:							
Residential							
Commercial							
Total nonperforming loans	27,494	5,745	(4,448)	(225)	(726)		27,148
Foreclosed assets	2,280		(278)		726		1,832
Total nonperforming assets	$ 29,774	$ 5,745	$ (4,726)	$ (225)	$	$	$ 28,980

The table above does not include deposit overdraft charge-offs.

Nonperforming assets increased during the fourth quarter of 2018 by $794,000 (2.7%) to $29,774,000 at December 31, 2018 compared to $28,980,000 at September 30, 2018. The increase in nonperforming assets during the fourth quarter of 2018 was primarily the result of new nonperforming loans of $5,745,000, that were partially offset by net paydowns, sales or upgrades of nonperforming loans to performing status totaling $4,448,000, dispositions of foreclosed assets totaling $278,000, and loan charge-offs of $225,000.

The $5,745,000 in new nonperforming loans during the fourth quarter of 2018 was comprised of increases of $1,104,000 on three residential real estate loans, $1,947,000 on seven commercial real estate loans, $1,356,000 on 14 home equity lines and loans, and $1,338,000 on 18 C&I loans.

The $1,104,000 in new nonperforming residential real estate loans was primarily made up of one loan in the amount of $624,000 secured by a single family property in northern California. The $1,947,000 in new nonperforming CRE loans was primarily comprised of three loans in the amount of $1,084,000 secured by agricultural real estate in northern California, one loan in the amount of $454,000 secured by a commercial building in northern California, and three smaller loans totaling $410,000. The $1,338,000 in new nonperforming C&I loans was primarily comprised of two loans totaling $740,000 within a single relationship secured by general business assets in northern California, and three loans within a single relationship in the amount of $209,000 also secured by general business assets in northern California.

Changes in nonperforming assets during the three months ended December 31, 2017

The following table shows the activity in the balance of nonperforming assets for the quarter ended December 31, 2017:

(in thousands):	Balance at December 31, 2017	New NPA	Advances/ Paydowns, net	Charge-offs/ Write-downs	Transfers to Foreclosed Assets	Category Changes	Balance at September 30, 2017
Real estate mortgage:							
Residential	$ 3,739	$ 830	$ (30)	$	$ (127)	$	$ 3,066
Commercial	11,820	6,318	(6,450)	(16)	(381)		12,349
Consumer							
Home equity lines	3,481	701	(93)	(1)	(88)	(57)	3,019
Home equity loans	1,435	510	(332)	(202)	(98)	57	1,500
Other consumer	(43)	198	(4)	(256)			19
Commercial	3,962	2,290	(185)		(144)		2,001
Construction:							
Residential							
Commercial							
Total nonperforming loans	24,394	10,847	(7,094)	(475)	(838)		21,954
Foreclosed assets	3,226		(683)		838		3,071
Total nonperforming assets	$ 27,620	$ 10,847	$ (7,777)	$ (475)	$	$	$ 25,025

The table above does not include deposit overdraft charge-offs.

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Nonperforming assets increased during the fourth quarter of 2017 by $2,595,000 (10.4%) to $27,620,000 at December 31, 2017 compared to $25,025,000 at September 30, 2017. The increase in nonperforming assets during the fourth quarter of 2017 was primarily the result of new nonperforming loans of $10,847,000, and advances on nonperforming loans of $196,000, that were partially offset by sales or upgrades of nonperforming loans to performing status totaling $7,290,000, dispositions of foreclosed assets totaling $683,000, and loan charge-offs of $475,000.

The $10,847,000 in new nonperforming loans during the fourth quarter of 2017 was comprised of increases of $830,000 on four residential real estate loans, $6,318,000 on four commercial real estate loans, $1,211,000 on nine home equity lines and loans, $198,000 on 30 consumer loans, and $2,290,000 on 11 C&I loans.

The $830,000 in new nonperforming residential real estate loans was primarily made up of one loan in the amount of $345,000 secured by a single family property in northern California. The $6,318,000 in new nonperforming CRE loans was primarily comprised of two loans in the amount of $5,178,000 secured by commercial office properties in northern California, one loan in the amount of $793,000 secured by a medical office building in northern California, one loan in the amount of $381,000 secured by residential development land in northern California, and one loan in the amount of $347,000 secured by commercial retail real estate in northern California. The $2,290,000 in new nonperforming C&I loans was primarily comprised of two loans totaling $1,865,000 within a single relationship secured by general business assets in central California, and one loan in the amount of $290,000 secured by general business assets in northern California.

Allowance for Loan Losses

The Company s method for assessing the appropriateness of the allowance for originated and PNCI loan losses includes specific allowances for impaired loans, formula allowance factors for pools of credits, and allowances for changing environmental factors (e.g., interest rates, growth, economic conditions, etc.). Allowance factors for loan pools were based on historical loss experience by product type and prior risk rating.

The first component, the specific allowance, results from the analysis of identified credits that meet management s criteria for specific evaluation. These loans are reviewed individually to determine if such loans are considered impaired. Impaired loans are those where management has concluded that it is probable that the borrower will be unable to pay all amounts due under the original contractual terms. Impaired loans are specifically reviewed and evaluated individually by management for loss potential by evaluating sources of repayment, including collateral as applicable, and a specified allowance for loan losses is established where necessary.

The second component of the allowance for originated and PNCI loan losses, the formula allowance, is an estimate of the probable losses that have occurred across the major loan categories in the Company s originated and PNCI loan portfolios. This analysis is based on loan grades by pool and the loss history of these pools. This analysis covers the Company s entire originated and PNCI loan portfolios including unused commitments but excludes any loans that were analyzed individually and assigned a specific allowance as discussed above. The total amount allocated for this component is determined by applying loss estimation factors to outstanding loans and loan commitments. The loss factors were previously based primarily on the Company s historical loss experience tracked over a five-year period and adjusted as appropriate for the input of current trends and events. Because historical loss experience varies for the different categories of originated loans, the loss factors applied to each category also differed. In addition, there is a greater chance that the Company would suffer a loss from a loan that was risk rated less than satisfactory than if the loan was last graded satisfactory. Therefore, for any given category, a larger loss estimation factor was applied to less than satisfactory loans than to those that the Company last graded as satisfactory. The resulting formula allowance was the sum of the allocations determined in this manner.

The third component of the allowances for originated and PNCI loan losses, the environmental factor allowance, is a component that is not allocated to specific loans or groups of loans, but rather is intended to absorb losses that may not be provided for by the other components.

There are several primary reasons that the other components discussed above might not be sufficient to absorb the losses present in the originated and PNCI loan portfolios, and the environmental factor allowance is used to provide for the losses that have occurred because of them.

The first reason is that there are limitations to any credit risk grading process. The volume of originated and PNCI loans makes it impractical to re-grade every loan every quarter. Therefore, it is possible that some currently performing originated or PNCI loans not recently graded will not be as strong as their last grading and an insufficient portion of the allowance will have been allocated to them. Grading and loan review often must be done without knowing whether all relevant facts are at hand. Troubled borrowers may deliberately or inadvertently omit important information from reports or conversations with lending officers regarding their financial condition and the diminished strength of repayment sources.

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The second reason is that the loss estimation factors are based primarily on historical loss totals. As such, the factors may not give sufficient weight to such considerations as the current general economic and business conditions that affect the Company s borrowers and specific industry conditions that affect borrowers in that industry. The factors might also not give sufficient weight to other environmental factors such as changing economic conditions and interest rates, portfolio growth, entrance into new markets or products, and other characteristics as may be determined by Management.

Specifically, in assessing how much environmental factor allowance needed to be provided, management considered the following:

- with respect to the economy, management considered the effects of changes in GDP, unemployment, CPI, debt statistics, housing starts, home affordability, and other economic factors which serve as indicators of economic health and trends and which may have an impact on the performance of our borrowers, and
- with respect to changes in the interest rate environment, management considered the recent changes in interest rates and the resultant economic impact it may have had on borrowers with high leverage and/or low profitability; and
- with respect to changes in energy prices, management considered the effect that increases, decreases or volatility may have on the performance of our borrowers, and
- with respect to loans to borrowers in new markets and growth in general, management considered the relatively short seasoning of such loans and the lack of experience with such borrowers, and
- with respect to loans that have not yet been identified as impaired, management considered the volume and severity of past due loans, and
- with respect to concentrations within the portfolio, management considered the risk introduced by concentrations among specific segments of the portfolio, underlying collateral types, borrowers or group of borrowers, and geographic areas.

Each of these considerations was assigned a factor and applied to a portion or the entire originated and PNCI loan portfolios. Since these factors are not derived from experience and are applied to large non-homogeneous groups of loans, they are available for use across the portfolio as a whole.

The Components of the Allowance for Loan Losses

The following table sets forth the Bank s allowance for loan losses as of the dates indicated (dollars in thousands):

December 31,

(dollars in thousands)	2018	2017	2016	2015	2014
Allowance for non-impaired originated and PNCI loan losses:					
Environmental factors allowance	$ 11,577	$ 10,252	$ 10,275	$ 9,625	$ 6,815
Formula allowance	18,689	17,100	17,485	20,603	22,076
Total allowance for non-impaired originated and PNCI loan losses	30,266	27,352	27,760	30,228	28,891
Allowance for impaired loans	2,194	2,699	2,046	2,890	4,267
Allowance for PCI loan losses	122	272	2,697	2,893	3,427
Total allowance for loan losses	$ 32,582	$ 30,323	$ 32,503	$ 36,011	$ 36,585
Allowance for loan losses to loans	0.81%	1.01%	1.18%	1.43%	1.60%

Based on the current conditions of the loan portfolio, management believes that the $32,582,000 allowance for loan losses at December 31, 2018 is adequate to absorb probable losses inherent in the Bank s loan portfolio. No assurance can be given, however, that adverse economic conditions or other circumstances will not result in increased losses in the portfolio.

