CALIFORNIA INDEPENDENT BANCORP
Form 10-Q
August 14, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2003

OR

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

For the transition period from to
Commission File Number 0-265520

California Independent Bancorp

(Exact name of registrant as specified in its charter)

California	**68-0349947**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

1227 Bridge St., Suite C, Yuba City, California 95991
(Address of principal executive offices)
(Zip Code)

(530) 674-6025
(Registrant's telephone number, including area code)

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

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 period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes o No ý

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at June 30, 2003
Common stock, no par value	2,073,911 shares

This report contains 29 pages. The Exhibit Index is on pages 28.

PART I FINANCIAL INFORMATION

PART II OTHER INFORMATION

PART I Financial Information

ITEM 1. FINANCIAL STATEMENTS

CALIFORNIA INDEPENDENT BANCORP AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
As of June 30, 2003, December 31, 2002, and June 30, 2002
(Dollars in thousands except share data)
(UNAUDITED)

	June 30, 2003	December 31, 2002	June 30, 2002
Assets			
Cash and Due From Banks	$ 15,486	$ 21,801	$ 15,217
Federal Funds Sold		18,245	
Cash and Cash Equivalents	15,486	40,046	15,217
Investment Securities Held-to-Maturity	2,440	2,265	2,435
Investment Securities Available-for-Sale	137,140	97,974	94,016
Total Investments	$ 139,580	$ 100,239	$ 96,451
Loans and Leases	205,208	214,428	201,059
Less: Allowance for Loan and Lease Losses	(5,963)	(6,532)	(5,817)
Net Loans and Leases	$ 199,245	$ 207,896	$ 195,242
Premises and Equipment, Net	6,550	6,731	6,911
Other Real Estate	2,729		698
Cash Surrender Value of Insurance Policies	6,364	6,239	5,231
Other Assets	7,598	5,932	5,650
Total Assets	$ 377,552	$ 367,083	$ 325,400
Liabilities and Shareholders' Equity			
Deposits:			

	June 30, 2003	December 31, 2002	June 30, 2002
Noninterest-Bearing	$ 70,943	$ 75,381	$ 58,773
Interest-Bearing	239,767	231,345	212,685
Total Deposits	$ 310,710	$ 306,726	$ 271,458
Federal Home Loan Bank Borrowings	22,370	15,000	15,000
Other Borrowings	80	80	5,458
Mandatorily Redeemable Cumulative Trust Preferred Securities of Subsidiary Grantor Trust	10,000	10,000	
Other Liabilities	6,378	6,221	4,815
Total Liabilities	$ 349,538	$ 338,027	$ 296,731
Commitments and Contingencies			
Shareholders' Equity:			
Common Stock, No Par Value Shares Authorized 20,000,000, Shares Issued and Outstanding 2,073,911 at June 30, 2003, 2,152,751 at December 31, 2002, and 2,223,241 at June 30, 2002	$ 20,325	$ 22,600	$ 22,323
Retained Earnings	6,978	5,589	5,574
Debt Guarantee of ESOP	(80)	(80)	(120)
Accumulated Other Comprehensive Income	791	947	892
Total Shareholders' Equity	$ 28,014	$ 29,056	$ 28,669
Total Liabilities and Shareholders' Equity	$ 377,552	$ 367,083	$ 325,400

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

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CALIFORNIA INDEPENDENT BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands except share data)
(UNAUDITED)

	Three months ended June 30, 2003	Three months ended June 30, 2002
Interest Income		
Interest and Fees on Loans and Leases	$ 3,810	$ 3,772
Interest on Investments		
Taxable Interest Income	1,144	1,329
Nontaxable Interest Income	27	16
Interest on Federal Funds Sold	29	7
Total Interest Income	5,010	5,124

Interest Expense

		Three months ended June 30, 2003		Three months ended June 30, 2002
Interest on Deposits		1,079		998
Interest on Mandatorily Redeemable Cumulative Trust Preferred Securities of Subsidiary Grantor Trust		120		
Interest on Borrowed Funds		168		175
Total Interest Expense		1,367		1,173
Net Interest Income		3,643		3,951
Provision for Loan and Lease Losses				150
Net Interest Income After Provision for Loan and Lease Losses		3,643		3,801
Noninterest Income				
Service Charges on Deposit Accounts		414		398
Brokered Loan Fees		64		34
Loan Servicing Fees		25		23
Other		94		165
Total Noninterest Income		597		620
Noninterest Expense				
Salaries and Employee Benefits		1,673		1,774
Occupancy Expense		217		210
Furniture and Equipment Expense		325		319
Other		777		835
Total Noninterest Expense		2,992		3,138
Income Before Provision for Income Taxes		1,248		1,283
Provision for Income Taxes		430		471
Net Income	$	818	$	812
Per Share Amounts				
Basic Earnings Per Share	$	0.39	$	0.37
Diluted Earnings Per Share	$	0.37	$	0.36
Basic Weighted Average Shares Outstanding		2,111,160		2,222,457
Diluted Weighted Average Shares Outstanding		2,193,550		2,228,499