The following table summarizes the allocation of the allowance for loan losses between loan types:

	December 31,				
(in thousands)	2018	2017	2016	2015	2014
Real estate mortgage	$ 15,620	$ 13,758	$ 14,265	$ 13,911	$ 12,313
Consumer	8,375	8,227	10,310	15,118	18,201
Commercial	6,090	6,512	5,831	5,271	4,226
Real estate construction	2,497	1,826	2,097	1,711	1,845
Total allowance for loan losses	$ 32,582	$ 30,323	$ 32,503	$ 36,011	$ 36,585

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The following table summarizes the allocation of the allowance for loan losses between loan types as a percentage of the total allowance for loan losses:

	December 31,				
	2018	2017	2016	2015	2014
Real estate mortgage	47.9%	45.4%	44.0%	38.7%	33.7%
Consumer	25.7%	27.1%	31.6%	41.9%	49.7%
Commercial	18.7%	21.5%	17.9%	14.6%	11.6%
Real estate construction	7.7%	6.0%	6.5%	4.8%	5.0%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

The following table summarizes the allocation of the allowance for loan losses between loan types as a percentage of total loans and as a percentage of total loans in each of the loan categories listed:

	December 31,				
	2018	2017	2016	2015	2014
Real estate mortgage	0.50%	0.60%	0.69%	0.77%	0.76%
Consumer	2.00%	2.31%	2.84%	3.81%	4.36%
Commercial	2.20%	2.95%	2.69%	2.70%	2.42%
Real estate construction	1.36%	1.33%	1.71%	1.42%	2.46%
Total	0.81%	1.01%	1.18%	1.43%	1.60%

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The following tables summarize the activity in the allowance for loan losses for the years indicated (dollars in thousands):

	Year ended December 31,				
	2018	2017	2016	2015	2014
Allowance for loan losses:					
Balance at beginning of period	$ 30,323	$ 32,503	$ 36,011	$ 36,585	$ 38,245
Provision for (benefit from) loan losses	2,583	89	(5,970)	(2,210)	(4,045)
Loans charged off:					
Real estate mortgage:					
Residential	(77)	(60)	(321)	(224)	(171)
Commercial	(15)	(186)	(827)		(110)
Consumer:					
Home equity lines	(277)	(98)	(585)	(694)	(1,094)
Home equity loans	(24)	(332)	(219)	(242)	(29)
Other consumer	(783)	(1,186)	(823)	(976)	(602)
Commercial	(1,188)	(1,444)	(455)	(680)	(479)
Construction:					
Residential		(1,104)			(4)
Commercial					(69)
Total loans charged off	(2,364)	(4,410)	(3,230)	(2,816)	(2,558)
Recoveries of previously charged-off loans:					
Real estate mortgage:					
Residential			880	204	2
Commercial	68	397	920	243	540
Consumer:					
Home equity lines	846	698	2,317	666	960
Home equity loans	297	242	590	252	34
Other consumer	288	375	449	542	581
Commercial	541	428	404	677	1,268
Construction:					
Residential			54	1,728	1,377
Commercial		1	78	140	181
Total recoveries of previously charged off loans	2,040	2,141	5,692	4,452	4,943
Net (charge-offs) recoveries	(324)	(2,269)	2,462	1,636	2,385
Balance at end of period	$ 32,582	$ 30,323	$ 32,503	$ 36,011	$ 36,585
Average total loans	$ 3,548,498	$ 2,842,659	$ 2,629,729	$ 2,389,437	$ 1,847,749

Ratios:					
Net charge-offs (recoveries) during period to average loans outstanding during period	0.01%	0.08%	(0.09)%	(0.07)%	(0.13)%
Provision for (benefit from) loan losses to average loans outstanding during period	0.07%	0.00%	(0.23)%	(0.09)%	(0.22)%
Allowance for loan losses to loans at year-end	0.81%	1.01%	1.18%	1.43%	1.60%

Generally losses are triggered by non-performance by the borrower and calculated based on any difference between the current loan amount and the current value of the underlying collateral less any estimated costs associated with the disposition of the collateral.

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Foreclosed Assets, Net of Allowance for Losses

The following tables detail the components and summarize the activity in foreclosed assets, net of allowances for losses for the years indicated (dollars in thousands):

	Balance at December 31, 2018	Additions	Advances/ Capitalized Costs/Other	Sales	Valuation Adjustments	Balance at December 31, 2017
Land & Construction	$ 445	$	$	$ (1,341)	$	$ 1,786
Residential real estate	1,742	1,262		(634)	(72)	1,186
Commercial real estate	93			(144)	(17)	254
Total foreclosed assets	$ 2,280	$ 1,262	$	$ (2,119)	$ (89)	$ 3,226

	Balance at December 31, 2017	Additions	Advances/ Capitalized Costs/Other	Sales	Valuation Adjustments	Balance at December 31, 2016
Land & Construction	$ 1,786	$ 381	$	$ (15)	$ (92)	$ 1,512
Residential real estate	1,186	865		(1,294)	(49)	1,664
Commercial real estate	254	317		(852)	(21)	810
Total foreclosed assets	$ 3,226	$ 1,563	$	$ (2,161)	$ (162)	$ 3,986

Premises and Equipment

Premises and equipment were comprised of:

	As of December 31, 2018	2017
	(In thousands)	
Land & land improvements	$ 29,065	$ 9,959
Buildings	64,478	50,340
Furniture and equipment	45,228	35,939
	138,771	96,238
Less: Accumulated depreciation	(50,125)	(40,644)
	88,646	55,594
Construction in progress	701	2,148
Total premises and equipment	$ 89,347	$ 57,742

During the year ended December 31, 2018, premises and equipment, net of depreciation, increased $31,605,000 and includes premises and equipment from the FNBB merger with a fair value of $30,522,000. In addition to the merger, the Company had purchases of $7,435,000 that were partially offset by depreciation of $6,104,000 and disposals of premises and equipment with net book value of $248,000. Depreciation expense for the years ended December 31, 2017 and 2016 was $5,686,000 and $5,314,000, respectively. Purchases of fixed assets during the years ended December 31, 2017 and 2016 totaled $15,164,000 and $10,930,000, respectively.

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Intangible Assets

Intangible assets were comprised of the following:

	December 31, 2018	December 31, 2017
	(In thousands)	
Core-deposit intangible	$ 29,280	$ 5,174
Goodwill	220,972	64,311
Total intangible assets	$ 250,252	$ 69,485

The core-deposit intangible assets resulted from the Company s acquisition of FNBB on July 6, 2018, three bank branches from Bank of America on March 18, 2016, North Valley Bancorp in 2014, and Citizens in 2011. The goodwill intangible asset includes $156,661,000 from the FNBB acquisition on July 6, 2018, $849,000 from the acquisition of three bank branches from Bank of America on March 18, 2016, $47,943,000 from the North Valley Bancorp acquisition in 2014, and $15,519,000 from the North State National Bank acquisition in 2003. Amortization of core deposit intangible assets amounting to $3,499,000, $1,389,000, and $1,377,000 was recorded in 2018, 2017, and 2016, respectively.

Deposit Portfolio Composition

The following table shows the Company s deposit balances at the dates indicated:

	Year ended December 31,				
(dollars in thousands)	2018	2017	2016	2015	2014
Noninterest-bearing demand	$ 1,760,580	$ 1,368,218	$ 1,275,745	$ 1,155,695	$ 1,083,900
Interest-bearing demand	1,252,366	971,459	887,625	853,961	782,385
Savings	1,921,324	1,364,518	1,397,036	1,281,540	1,156,126
Time certificates, over $250,000	132,429	73,596	75,184	74,647	38,217
Other time certificates	299,767	231,340	259,970	265,423	319,795
Total deposits	$ 5,366,466	$ 4,009,131	$ 3,895,560	$ 3,631,266	$ 3,380,423

Long-Term Debt

See Note 12 to the consolidated financial statements at Item 8 of this report for information about the Company s other borrowings, including long-term debt.

Junior Subordinated Debt

See Note 13 to the consolidated financial statements at Item 8 of this report for information about the Company s junior subordinated debt.

Equity

See Note 15 and Note 25 in the consolidated financial statements at Item 8 of this report for a discussion of shareholders equity and regulatory capital, respectively. Management believes that the Company s capital is adequate to support anticipated growth, meet the cash dividend requirements of the Company and meet the future risk-based capital requirements of the Bank and the Company.

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Market Risk Management

Overview. The goal for managing the assets and liabilities of the Bank is to maximize shareholder value and earnings while maintaining a high quality balance sheet without exposing the Bank to undue interest rate risk. The Board of Directors has overall responsibility for the Company s interest rate risk management policies. The Bank has an Asset and Liability Management Committee which establishes and monitors guidelines to control the sensitivity of earnings and the fair value of certain assets and liabilities as may be caused by changes in interest rates. The Company does not hold any financial instruments that are not maintained in US dollars and is not party to any contracts that may be settled or repaid in a denomination other than US dollars.

Asset/Liability Management. Activities involved in asset/liability management include but are not limited to lending, accepting and placing deposits, investing in securities and issuing debt. Interest rate risk is the primary market risk associated with asset/liability management. Sensitivity of earnings to interest rate changes arises when yields on assets change in a different time period or in a different amount from that of interest costs on liabilities. To mitigate interest rate risk, the structure of the balance sheet is managed with the goal that movements of interest rates on assets and liabilities are correlated and contribute to earnings even in periods of volatile interest rates. The asset/liability management policy sets limits on the acceptable amount of variance in net interest margin and market value of equity under changing interest environments. Market value of equity is the net present value of estimated cash flows from the Bank s assets, liabilities and off-balance sheet items. The Bank uses simulation models to forecast net interest margin and market value of equity.

Simulation of net interest margin and market value of equity under various interest rate scenarios is the primary tool used to measure interest rate risk. The Bank estimated the potential impact of changing interest rates on net interest margin and market value of equity using computer-modeling techniques. A balance sheet forecast is prepared using inputs of actual loan, securities and interest-bearing liability (i.e. deposits/borrowings) positions as the beginning base.

In the simulation of net interest income and market value of equity, the forecast balance sheet is processed against various interest rate scenarios. These various interest rate scenarios include a flat rate scenario, which assumes interest rates are unchanged in the future, and rate ramp and or shock scenarios including -200, -100, +100, and +200 basis points around the flat scenario. These scenarios assume that 1) interest rates increase or decrease evenly (in a ramp fashion) over a twelve-month period and remain at the new levels beyond twelve months or 2) that interest rates change instantaneously (shock). The simulation results shown below assume no changes in the structure of the Company s balance sheet over the twelve months being measured.

The following table summarizes the estimated effect on net interest income and net income due to changing interest rates as measured against a flat rate (no interest rate change) scenario over the following twelve month period.

Interest Rate Risk Simulation of Net Interest Income as of December 31, 2018:

Change in Interest Rates (Basis Points)	Estimated Change in Net Interest Income (NII) (as % of flat NII)
+200 (shock)	(0.6%)
+100 (shock)	(0.1%)

+ 0 (flat)	
-100 (shock)	(4.3%)
-200 (shock)	(9.2%)

The following table summarizes the estimated effect on market value of equity due to changing interest rates as measured against a flat rate (no change) scenario:

Interest Rate Risk Simulation of Market Value of Equity as of December 31, 2018:

Change in Interest Rates (Basis Points)	Estimated Change in Market Value of Equity (MVE) (as % of flat MVE)
+200 (shock)	(0.2%)
+100 (shock)	1.1%
+ 0 (flat)	
-100 (shock)	(8.8%)
-200 (shock)	(22.8%)

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These simulations indicate that given a flat balance sheet scenario, and if interest-bearing checking, savings and time deposit interest rates track general interest rate changes by approximately 25%, 50%, and 75%, respectively, the Company s balance sheet is slightly liability sensitive over a twelve month time horizon for rates up, and slightly asset sensitive over a twelve month time horizon for rates down. Liability sensitive implies that net interest income decreases when interest rates rise and increase when interest rates decrease. Asset sensitive implies that net interest income increases when interest rates rise and decrease when interest rates decrease. Neutral sensitivity implies that net interest income does not change when interest rates change. The asset liability management policy limits aggregate market risk, as measured in this fashion, to an acceptable level within the context of risk-return trade-offs.

The simulation results noted above do not incorporate any management actions that might moderate the negative consequences of interest rate deviations. In addition, the simulation results noted above contain various assumptions such as a flat balance sheet, and the rate that deposit interest rates change as general interest rates change. Therefore, they do not reflect likely actual results, but serve as estimates of interest rate risk.

As with any method of measuring interest rate risk, certain shortcomings are inherent in the method of analysis presented in the preceding tables. For example, although certain of the Company s assets and liabilities may have similar maturities or repricing time frames, they may react in different degrees to changes in market interest rates. In addition, the interest rates on certain of the Company s asset and liability categories may precede, or lag behind, changes in market interest rates. Also, the actual rates of prepayments on loans and investments could vary significantly from the assumptions utilized in deriving the results as presented in the preceding tables. Further, a change in U.S. Treasury rates accompanied by a change in the shape of the treasury yield curve could result in different estimations from those presented herein. Accordingly, the results in the preceding tables should not be relied upon as indicative of actual results in the event of changing market interest rates. Additionally, the resulting estimates of changes in market value of equity are not intended to represent, and should not be construed to represent, estimates of changes in the underlying value of the Company.

Interest rate sensitivity is a function of the repricing characteristics of the Company s portfolio of assets and liabilities. One aspect of these repricing characteristics is the time frame within which the interest-bearing assets and liabilities are subject to change in interest rates either at replacement, repricing or maturity. An analysis of the repricing time frames of interest-bearing assets and liabilities is sometimes called a gap analysis because it shows the gap between assets and liabilities repricing or maturing in each of a number of periods. Another aspect of these repricing characteristics is the relative magnitude of the repricing for each category of interest earning asset and interest-bearing liability given various changes in market interest rates. Gap analysis gives no indication of the relative magnitude of repricing given various changes in interest rates. Interest rate sensitivity management focuses on the maturity of assets and liabilities and their repricing during periods of changes in market interest rates. Interest rate sensitivity gaps are measured as the difference between the volumes of assets and liabilities in the Company s current portfolio that are subject to repricing at various time horizons.

The following interest rate sensitivity table shows the Company s repricing gaps as of December 31, 2018. In this table transaction deposits, which may be repriced at will by the Company, have been included in the less than 3-month category. The inclusion of all of the transaction deposits in the less than 3-month repricing category causes the Company to appear liability sensitive. Because the Company may reprice its transaction deposits at will, transaction deposits may or may not reprice immediately with changes in interest rates.

Due to the limitations of gap analysis, as described above, the Company does not actively use gap analysis in managing interest rate risk. Instead, the Company relies on the more sophisticated interest rate risk simulation model described above as its primary tool in measuring and managing interest rate risk.

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Repricing Analysis as of December 31, 2018	Repricing within:				
(dollars in thousands)	Less than 3 months	3 - 6 months	6 - 12 months	1 - 5 months	Over 5 years
Interest-earning assets:					
Cash at Federal Reserve and other banks	$ 107,752	$	$	$	$
Securities	176,611	256,707	70,291	438,062	639,275
Loans	824,193	199,828	381,087	2,174,494	442,412
Total interest-earning assets	1,108,556	456,535	451,378	2,612,556	1,081,687
Interest-bearing liabilities					
Transaction deposits	3,173,690				
Time	102,763	116,787	79,305	133,335	6
Other borrowings	15,839				
Junior subordinated debt	57,042				
Total interest-bearing liabilities	$ 3,349,334	$ 116,787	$ 79,305	$ 133,335	6
Interest sensitivity gap	$ (2,240,778)	$ 339,748	$ 372,073	$ 2,479,221	$ 1,081,681
Cumulative sensitivity gap	$ (2,240,778)	$ (1,901,030)	$ (1,528,957)	$ 950,264	$ 2,031,945
As a percentage of earning assets:					
Interest sensitivity gap	(39.2)%	5.9%	6.5%	43.4%	18.9%
Cumulative sensitivity gap	(39.2)%	(33.3)%	(26.8)%	16.6%	35.6%

Liquidity

Liquidity refers to the Company s ability to provide funds at an acceptable cost to meet loan demand and deposit withdrawals, as well as contingency plans to meet unanticipated funding needs or loss of funding sources. These objectives can be met from either the asset or liability side of the balance sheet. Asset liquidity sources consist of the repayments and maturities of loans, selling of loans, short-term money market investments, maturities of securities and sales of securities from the available-for-sale portfolio. These activities are generally summarized as investing activities in the Consolidated Statement of Cash Flows. Net cash used by investing activities totaled $142,003,000,000 in 2018. Net increases in investment and loan balances used $436,679,000 and $173,752,000 of cash, respectively.

Liquidity may also be generated from liabilities through deposit growth and borrowings. These activities are included under financing activities in the Consolidated Statement of Cash Flows. In 2018, financing activities provided funds totaling $73,039,000 due to a $365,400,000 increase in deposit balances, which was offset by a decrease of $271,327,000 in other borrowings. Dividends paid used $18,769,000 of cash during 2018. The Company also had available correspondent banking lines of credit totaling $22,000,000 at December 31, 2018. In addition, at December 31, 2018 the Company had loans and securities available to pledge towards future borrowings from the Federal Home Loan Bank and the Federal Reserve Bank of up to $2,063,815,000 and $142,272,000, respectively. As of December 31, 2018, the Company had $15,839,000 of other borrowings as described in Note 12 of the consolidated financial statements of the Company and the related notes at Item 8 of this report. While these sources are expected to continue to provide significant amounts of funds in the future, their mix, as well as the possible use of other sources, will depend on future economic and market conditions. Liquidity is also provided or used through the results of operating activities. In 2018, operating activities provided cash of $91,069,000.

The Company s investment securities, excluding held-to-maturity securities, plus cash and cash equivalents in excess of reserve requirements totaled $1,226,126,000 at December 31, 2018, which was 19.3% of total assets at that time. This was an increase of $406,122,000 from $854,243,000 and an increase from 17.9% of total assets as of December 31, 2017.

Loan demand during 2019 will depend in part on economic and competitive conditions. The Company emphasizes the solicitation of non-interest bearing demand deposits and money market checking deposits, which are the least sensitive to interest rates. The growth of deposit balances is subject to heightened competition, the success of the Company s sales efforts, delivery of superior customer service and market conditions. Federal Reserve interest rate manipulation efforts have resulted in historic low short-term and long-term interest rates, which could impact deposit volumes in the future. Depending on economic conditions, interest rate levels, and a variety of other conditions, deposit growth may be used to fund loans, to reduce short-term borrowings or purchase investment securities. However, due to concerns such as uncertainty in the general economic environment, competition and political uncertainty, loan demand and levels of customer deposits are not certain.

The principal cash requirements of the Company are dividends on common stock when declared. The Company is dependent upon the payment of cash dividends by the Bank to service its commitments. Shareholder dividends are expected to continue subject to the Board s discretion and continuing evaluation of capital levels, earnings, asset quality and other factors. The Company expects that the cash dividends paid by the Bank to the Company will be sufficient to meet this payment schedule. Dividends from the Bank are subject to certain regulatory restrictions.

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The maturity distribution of certificates of deposit in denominations of $100,000 or more is set forth in the following table. These deposits are generally more rate sensitive than other deposits and, therefore, are more likely to be withdrawn to obtain higher yields elsewhere if available. The Bank participates in a program wherein the State of California places time deposits with the Bank at the Bank s option. At December 31, 2018, 2017 and 2016, the Bank had $65,000,000, $50,000,000 and $50,000,000, respectively, of these State deposits.

Certificates of Deposit in Denominations of $100,000 or More

	Amounts as of December 31,		
(dollars in thousands)	2018	2017	2016
Time remaining until maturity:			
Less than 3 months	$ 70,473	$ 101,552	$ 116,791
3 months to 6 months	85,781	28,832	31,984
6 months to 12 months	47,254	29,196	23,525
More than 12 months	77,912	29,144	26,850
Total	$ 281,420	$ 188,724	$ 199,150

Loan maturities

Loan demand also affects the Company s liquidity position. The following table presents the maturities of loans, net of deferred loan costs, at December 31, 2018:

	Within One Year	After One But Within 5 Years	After 5 Years	Total
		(dollars in thousands)		
Loans with predetermined interest rates:				
Real estate mortgage	$ 22,843	$ 195,906	$ 864,408	$ 1,083,157
Consumer	2,609	29,063	85,291	116,963
Commercial	6,204	109,015	16,659	131,878
Real estate construction	7,946	3,789	34,445	46,180
Total loans with predetermined interest rates	39,602	337,773	1,000,803	1,378,178
Loans with floating interest rates:				
Real estate mortgage	40,737	268,390	1,750,816	2,059,943
Consumer	4,349	19,937	277,733	302,019
Commercial	79,912	30,533	34,225	144,670
Real estate construction	34,456	25,553	77,195	137,204
Total loans with floating interest rates	159,454	344,413	2,139,969	2,643,836
Total loans	$ 199,056	$ 682,186	$ 3,140,772	$ 4,022,014

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Investment maturities

The maturity distribution and yields of the investment portfolio at December 31, 2018 is presented in the following tables. The timing of the maturities indicated in the tables below is based on final contractual maturities. Most mortgage-backed securities return principal throughout their contractual lives. As such, the weighted average life of mortgage-backed securities based on outstanding principal balance is usually significantly shorter than the final contractual maturity indicated below. Yields on tax exempt securities are shown on a tax equivalent basis.