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

CALIFORNIA INDEPENDENT BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands except share data)
(UNAUDITED)

	Six months ended June 30, 2003	Six months ended June 30, 2002
Interest Income		
Interest and Fees on Loans and Leases	$ 7,841	$ 7,347
Interest on Investments		
Taxable Interest Income	2,365	2,523
Nontaxable Interest Income	44	36
Interest on Federal Funds Sold	100	42
Total Interest Income	10,350	9,948
Interest Expense		
Interest on Deposits	2,188	2,078
Interest on Mandatorily Redeemable Cumulative Trust Preferred Securities of Subsidiary Grantor Trust	245	
Interest on Borrowed Funds	330	260
Total Interest Expense	2,763	2,338
Net Interest Income	7,587	7,610
Provision for Loan and Lease Losses	10	300
Net Interest Income After Provision for Loan and Lease Losses	7,577	7,310
Noninterest Income		
Service Charges on Deposit Accounts	704	698
Brokered Loan Fees	128	61
Loan Servicing Fees	133	158
Loss on Disposal of Available-for-Sale Security		(55)
Gain on Sale of Other Real Estate	108	
Other	343	357
Total Noninterest Income	1,416	1,219
Noninterest Expense		
Salaries and Employee Benefits	3,393	3,452
Occupancy Expense	427	407
Furniture and Equipment Expense	634	637
Other	1,558	1,576

	Six months ended June 30, 2003	Six months ended June 30, 2002
Total Noninterest Expense	6,012	6,072
Income Before Provision for Income Taxes	2,981	2,457
Provision for Income Taxes	1,057	899
Net Income	$ 1,924	$ 1,558
Per Share Amounts		
Basic Earnings Per Share	$ 0.90	$ 0.70
Diluted Earnings Per Share	$ 0.87	$ 0.70
Basic Weighted Average Shares Outstanding	2,129,514	2,221,827
Diluted Weighted Average Shares Outstanding	2,206,814	2,234,188

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

CALIFORNIA INDEPENDENT BANCORP AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Six-month Periods Ended June 30, 2003 and June 30, 2002
(Dollars in thousands)
(UNAUDITED)

	June 30, 2003	June 30, 2002
Cash Flows From Operating Activities		
Net Income	$ 1,924	$ 1,558
Adjustments to Reconcile Net Income to Net Cash		
Provided by Operating Activities:		
Depreciation and Amortization	507	485
Provision for Loan and Lease Losses	10	300
Loss on Disposal of Investment Securities		55
Gain on Sale of Other Real Estate, Net	(108)	
Gain on Sale of Loans and Leases, Net		(6)
Gain on Sale of Premises and Equipment		(10)
(Increase) Decrease in Other Assets	(1,751)	412
(Decrease) Increase in Other Liabilities	(700)	1,555
Net Cash (Used For) Provided By Operating Activities	$ (118)	$ 4,349
Cash Flows From Investing Activities		
Net Decrease (Increase) in Loans and Leases	6,858	(8,910)

		June 30, 2003		June 30, 2002
Purchases of Securities Available-for-Sale		(73,378)		(25,774)
Purchases of Securities Held-to-Maturity		(1,175)		
Proceeds From Maturity of Securities Held-to-Maturity		1,000		350
Proceeds From Sales, Maturities and Calls of Securities Available-for-Sale		33,927		6,847
Proceeds From Sales of Other Real Estate		108		
Purchases of Premises and Equipment		(326)		(450)
Net Cash Used for Investing Activities	$	(32,986)	$	(27,937)
Cash Flows From Financing Activities				
Net Decrease in Noninterest-Bearing Deposits		(4,436)		(11,195)
Net Increase in Interest-Bearing Deposits		8,421		7,077
Net Increase in Borrowed Funds		7,370		20,338
Repurchase of Common Stock		(2,361)		(96)
Cash Dividends		(535)		(465)
Stock Options Exercised		85		99
Net Cash Provided by Financing Activities	$	8,544	$	15,758
Net Decrease in Cash and Cash Equivalents	**$**	**(24,560)**	**$**	**(7,830)**
Cash and Cash Equivalents, Beginning of Year	**$**	**40,046**	**$**	**23,047**
Cash and Cash Equivalents, End of Period	**$**	**15,486**	**$**	**15,217**

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

CALIFORNIA INDEPENDENT BANCORP AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 ***Basis of Presentation***

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules and regulations of the Securities and Exchange Commission ("SEC"). In the opinion of Management, the unaudited consolidated financial statements contain all adjustments (consisting solely of recurring adjustments) that are necessary to present fairly the financial position of California Independent Bancorp ("CIB") and its subsidiaries (collectively, the "Company") at June 30, 2003, December 31, 2002, and June 30, 2002, the results of its operations for the three and six-month periods ended June 30, 2003 and June 30, 2002, and cash flows for the six-month periods ended June 30, 2003 and June 30, 2002.