	Within One Year		After One Year but Through Five Years		After Five Years but Through Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
	(dollars in thousands)									
Debt Securities Available for Sale										
Obligations of US government agencies	$ 1	0.93%	$ 6,688	3.19%	$ 11,823	3.73%	$ 611,469	2.67%	$ 629,981	2.69%
Obligations of states and political subdivisions	431	1.81%	1,609	2.85%	5,799	4.05%	118,233	4.03%	126,072	4.00%
Corporate bonds	1,981	3.04%	2,497	6.14%					4,478	4.77%
Asset backed securities							354,505	3.62%	354,505	3.62%
Total debt securities available for sale	$ 2,413	2.82%	$ 10,794	3.81%	$ 17,622	3.83%	$ 1,084,207	3.12%	$ 1,115,036	3.14%
Debt Securities Held to Maturity										
Obligations of US government agencies	$		$		$ 23,018	2.28%	$ 407,325	2.72%	$ 430,343	2.70%
			1,238	3.33%	2,021	4.13%	11,334	3.31%	14,593	3.42%

Obligations of states and political subdivisions										
Total debt securities held to maturity	$		$ 1,238	3.33%	$ 25,039	2.43%	$ 418,659	2.74%	$ 444,936	2.72%

Off-Balance Sheet Items

The Bank has certain ongoing commitments under operating and capital leases. See Note 18 of the financial statements at Item 8 of this report for the terms. These commitments do not significantly impact operating results. As of December 31, 2018 commitments to extend credit and commitments related to the Bank s deposit overdraft privilege product were the Bank s only financial instruments with off-balance sheet risk. The Bank has not entered into any material contracts for financial derivative instruments such as futures, swaps, options, etc. Commitments to extend credit were $1,203,400,000, and $946,617,000 at December 31, 2018 and 2017, respectively, and represent 29.92% of the total loans outstanding at year-end 2018 versus 31.40% at December 31, 2017. Commitments related to the Bank s deposit overdraft privilege product totaled $111,956,000 and $98,260,000 at December 31, 2018 and 2017, respectively.

Certain Contractual Obligations

The following chart summarizes certain contractual obligations of the Company as of December 31, 2018:

(dollars in thousands)	Total	Less than one year	1-3 years	3-5 years	More than 5 years
Time deposits	$ 432,196	$ 298,855	$ 112,256	$ 21,079	$ 6
Other collateralized borrowings, fixed rate of 0.05% payable on January 2, 2019	15,839	15,839			
Junior subordinated debt:					
TriCo Trust I(1)	20,619				20,619
TriCo Trust II(2)	20,619				20,619
North Valley Trust II(3)	5,135				5,135
North Valley Trust III(4)	4,041				4,041
North Valley Trust IV(5)	6,444				6,444
Operating lease obligations	19,600	4,639	7,680	4,645	2,636
Deferred compensation(6)	3,022	785	1,327	390	520
Supplemental retirement plans(6)	13,033	1,557	2,206	2,002	7,268
Total contractual obligations	$ 540,548	$ 321,675	$ 123,469	$ 28,116	$ 67,288

(1) Junior subordinated debt, adjustable rate of three-month LIBOR plus 3.05%, callable in whole or in part by the Company on a quarterly basis beginning October 7, 2008, matures October 7, 2033.

(2) Junior subordinated debt, adjustable rate of three-month LIBOR plus 2.55%, callable in whole or in part by the Company on a quarterly basis beginning July 23, 2009, matures July 23, 2034.

(3) Junior subordinated debt, adjustable rate of three-month LIBOR plus 3.25%, callable in whole or in part by the Company on a quarterly basis beginning April 24, 2008, matures April 24, 2033.
(4) Junior subordinated debt, adjustable rate of three-month LIBOR plus 2.80%, callable in whole or in part by the Company on a quarterly basis beginning July 23, 2009, matures July 23, 2034.
(5) Junior subordinated debt, adjustable rate of three-month LIBOR plus 1.33%, callable in whole or in part by the Company on a quarterly basis beginning March 15, 2011, matures March 15, 2036.
(6) These amounts represent known certain payments to participants under the Company s deferred compensation and supplemental retirement plans. See Note 21 in the financial statements at Item 8 of this report for additional information related to the Company s deferred compensation and supplemental retirement plan liabilities.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See Market Risk Management under Item 7 of this report which is incorporated herein.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO FINANCIAL STATEMENTS

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TRICO BANCSHARES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	At December 31, 2018	At December 31, 2017
Assets:		
Cash and due from banks	$ 119,781	$ 105,968
Cash at Federal Reserve and other banks	107,752	99,460
Cash and cash equivalents	227,533	205,428
Investment securities:		
Marketable equity securities	2,874	2,938
Available for sale debt securities	1,115,036	727,945
Held to maturity debt securities	444,936	514,844
Restricted equity securities	17,250	16,956
Loans held for sale	3,687	4,616
Loans	4,022,014	3,015,165
Allowance for loan losses	(32,582)	(30,323)
Total loans, net	3,989,432	2,984,842
Foreclosed assets, net	2,280	3,226
Premises and equipment, net	89,347	57,742
Cash value of life insurance	117,318	97,783
Accrued interest receivable	19,412	13,772
Goodwill	220,972	64,311
Other intangible assets, net	29,280	5,174
Mortgage servicing rights	7,098	6,687
Other assets	65,986	55,051
Total assets	$ 6,352,441	$ 4,761,315
Liabilities and Shareholders Equity:		
Liabilities:		
Deposits:		
Noninterest-bearing demand	$ 1,760,580	$ 1,368,218
Interest-bearing	3,605,886	2,640,913
Total deposits	5,366,466	4,009,131
Accrued interest payable	1,997	930
Other liabilities	83,724	66,422
Other borrowings	15,839	122,166
Junior subordinated debt	57,042	56,858

Total liabilities		5,525,068		4,255,507
Commitments and contingencies (Note 14)				
Shareholders equity:				
Preferred stock, no par value: 1,000,000 shares authorized; zero issued and outstanding at December 31, 2018 and 2017				
Common stock, no par value: 50,000,000 shares authorized; issued and outstanding: 30,417,223 and 22,955,963 at December 31, 2018 and 2017, respectively		541,762		255,836
Retained earnings		303,490		255,200
Accumulated other comprehensive loss, net of tax		(17,879)		(5,228)
Total shareholders equity		827,373		505,808
Total liabilities and shareholders equity	$	6,352,441	$	4,761,315

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

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TRICO BANCSHARES

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

	Year ended December 31,		
	2018	2017	2016
Interest and dividend income:			
Loans, including fees	$ 186,117	$ 146,794	$ 141,086
Investments:			
Taxable securities	33,997	27,772	25,397
Tax exempt securities	4,345	4,165	3,881
Dividends	1,705	1,324	2,181
Interest bearing cash at Federal Reserve and other banks	2,054	1,347	1,163
Total interest and dividend income	228,218	181,402	173,708
Interest expense:			
Deposits	6,996	3,958	3,483
Other borrowings	2,745	305	9
Junior subordinated debt	3,131	2,535	2,229
Total interest expense	12,872	6,798	5,721
Net interest income	215,346	174,604	167,987
Provision for (benefit from) loan losses	2,583	89	(5,970)
Net interest income after provision for (benefit from) loan losses	212,763	174,515	173,957
Noninterest income:			
Service charges and fees	38,460	37,423	33,226
Commissions on sale of non-deposit investment products	3,151	2,729	2,329
Increase in cash value of life insurance	2,718	2,685	2,717
Gain on sale of loans	2,371	3,109	4,037
Gain on sale of investment securities	207	961	
Other	2,377	3,114	2,254
Total noninterest income	49,284	50,021	44,563
Noninterest expense:			
Salaries and related benefits	93,942	82,930	80,724
Other	74,753	64,094	65,273
Total noninterest expense	168,695	147,024	145,997

Income before income taxes	93,352	77,512	72,523
Provision for income taxes	25,032	36,958	27,712
Net income	$ 68,320	$ 40,554	$ 44,811
Earnings per share:			
Basic	$ 2.57	$ 1.77	$ 1.96
Diluted	$ 2.54	$ 1.74	$ 1.94

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

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TRICO BANCSHARES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Year ended 2018	2017	2016
Net income	$ 68,320	$ 40,554	$ 44,811
Other comprehensive (loss) income, net of tax:			
Unrealized (losses) gains on available for sale securities arising during the period, after reclassifications	(12,434)	3,165	(6,384)
Change in minimum pension liability, after reclassifications	388	(370)	592
Change in joint beneficiary agreement liability	426	(110)	(343)
Other comprehensive (loss) income	(11,620)	2,685	(6,135)
Comprehensive income	$ 56,700	$ 43,239	$ 38,676

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

TRICO BANCSHARES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(In thousands, except share and per share data)

	Shares of Common Stock	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Total
Balance at January 1, 2016	22,775,173	$ 247,587	$ 206,307	$ (1,778)	$ 452,116
Net income			44,811		44,811
Other comprehensive loss				(6,135)	(6,135)
Stock option vesting		580			580
Service condition RSU vesting		616			616
Market plus service condition RSU vesting		271			271
Stock options exercised	336,900	6,506			6,506
Tax effect of stock options exercised		154			154
Service condition RSUs released	20,529				
Tax benefit from release of service condition RSUs		1			1
Repurchase of common stock	(264,800)	(2,895)	(4,983)		(7,878)
Dividends paid ($ 0.60 per share)			(13,695)		(13,695)

Balance at December 31, 2016	22,867,802	$ 252,820	$ 232,440	$ (7,913)	$ 477,347
Net income			40,554		40,554
Other comprehensive income				2,685	2,685
Stock option vesting		259			259
Service condition RSU vesting		895			895
Market plus service condition RSU vesting		432			432
Stock options exercised	145,850	2,621			2,621
Service condition RSUs released	30,896				
Market plus service condition RSUs released	18,805				
Repurchase of common stock	(107,390)	(1,191)	(2,663)		(3,854)
Dividends paid ($ 0.66 per share)			(15,131)		(15,131)
Balance at December 31, 2017	22,955,963	$ 255,836	$ 255,200	$ (5,228)	$ 505,808
Net income			68,320		68,320
Adoption ASU 2016-01			(62)	62	
Adoption ASU 2018-02			1,093	(1,093)	
Other comprehensive loss				(11,620)	(11,620)
Stock option vesting		75			75
Service condition RSU vesting		1,017			1,017
Market plus service condition RSU vesting		370			370
Service condition RSUs released	35,060				
Market plus service condition RSUs released	25,512				
Stock options exercised	100,400	1,704			1,704
Issuance of common stock	7,405,277	284,437			284,437
Repurchase of common stock	(104,989)	(1,677)	(2,292)		(3,969)
Dividends paid ($ 0.70 per share)			(18,769)		(18,769)
Balance at December 31, 2018	30,417,223	$ 541,762	$ 303,490	$ (17,879)	$ 827,373

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

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TRICO BANCSHARES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands; unaudited)

	Years ended December 31, 2018	2017	2016
Operating activities:			
Net income	$ 68,320	$ 40,554	$ 44,811
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation of premises and equipment, and amortization	7,014	6,787	6,474
Amortization of intangible assets	3,499	1,389	1,377
Provision for (benefit from) loan losses	2,583	89	(5,970)
Amortization of investment securities premium, net	2,512	3,200	4,926
Gain on sale of investment securities	(207)	(961)	
Originations of loans for resale	(84,245)	(114,107)	(142,619)
Proceeds from sale of loans originated for resale	86,988	114,788	144,062
Gain on sale of loans	(2,371)	(3,109)	(4,037)
Change in market value of mortgage servicing rights	146	718	2,184
Provision for losses on foreclosed assets	89	162	140
Gain on sale of foreclosed assets	(408)	(711)	(262)
Loss on disposal of fixed assets	185	142	929
Gain on sale of premises held for sale		(3)	
Increase in cash value of life insurance	(2,718)	(2,685)	(2,717)
Life insurance proceeds in excess of cash value		(108)	(238)
Loss on marketable equity securities	64		
Equity compensation vesting expense	1,462	1,586	1,467
Equity compensation tax effect			(155)
Deferred income tax expense	2,600	12,473	3,190
Change in:			
Interest receivable	(5,640)	(1,745)	(1,241)
Interest payable	1,067	112	44
Other assets and liabilities, net	10,129	(3,190)	(4,139)
Net cash from operating activities	91,069	55,381	48,226
Investing activities:			
Cash acquired in acquisition, net of consideration paid	30,613		156,316
Proceeds from maturities of securities available for sale	73,014	63,942	71,684
Proceeds from maturities of securities held to maturity	68,937	86,371	121,666
Proceeds from sale of available for sale securities	293,279	25,757	
Purchases of securities available for sale	(436,678)	(265,806)	(247,717)
Net redemption of restricted equity securities	7,429		
Loan origination and principal collections, net	(173,752)	(247,837)	(251,479)

Loans purchased		(11,567)	(22,503)
Proceeds from sale of loans other than loans originated for resale			37,880
Proceeds from sale of foreclosed assets	2,527	2,872	4,010
Proceeds from sale of premises held for sale		3,338	
Proceeds from sale of premises and equipment	63		1,682
Purchases of premises and equipment	(7,435)	(15,164)	(10,930)
Life insurance proceeds		649	
Net cash from investing activities	(142,003)	(357,445)	(139,391)
Financing activities:			
Net change in deposits	365,400	113,571	103,063
Net change in other borrowings	(271,327)	104,673	5,165
Equity compensation tax effect			155
Repurchase of common stock	(2,483)	(1,629)	(1,890)
Dividends paid	(18,769)	(15,131)	(13,695)
Exercise of stock options	218	396	518
Net cash from financing activities	73,039	201,880	93,316
Net change in cash and cash equivalents	22,105	(100,184)	2,151
Cash and cash equivalents at beginning of year	205,428	305,612	303,461
Cash and cash equivalents at end of year	$ 227,533	$ 205,428	$ 305,612
Supplemental disclosure of noncash activities:			
Unrealized (loss) gain on securities available for sale	$ (17,627)	$ 5,461	$ (11,015)
Loans transferred to foreclosed assets	$ 1,262	$ 1,563	$ 2,505
Market value of shares tendered in-lieu of cash to pay for exercise of options and/or related taxes	$ 1,486	$ 2,225	$ 5,988
Supplemental disclosure of cash flow activity:			
Cash paid for interest expense	$ 11,805	$ 5,609	$ 5,677
Cash paid for income taxes	$ 14,525	$ 21,170	$ 27,575
Assets acquired in acquisition and goodwill, net	$ 1,463,200	$	$ 161,231
Liabilities assumed in acquisition	$ 1,172,068	$	$ 161,231

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

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TRICO BANCSHARES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2018, 2017 and 2016

Note 1 Summary of Significant Accounting Policies

Description of Business and Basis of Presentation

TriCo Bancshares (the Company or we) is a California corporation organized to act as a bank holding company for Tri Counties Bank (the Bank). The Company and the Bank are headquartered in Chico, California. The Bank is a California-chartered bank that is engaged in the general commercial banking business in 29 California counties. The Company has five capital subsidiary business trusts (collectively, the Capital Trusts) that issued trust preferred securities, including two organized by the Company and three acquired with the acquisition of North Valley Bancorp.

The consolidated financial statements are prepared in accordance with accounting policies generally accepted in the United States of America and general practices in the banking industry. All adjustments necessary for a fair presentation of these consolidated financial statements have been included and are of a normal and recurring nature. The financial statements include the accounts of the Company. All inter-company accounts and transactions have been eliminated in consolidation. For financial reporting purposes, the Company s investments in the Capital Trusts of $1,713,000 are accounted for under the equity method and, accordingly, are included in other assets on the consolidated balance sheets. The subordinated debentures issued and guaranteed by the Company and held by the Capital Trusts are reflected as debt on the Company s consolidated balance sheets.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Segment and Significant Group Concentration of Credit Risk

The Company grants agribusiness, commercial, consumer, and residential loans to customers located throughout Northern and Central California. The Company has a diversified loan portfolio within the business segments located in this geographical area. The Company currently classifies all its operation into one business segment that it denotes as community banking.

Geographical Descriptions

For the purpose of describing the geographical location of the Company s operations, the Company has defined northern California as that area of California north of, and including, Stockton to the east and San Jose to the west; central California as that area of the state south of Stockton and San Jose, to and including, Bakersfield to the east and San Luis Obispo to the west; and southern California as that area of the state south of Bakersfield and San Luis

Obispo.

Business Combinations

The Company accounts for acquisitions of businesses using the acquisition method of accounting. Under the acquisition method, assets acquired and liabilities assumed are recorded at their estimated fair values at the date of acquisition. Management utilizes various valuation techniques including discounted cash flow analyses to determine these fair values. Any excess of the purchase price over amounts allocated to the acquired assets, including identifiable intangible assets, and liabilities assumed is recorded as goodwill.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold. Net cash flows are reported for loan and deposit transactions and other borrowings.

Marketable Equity Securities

As of December 31, 2017, marketable equity securities with a fair value of $2,938,000 were recorded within investment securities available for sale on the consolidated balance sheets with changes in the fair value recorded through other comprehensive income and accumulated other comprehensive income (loss). As of January 1, 2018, the Company adopted the new accounting standard for Financial Instruments using a prospective transition approach, which requires equity investments to be measured at fair value with changes in fair value recognized in net income. The adoption of this guidance resulted in a $62,000 decrease to beginning retained earnings and a decrease to the deferred tax of $18,000. During the twelve months ended December 31, 2018, the Company recognized $64,000 of unrealized losses in the consolidated statements of income related to changes in the fair value of marketable equity securities.

Debt Securities

The Company classifies its debt securities into one of three categories: trading, available for sale or held to maturity. Trading securities are bought and held principally for the purpose of selling in the near term and changes in the value of these securities are recorded through earnings. Held to maturity securities are those securities which the Company has the ability and intent to hold until maturity. These securities are carried at cost adjusted for amortization of premium and accretion of discount, computed by the effective interest method over their contractual lives. All other securities not included in trading or held to maturity are classified as available for sale. Available for sale securities are recorded at fair value. Unrealized gains and losses, net of the related tax effect, on available for sale securities are reported as a separate component of other accumulated comprehensive income in shareholders equity until realized. Premiums and discounts are amortized or accreted over the life of the related investment security as an adjustment to yield using the effective interest method. Dividend and interest income are recognized when earned. Realized gains and losses are derived from the amortized cost of the security sold. The Company did not have any debt securities classified as trading during 2018, 2017 or 2016.

The Company assesses other-than-temporary impairment (OTTI) based on whether it intends to sell a security or if it is likely that the Company would be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity. For debt securities, if we intend to sell the security or it is more likely than not that we will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If we do not intend to sell the security and it is not likely that we will be required to sell the security but we do not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (OCI). Impairment losses related to all other factors are presented as separate categories within OCI. The accretion of the amount recorded in OCI increases the carrying value of the investment and does not affect earnings. If there is an indication of additional credit losses the security is re-evaluated according to the procedures described above. No OTTI losses were recognized during the years ended December 31, 2018, 2017 or 2016.

Restricted Equity Securities

Restricted equity securities represent the Company s investment in the stock of the Federal Home Loan Bank of San Francisco (FHLB) and are carried at par value, which reasonably approximates its fair value. While technically these are considered equity securities, there is no market for the FHLB stock. Therefore, the shares are considered as restricted investment securities. Management periodically evaluates FHLB stock for other-than-temporary impairment. Management s determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB.

As a member of the FHLB system, the Bank is required to maintain a minimum level of investment in FHLB stock based on specific percentages of its outstanding mortgages, total assets, or FHLB advances. The Bank may request redemption at par value of any stock in excess of the minimum required investment. Stock redemptions are at the discretion of the FHLB. Both cash and stock dividends are reported as income when received.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by aggregate outstanding commitments from investors of current investor yield requirements. Net unrealized losses are recognized through a valuation allowance by charges to noninterest income.

Mortgage loans held for sale are generally sold with the mortgage servicing rights retained by the Company. Gains or losses on the sale of loans that are held for sale are recognized at the time of the sale and determined by the difference between net sale proceeds and the net book value of the loans less the estimated fair value of any retained mortgage servicing rights.

Loans and Allowance for Loan Losses

Loans originated by the Company, i.e., not purchased or acquired in a business combination, are referred to as originated loans. Originated loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal amount outstanding, net of deferred loan fees and costs. Loan origination and commitment fees and certain direct loan origination costs are deferred, and the net amount is amortized as an adjustment to the related loan s yield over the actual life of the loan. Originated loans on which the accrual of interest has been discontinued are designated as nonaccrual loans.

Originated loans are placed in nonaccrual status when reasonable doubt exists as to the full, timely collection of interest or principal, or a loan becomes contractually past due by 90 days or more with respect to interest or principal and is not well secured and in the process of collection. When an originated loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is considered probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of Management, the loan is estimated to be fully collectible as to both principal and interest.

An allowance for loan losses for originated loans is established through a provision for loan losses charged to expense. The allowance is maintained at a level which, in Management s judgment, is adequate to absorb probable incurred credit losses inherent in the loan portfolio as of the balance sheet date. Originated loans and deposit related overdrafts are charged against the allowance for loan losses when Management believes that the collectability of the principal is unlikely or, with respect to consumer installment loans, according to an established delinquency schedule. The allowance is an amount that Management believes will be adequate to absorb probable incurred losses inherent in existing loans, based on evaluations of the collectability, impairment and prior loss experience of loans. The evaluations take into consideration such factors as changes in the nature and size of the portfolio, overall portfolio quality, loan concentrations, specific problem loans, and current economic conditions that may affect the borrower s ability to pay. The Company defines an originated loan as impaired when it is probable the Company will be unable to collect all amounts due according to the original contractual terms of the loan agreement. Impaired originated loans are measured based on the present value of expected future cash flows discounted at the loan s original effective interest rate. As a practical expedient, impairment may be measured based on the loan s observable market price or the fair value of the collateral if the loan is collateral dependent. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a specific reserve allocation within the allowance for loan losses.

In situations related to originated loans where, for economic or legal reasons related to a borrower s financial difficulties, the Company grants a concession for other than an insignificant period of time to the borrower that the Company would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). The Company strives to identify borrowers in financial difficulty early and work with them to modify, if any, certain repayment terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where the Company grants the borrower new terms that result in the loan being classified as a TDR, the Company measures any impairment on the restructuring as noted above for impaired loans. TDR loans are classified as impaired until they are fully paid off or charged off. Loans that are in nonaccrual status at the time they become TDR loans, remain in nonaccrual status until the borrower demonstrates a sustained period of performance which the Company generally believes to be six consecutive months of payments, or equivalent. Otherwise, TDR loans are subject to the same nonaccrual and charge-off policies as noted above with respect to their restructured principal balance.

Credit risk is inherent in the business of lending. As a result, the Company maintains an allowance for loan losses to absorb probable incurred losses inherent in the Company s originated loan portfolio. This is maintained through periodic charges to earnings. These charges are included in the Consolidated Statements of Income as provision for loan losses. All specifically identifiable and quantifiable losses are immediately charged off against the allowance. However, for a variety of reasons, not all losses are immediately known to the Company and, of those that are known, the full extent of the loss may not be quantifiable at that point in time. The balance of the Company s allowance for originated loan losses is an estimate of these probable incurred losses inherent in the portfolio.

The Company formally assesses the adequacy of the allowance for originated loan losses on a quarterly basis. Determination of the adequacy is based on ongoing assessments of the probable risk in the outstanding originated loan portfolio, and to a lesser extent the Company s originated loan commitments. These assessments include the periodic re-grading of credits based on changes in their individual credit characteristics including delinquency, seasoning, recent financial performance of the borrower, economic factors, changes in the interest rate environment, growth of the portfolio as a whole or by segment, and other factors as warranted. Loans are initially graded when originated. They are re-graded as they are renewed, when there is a new loan to the same borrower, when identified facts demonstrate changes in the risk of repayment, or if they become delinquent. Re-grading of larger problem loans occurs at least quarterly. Confirmation of the quality of the grading process is obtained by periodic independent credit reviews conducted by consultants specifically hired for this purpose and by various bank regulatory agencies.

The Company s method for assessing the appropriateness of the allowance for originated loan losses includes specific allowances for impaired originated loans, formula allowance factors for pools of credits, and allowances for changing environmental factors (e.g., interest rates, growth, economic conditions, etc.). Allowance factors for loan pools are based on historical loss experience by product type and prior risk rating.

Loans purchased or acquired in a business combination are referred to as acquired loans. Acquired loans are measured and recorded at their fair value as of the acquisition date. Loans acquired with evidence of credit deterioration since origination for which it is probable that all contractually required payments will not be collected are referred to as purchased credit impaired (PCI) loans. PCI loans are recorded at fair value at acquisition date, factoring in credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for loan losses is not carried over or recorded as of the acquisition date. Fair value is defined as the present value of the future estimated principal and interest payments of the loan, with the discount rate used in the present value calculation representing the estimated effective yield of the loan. Default rates, loss severity, and prepayment speed assumptions are periodically reassessed and our estimate of future payments is adjusted accordingly. The difference between contractual future payments and estimated future payments is referred to as the nonaccretable difference. The difference between estimated future payments and the present value of the estimated future payments is referred to as the accretable yield. The accretable yield represents the amount that is expected to be recorded as interest income over the remaining life of the loan. If after acquisition, the Company determines that the estimated future cash flows of a PCI loan are expected to be more than originally estimated, an increase in the discount rate (effective yield) would be made such that the newly increased accretable yield would be recognized, on a level yield basis, over the remaining estimated life of the loan. If, thereafter, the Company determines that the estimated future cash flows of a PCI loan are expected to be less than previously estimated, an allowance for loan loss would be established through a provision for loan losses charged to expense to decrease the present value to the required level. If the estimated cash flows improve after an allowance has been established for a loan, the allowance may be partially or fully reversed depending on the improvement in the estimated cash flows. Only after the allowance has been fully reversed may the discount rate be increased.

PCI loans are put on nonaccrual status when cash flows cannot be reasonably estimated. PCI loans on nonaccrual status are accounted for using the cost recovery method or cash basis method of income recognition. PCI loans are charged off when evidence suggests cash flows are not recoverable. Foreclosed assets from PCI loans are recorded in foreclosed assets at fair value with the fair value at time of foreclosure representing estimated proceeds less selling costs from the collateral securing the loan. PCI loans with similar risk characteristics and acquisition time frame may be pooled and have their cash flows aggregated as if they were one loan or accounted for individually.

Acquired loans that are not PCI loans are referred to as purchased not credit impaired (PNCI) loans and interest income is accrued on a level-yield basis. For income recognition purposes, this method assumes that all contractual cash flows will be collected, and no allowance for loan losses is established at the time of acquisition. Post-acquisition date, an allowance for loan losses may need to be established for acquired loans through a provision charged to earnings for credit losses incurred subsequent to acquisition. The loss estimate for acquired loans is measured based on the probable shortfall in relation to the contractual note requirements, consistent with our allowance for loan loss policy for similar loans.

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Throughout these financial statements, reference to Loans or Allowance for loan losses relates to all categories of loans, including Originated, PNCI, and PCI. When not referring to all categories of loans, specific reference to Originated, PNCI, or PCI is made.

When referring to PNCI and PCI loans we use the terms nonaccretable difference , accretable yield , or purchase discount . Nonaccretable difference is the difference between undiscounted contractual cash flows due and undiscounted cash flows we expect to collect, or put another way, it is the undiscounted contractual cash flows we do not expect to collect. Accretable yield is the difference between undiscounted cash flows we expect to collect and the value at which we have recorded the loan on our financial statements. On the date of acquisition, all purchased loans are recorded on our consolidated financial statements at estimated fair value. Purchase discount is the difference between the estimated fair value of loans on the date of acquisition and the principal amount owed by the borrower, net of charge offs, on the date of acquisition. We may also refer to discounts to principal balance of loans owed, net of charge-offs . Discounts to principal balance of loans owed, net of charge-offs is the difference between principal balance of loans owed, net of charge-offs, and loans as recorded on our financial statements. Discounts to principal balance of loans owed, net of charge-offs arise from purchase discounts, and equal the purchase discount on the acquisition date.

Foreclosed Assets

Foreclosed assets include assets acquired through, or in lieu of, loan foreclosure. Foreclosed assets are held for sale and are initially recorded at fair value less estimated costs to sell at the date of foreclosure, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Any write-downs based on the asset s fair value less costs to sell at the date of acquisition are charged to the allowance for loan and lease losses. Any recoveries based on the asset s fair value less estimated costs to sell in excess of the recorded value of the loan at the date of acquisition are recorded to the allowance for loan and lease losses. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed. Revenue and expenses from operations and changes in the valuation allowance are included in other noninterest expense. Gain or loss on sale of foreclosed assets is included in noninterest income.

Premises and Equipment

Land is carried at cost. Land improvements, buildings and equipment, including those acquired under capital lease, are stated at cost less accumulated depreciation and amortization. Depreciation and amortization expenses are computed using the straight-line method over the shorter of the estimated useful lives of the related assets or lease terms. Asset lives range from 3-10 years for furniture and equipment and 15-40 years for land improvements and buildings.

Company Owned Life Insurance

The Company has purchased life insurance policies on certain key executives. Company owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Goodwill, Other Intangible and Long-Lived Assets

Goodwill represents the excess of costs over fair value of net assets of businesses acquired from a business combination. The Company has an identifiable intangible asset consisting of core deposit intangibles (CDI). CDI are amortized over their respective estimated useful lives, and reviewed periodically for impairment. Goodwill and other intangible assets acquired in a business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually. Other intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values, and reviewed periodically for impairment.

As of September 30 of each year, goodwill is tested for impairment, and is tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s fair value.

Long-lived assets, such as premises and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the consolidated balance sheet.

Mortgage Servicing Rights

Mortgage servicing rights (MSR) represent the Company s right to a future stream of cash flows based upon the contractual servicing fee associated with servicing mortgage loans. Our MSR arise from residential and commercial mortgage loans that we originate and sell, but retain the right to service the loans. The net gain from the retention of the servicing right is included in gain on sale of loans in noninterest income when the loan is sold. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Servicing fees, when earned, and changes in fair value of the MSR, are recorded in noninterest income.

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The Company accounts for MSR at fair value. The determination of fair value of our MSR requires management judgment because they are not actively traded. The determination of fair value for MSR requires valuation processes which combine the use of discounted cash flow models and extensive analysis of current market data to arrive at an estimate of fair value. The cash flow and prepayment assumptions used in our discounted cash flow model are based on empirical data drawn from the historical performance of our MSR, which we believe are consistent with assumptions used by market participants valuing similar MSR, and from data obtained on the performance of similar MSR. The key assumptions used in the valuation of MSR include mortgage prepayment speeds and the discount rate. These variables can, and generally will, change from quarter to quarter as market conditions and projected interest rates change. The key risks inherent with MSR are prepayment speed and changes in interest rates.

Reserve for Unfunded Commitments

The reserve for unfunded commitments is established through a provision for losses unfunded commitments, the changes of which are recorded in noninterest expense. The reserve for unfunded commitments is an amount that Management believes will be adequate to absorb probable losses inherent in existing commitments, including unused portions of revolving lines of credit and other loans, standby letters of credit, and unused deposit account overdraft privileges. The reserve for unfunded commitments is based on evaluations of the collectability, and prior loss experience of unfunded commitments. The evaluations take into consideration such factors as changes in the nature and size of the loan portfolio, overall loan portfolio quality, loan concentrations, specific problem loans and related unfunded commitments, and current economic conditions that may affect the borrower s or depositor s ability to pay.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under credit card arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded.

Low Income Housing Tax Credits

The Company accounts for low income housing tax credits and the related qualified affordable housing projects using the proportional amortization method. Under the proportional amortization method, the Company amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). Upon entering into a qualified affordable housing project, the Company records, in other liabilities, the entire amount that it has agreed to invest in the project, and an equal amount, in other assets, representing its investment in the project. As the Company disburses cash to satisfy its investment obligation, other liabilities are reduced. Over time, as the tax credits and other tax benefits of the project are realized by the Company, the investment recorded in other assets is reduced using the proportional amortization method.

Income Taxes

The Company s accounting for income taxes is based on an asset and liability approach. The Company recognizes the amount of taxes payable or refundable for the current year, and deferred tax assets and liabilities for the future tax consequences that have been recognized in its financial statements or tax returns. The measurement of tax assets and liabilities is based on the provisions of enacted tax laws. A valuation allowance, if needed, reduces deferred tax assets to the expected amount most likely to be realized. Realization of deferred tax assets is dependent upon the generation of a sufficient level of future taxable income and recoverable taxes paid in prior years. Although realization is not assured, management believes it is more likely than not that all of the deferred tax assets will be realized.

A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded. Interest and/or penalties related to income taxes are reported as a component of noninterest income.

Earnings per Share

Basic earnings per share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. There are no unvested share-based payment awards that contain rights to nonforfeitable dividends (participating securities). Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from assumed issuance. Potential common shares that may be issued by the Company relate solely from outstanding stock options and restricted stock units, and are determined using the treasury stock method.

Revenue Recognition

The Company records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, Revenue from Contracts with Customers (Topic 606). Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Company satisfies a performance obligation.

Most of our revenue-generating transactions are not subject to Topic 606, including revenue generated from financial instruments, such as our loans and investment securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives, and certain credit card fees are also not in scope of the new guidance. The Company s noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of December 31, 2018 and December 31, 2017, the Company did not have any significant contract balances. The Company has evaluated the nature of its revenue streams and determined that further disaggregation of revenue into more granular categories beyond what is presented in Note 17 was not necessary. The following are descriptions of revenues within the scope of ASC 606.

Deposit service charges

The Company earns fees from its deposit customers for account maintenance, transaction-based and overdraft services. Account maintenance fees consist primarily of account fees and analyzed account fees charged on deposit accounts on a monthly basis. The performance obligation is satisfied and the fees are recognized on a monthly basis as the service period is completed. Transaction-based fees on deposit accounts are charged to deposit customers for specific services provided to the customer, such as non-sufficient funds fees, overdraft fees, and wire fees. The performance obligation is completed as the transaction occurs and the fees are recognized at the time each specific service is provided to the customer.

Debit and ATM interchange fee income and expenses

Debit and ATM interchange income represent fees earned when a debit card issued by the Company is used. The Company earns interchange fees from debit cardholder transactions through the Visa payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the cardholders debit card. Certain expenses directly associated with the credit and debit card are recorded on a net basis with the interchange income.

Commission on sale of non-deposit investment products

Commissions on sale of non-deposit investment products consist of fees earned from advisory asset management, trade execution and administrative fees from investments. Advisory asset management fees are variable, since they are based on the underlying portfolio value, which is subject to market conditions and asset flows. Advisory asset management fees are recognized quarterly and are based on the portfolio values at the end of each quarter. Brokerage accounts are charged commissions at the time of a transaction and the commission schedule is based upon the type of security and quantity. In addition, revenues are earned from selling insurance and annuity policies. The amount of revenue earned is determined by the value and type of each instrument sold and is recognized at the time the policy or contract is written.

Merchant fee income

Merchant fee income represents fees earned by the Company for card payment services provided to its merchant customers. The Company outsources these services to a third party to provide card payment services to these merchants. The third party provider passes the payments made by the merchants through to the Company. The Company, in turn, pays the third party provider for the services it provides to the merchants. These payments to the third party provider are recorded as expenses as a net reduction against fee income. In addition, a portion of the payment received represents interchange fees which are passed through to the card issuing bank. Income is primarily earned based on the dollar volume and number of transactions processed. The performance obligation is satisfied and the related fee is earned when each payment is accepted by the processing network.

Gain/loss on other real estate owned, net

The Company records a gain or loss from the sale of other real estate owned when control of the property transfers to the buyer, which generally occurs at the time of an executed deed of trust. When the Company finances the sale of other real estate owned to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the other real estate owned asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on sale, the Company adjusts the transaction price and related gain or loss on sale if a significant financing component is present.

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Reclassifications

Certain amounts reported in previous consolidated financial statements have been reclassified and recalculated to conform to the presentation in this report. These reclassifications did not affect previously reported net income, total assets or total shareholders equity.

Accounting Standards Adopted in 2018

FASB Accounting Standards Update (ASU) No.2014-09, *Revenue from Contracts with Customers (Topic 606):* ASU 2014-09 is intended to clarify the principles for recognizing revenue, and to develop common revenue standards and disclosure requirements that would: (1) remove inconsistencies and weaknesses in revenue requirements; (2) provide a more robust framework for addressing revenue issues; (3) improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) provide more useful information to users of financial statements through improved disclosures; and (5) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The guidance affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required with regard to contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, including interim periods therein, with early adoption permitted for reporting periods beginning after December 15, 2016. ASU 2014-09 does not apply to revenue associated with financial instruments such as loans and investments, which are accounted for under other provisions of GAAP. The Company adopted ASU 2014-09 on January 1, 2018 utilizing the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary.

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities.* This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (8) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity s other deferred tax assets. The adoption of ASU No. 2016-01 on January 1, 2018 did not have a material impact on the Company s Consolidated Financial Statements. In accordance with (1) above, the Company recorded a reclassification of cumulative unrealized losses of its marketable equity securities from accumulated other comprehensive income (loss) to retained earnings as of January 1, 2018. Additionally, the Company recognized changes in the fair value of its marketable equity securities in the condensed consolidated statements of net income for the year ended December 31, 2018. In accordance with (5) above, the Company measured the fair value of its loan portfolio as of December 31, 2018 using an exit price notion (see Note 23 *Fair Value Measurement*).

FASB issued ASU No. 2017-01, *Business Combinations Clarifying the Definition of a Business (Topic 805).* ASU 2017-01 clarifies the definition and provides a more robust framework to use in determining when a set of assets and activities constitutes a business. ASU 2017-01 is intended to provide guidance when evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 was effective for the Company on January 1, 2018 and did not have a significant impact on the Company s consolidated financial statements.

FASB issued ASU No. 2017-07, *Compensation Retirement Benefits (Topic 715).* ASU 2017-07 requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component. ASU 2017-07 was effective for the Company on January 1, 2018 and did not have a significant impact on the Company s consolidated financial statements.

FASB issued ASU 2017-09, *Compensation Stock Compensation (Topic 718).* ASU 2017-09 clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. Under ASU 2017-09, an entity will not apply modification accounting to a share-based payment award if all of the following are the same immediately before and after the change: (i) the award s fair value, (ii) the award s vesting conditions and (iii) the award s classification as an equity or liability instrument. ASU 2017-09 was effective for the Company on January 1, 2018 and did not have a significant impact on the Company s consolidated financial statements.

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FASB issued ASU 2018-02, *Income Statement Reporting Comprehensive Income (Topic 220).* ASU 2018-02 allows, but does not require, entities to reclassify certain income tax effects in accumulated other comprehensive income (AOCI) to retained earnings that resulted from the Tax Cuts and Jobs Act (Tax Act) that was enacted on December 22, 2017. The Tax Act included a reduction to the Federal corporate income tax rate from 35 percent to 21 percent effective January 1, 2018. The amount of the reclassification would be the difference between the income tax effects in AOCI calculated using the historical Federal corporate income tax rate of 35 percent and the income tax effects in AOCI calculated using the newly enacted 21 percent Federal corporate income tax rate. The amendments in ASU 2018-02 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company adopted ASU 2018-02 on January 1, 2018, and elected to reclassify certain income tax effects in AOCI to retained earnings. This change in accounting principle was accounted for as a cumulative-effect adjustment to the balance sheet resulting in a $1,093,000 increase to retained earnings and a corresponding decrease to AOCI on January 1, 2018.

Accounting Standards Pending Adoption

FASB issued ASU No. 2016-02, *Leases (Topic 842).* ASU 2016-2, among other things, requires lessees to recognize most leases on-balance sheet, increasing reported assets and liabilities. Lessor accounting remains substantially similar to current U.S. GAAP. ASU 2016-02 will be effective for the Company on January 1, 2019, utilizing the modified retrospective transition approach. FASB has issued incremental guidance to the new leasing standard through ASU No. 2018-10 and 2018-11. The Company estimates that the adoption of this standard will result in an increase in assets of approximately $31,500,000 to recognize the present value of the lease obligations with a corresponding increase in liabilities. The Company does not expect this to have a material impact on the Company s results of operations or cash flows.

FASB issued ASU No. 2016-13, *Financial Instruments Credit Losses (Topic 326).* ASU 2016-13 is the final guidance on the new current expected credit loss (CECL) model. ASU 2016-13, among other things, requires the incurred loss impairment methodology in current GAAP be replaced with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to estimate future credit loss estimates. As CECL encompasses all financial assets carried at amortized cost, the requirement that reserves be established based on an organization s reasonable and supportable estimate of expected credit losses extends to held to maturity (HTM) debt securities. ASU 2016-13 amends the accounting for credit losses on available-for-sale securities (AFS), whereby credit losses will be presented as an allowance as opposed to a write-down. In addition, CECL will modify the accounting for purchased loans with credit deterioration since origination, so that reserves are established at the date of acquisition for purchased loans. Lastly, ASU 2016-13 requires enhanced disclosures on the significant estimates and judgments used to estimate credit losses, as well as on the credit quality and underwriting standards of an organization s portfolio. These disclosures require organizations to present the currently required credit quality disclosures disaggregated by the year of origination or vintage. ASU 2016-13 allows for a modified retrospective approach with a cumulative effect adjustment to the balance sheet upon adoption (charge to retained earnings instead of the income statement). ASU 2016-13 will be effective for the Company on January 1, 2020, and early adoption is permitted. While the Company is currently evaluating the provisions of ASU 2016-13 to determine the potential impact the new standard will have on the Company s Consolidated Financial Statements, it has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, consulting with outside professionals, and evaluating its current IT systems. Management expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the first reporting period in which the new standard is effective, but cannot yet estimate the magnitude of the one-time adjustment or the overall impact of the new guidance on the Company s financial position, results of operations or cash flows.

FASB issued ASU No. 2017-04, *Intangibles Goodwill and Other: Simplifying the Test for Goodwill Impairment (Topic 350):* ASU 2017-04 eliminates step two of the goodwill impairment test (the hypothetical purchase price allocation used to determine the implied fair value of goodwill) when step one (determining if the carrying value of a reporting unit exceeds its fair value) is failed. Instead, entities simply will compare the fair value of a reporting unit to its carrying amount and record goodwill impairment for the amount by which the reporting unit s carrying amount exceeds its fair value. ASU 2017-04 will be effective for the Company on January 1, 2020 and is not expected to have a significant impact on the Company s consolidated financial statements.

FASB issued ASU 2017-08, *Receivables Nonrefundable Fees and Other Costs (Topic 310).* ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium to require such premiums to be amortized to the earliest call date unless applicable guidance related to certain pools of securities is applied to consider estimated prepayments. Under prior guidance, entities were generally required to amortize premiums on individual, non-pooled callable debt securities as a yield adjustment over the contractual life of the security. ASU 2017-08 does not change the accounting for callable debt securities held at a discount. ASU 2017-08 will be effective for the Company on January 1, 2019, and is not expected to have a significant impact on the Company s consolidated financial statements.

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Note 2 Business Combinations

Merger with FNB Bancorp

On July 6, 2018, the Company completed the acquisition of FNB Bancorp (FNBB) for an aggregate transaction value of $291,132,000. FNBB was merged into the Company, and the Company issued 7,405,277 shares of common stock to the former shareholders of FNBB. FNBB s subsidiary, First National Bank of Northern California, merged into the Bank on the same day. The Company also paid $6.7 million to settle and retire all FNBB stock options outstanding as of the acquisition date. Upon the consummation of the merger, the Company added 12 branches within San Mateo, San Francisco, and Santa Clara counties.

In accordance with accounting for business combinations, the Company recorded $156,661,000 of goodwill and $27,605,000 of core deposit intangibles on the acquisition date. The core deposit intangibles will be amortized over the weighted average remaining life of 6.2 years with no significant residual value. For tax purposes, purchase prices accounting adjustments including goodwill are all non-taxable and /or non-deductible. Acquisition related costs of $5,227,000, $530,000 and $784,000 are included in the income statement for each of the years ended December 31, 2018, 2017 and 2016, respectively.

The acquisition was consistent with the Company s strategy to expand into the Bay Area market. The acquisition offers the Company the opportunity to increase profitability by introducing existing products and services to the acquired customer base as well as add new customers in the expanded region. Goodwill arising from the acquisition consisted largely of the estimated cost savings resulting from the combined operations.

The following table summarizes the consideration paid for FNBB and the amounts of assets acquired and liabilities assumed that were recorded at the acquisition date (in thousands).

	FNB Bancorp July 6, 2018
Fair value of consideration transferred:	
Fair value of shares issued	$ 284,437
Cash consideration	6,695
Total fair value of consideration transferred	291,132
Assets acquired:	
Cash and cash equivalents	37,308
Securities available for sale	335,667
Restricted equity securities	7,723
Loans	834,683
Premises and equipment	30,522
Cash value of life insurance	16,817
Core deposit intangible	27,605
Other assets	16,214
Total assets acquired	1,306,539

Liabilities assumed:		
Deposits		991,935
Other liabilities		15,133
Short-term borrowings Federal Home Loan Bank		165,000
Total liabilities assumed		1,172,068
Total net assets acquired		134,471
Goodwill recognized	$	156,661

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A summary of the estimated fair value adjustments resulting in the goodwill recorded in the FNB Bancorp acquisition are presented below (in thousands):

	FNB Bancorp July 6, 2018
Value of stock consideration paid to FNB Bancorp Shareholders	$ 284,437
Cash consideration	6,695
Less:	
Cost basis net assets acquired	114,030
Fair value adjustments:	
Investments	(1,081)
Loans	(22,390)
Premises and Equipment	21,590
Core deposit intangible	27,327
Deferred income taxes	(6,394)
Other	1,389
Goodwill	$ 156,661

The fair value of net assets acquired includes fair value adjustments to certain loans that were not considered impaired (PNCI loans) as of the acquisition date. The fair value adjustments were determined using discounted contractual cash flows. As such, these loans were not considered impaired at the acquisition date and were not subject to the guidance relating to purchased credit impaired loans (PCI loans), which have shown evidence of credit deterioration since origination. The gross contractual amounts receivable and fair value for PNCI loans as of the acquisition date was $866,189,000 and $833,381,000, respectively. The gross contractual amounts receivable and fair value for PCI loans as of the acquisition date was $1,683,000 and $1,302,000, respectively. At the acquisition date, the Company was unable to estimate the expected contractual cash flows to be collected from the purchased credit impaired loans.

The table below presents the unaudited proforma information as if the acquisition of FNB Bancorp had occurred on January 1, 2017 after giving effect to certain acquisition accounting adjustments. The proforma information for the years ended December 31, 2018 and 2017 includes acquisition adjustments for the amortization/accretion on loans, core deposit intangibles, and related income tax effects. The proforma financial information also includes one-time costs associated with the acquisitions but does not include expected costs savings synergies that we expect to achieve. The unaudited pro forma financial information is not necessarily indicative of the results of operations that would have occurred had the transaction been effected on the assumed date.

	Year ended December 31, 2018	Year ended December 31, 2017
	(in thousands, except per share data)	
Summarized proforma income statement data:		
Net interest income	$ 242,793	$ 227,795
(Provision for) benefit from loan losses	(2,180)	271

Noninterest income	51,152	53,881
Noninterest expense	(180,884)	(181,833)
Income before taxes	110,881	100,114
Income taxes	(30,337)	(47,352)
Net income	$ 80,544	$ 52,762
Basic earnings per share	$ 2.65	$ 1.74
Diluted earnings per share	$ 2.63	$ 1.72

It is impracticable to separately provide information regarding the revenue and earnings of FNB Bancorp included in the Company s consolidated income statement from the July 6, 2018 acquisition date to December 31, 2018 because the operations of FNBB were substantially comingled with the operations of the Company as of the system conversion date of July 22, 2018.

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Note 3 Investment Securities

The amortized cost and estimated fair values of investment securities classified as available for sale and held to maturity are summarized in the following tables:

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Debt Securities Available for Sale				
Obligations of U.S. government agencies	$ 647,288	$ 771	$ (18,078)	$ 629,981
Obligations of states and political subdivisions	128,890	294	(3,112)	126,072
Corporate bonds	4,381	97		4,478
Asset backed securities	355,451	73	(1,019)	354,505
Total debt securities available for sale	$ 1,136,010	$ 1,235	$ (22,209)	$ 1,115,036
Debt Securities Held to Maturity				
Obligations of U.S. government agencies	$ 430,343	$ 327	$ (7,745)	$ 422,925
Obligations of states and political subdivisions	14,593	82	(230)	14,445
Total debt securities held to maturity	$ 444,936	$ 409	$ (7,975)	$ 437,370

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Debt Securities Available for Sale				
Obligations of U.S. government agencies	$ 609,695	$ 695	$ (5,601)	$ 604,789
Obligations of states and political subdivisions	121,597	1,888	(329)	123,156
Total debt securities available for sale	$ 731,292	$ 2,583	$ (5,930)	$ 727,945
Debt Securities Held to Maturity				
Obligations of U.S. government agencies	$ 500,271	$ 5,101	$ (1,889)	$ 503,483
Obligations of states and political subdivisions	14,573	146	(37)	14,682
Total debt securities held to maturity	$ 514,844	$ 5,247	$ (1,926)	$ 518,165

During 2018, proceeds from sales of debt securities were $293,279,000, resulting in gross gains of $207,000. During 2017 investment securities with cost basis of $24,796,000 were sold for $25,757,000, resulting in a gain of $961,000 on sale. No investment securities were sold during 2016. Investment securities with an aggregate carrying value of

$597,591,000 and $285,596,000 at December 31, 2018 and 2017, respectively, were pledged as collateral for specific borrowings, lines of credit and local agency deposits.

The amortized cost and estimated fair value of debt securities at December 31, 2018 by contractual maturity are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. At December 31, 2018, obligations of U.S. government and agencies with an amortized cost basis totaling $1,077,631 consist almost entirely of residential real estate mortgage-backed securities whose contractual maturity, or principal repayment, will follow the repayment of the underlying mortgages. For purposes of the following table, the entire outstanding balance of these mortgage-backed securities issued by U.S. government corporations and agencies is categorized based on final maturity date. At December 31, 2018, the Company estimates the average remaining life of these mortgage-backed securities issued by U.S. government corporations and agencies to be approximately 5.8 years. Average remaining life is defined as the time span after which the principal balance has been reduced by half.

Debt Securities	Available for Sale		Held to Maturity	
(In thousands)	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year	$ 2,410	$ 2,413	$	$
Due after one year through five years	10,625	10,794	1,238	1,250
Due after five years through ten years	17,381	17,622	25,039	24,744
Due after ten years	1,105,594	1,084,207	418,659	411,376
Totals	$ 1,136,010	$ 1,115,036	$ 444,936	$ 437,370