Certain information and footnote disclosures normally presented in annual financial statements prepared in accordance with generally accepted accounting principles have been omitted in accordance with SEC rules or regulations. The results of operations for the three and six-month periods ended June 30, 2003 are not necessarily indicative of the operating results for the full year ending December 31, 2003. These financial statements should be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002.

Note 2 ***Principles of Consolidation***

The consolidated financial statements include the accounts of CIB and its wholly owned subsidiaries, Feather River State Bank, E.P.I. Leasing Company, Inc., and CIB Capital Trust. Significant intercompany transactions and balances have been eliminated in consolidation.

Note 3 ***Commitments and Contingent Liabilities***

In the normal course of business there are various outstanding commitments and contingent liabilities, such as commitments to extend credit and letters of credit that are not reflected in the financial statements. Management does not anticipate any material loss as a result of these transactions.

The contract amount of commitments not reflected on the balance sheet at June 30, 2003 and June 30, 2002 were as follows:

(Dollars in thousands)	June 30, 2003	June 30, 2002
Loan Commitments	$ 46,502	$ 54,420
Standby Letters of Credit	860	520

Note 4 ***Cash and Stock Dividends***

In February, May, August, and November of 2002, CIB paid an eleven-cent ($0.11) per share cash dividend and in February and May of 2003, CIB paid a twelve and one-half cent ($0.125) per share cash dividend.

On August 20, 2002, CIB's Board of Directors authorized and declared a five percent (5%) stock dividend for shareholders of record as of September 5, 2002. The dividend was distributed on September 20, 2002, and resulted in the issuance of 105,405 additional shares of common stock.

Note 5 ***Stock-Based Compensation***

At June 30, 2003, the Company had three stock-based compensation plans: the Feather River State Bank 1989 Amended and Restated Stock Option Plan, the California Independent Bancorp 1996 Stock Option Plan, and the California Independent Bancorp 2000 Stock Option Plan (the "Plans"). The Company accounts for the Plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. No stock-based compensation cost is reflected in net income, as all options granted under the Plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

For purposes of pro forma disclosures, the estimated fair value of stock-based compensation plans and other options is amortized to expense primarily over the vesting period. The following tables illustrate the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation," to stock-based compensation.

	For the three-months ended,	
(Dollars in thousands, except share data)	June 30, 2003	June 30, 2002
Net Income, As Reported	$ 818	$ 812
Deduct Total Stock-Based Employee Compensation Expense Determined Under the Fair Value Based Method for all Awards, Net of Related Tax Effects	(42)	(41)
Pro Forma Net Income	$ 776	$ 771

Basic Earnings Per Share:

	For the three-months ended,	
As Reported	$ 0.39	$ 0.37
Pro Forma	$ 0.37	$ 0.35
Diluted Earnings Per Share:		
As Reported	$ 0.37	$ 0.36
Pro Forma	$ 0.35	$ 0.35

	For the six-months ended,	
(Dollars in thousands, except share data)	June 30, 2003	June 30, 2002
Net Income, As Reported	$ 1,924	$ 1,558
Deduct Total Stock-Based Employee Compensation Expense Determined Under the Fair Value Based Method for all Awards, Net of Related Tax Effects	(82)	(125)
Pro Forma Net Income	$ 1,842	$ 1,433
Basic Earnings Per Share:		
As Reported	$ 0.90	$ 0.70
Pro Forma	$ 0.86	$ 0.64
Diluted Earnings Per Share:		
As Reported	$ 0.87	$ 0.70
Pro Forma	$ 0.83	$ 0.64

As required, the pro forma disclosures above include options granted since January 1, 1995. Consequently, the effects of applying FASB Statement No. 123 for providing pro forma disclosures may

not be representative of the effects on reported net income for future years until all options outstanding are included in the pro forma disclosures.

The fair value of each option granted during the periods indicated was estimated on the date of grant using an option-pricing model with the following assumptions:

	Three-months ended, June 30, 2002
Weighted Average Fair Value of Options Granted	$ 6.46
Dividend Yield	2.21%
Expected Volatility	30.24%
Risk-Free Interest Rate	4.55%
Expected Option Life	7.50 Years

	For the six months ended,	
	June 30, 2003	June 30, 2002
Weighted Average Fair Value of Options Granted	$ 9.29	$ 6.46
Dividend Yield	1.70%	2.21%
Expected Volatility	32.65%	30.24%

	For the six months ended,	
Risk-Free Interest Rate	3.54%	4.55%
Expected Option Life	7.50 Years	7.50 Years

There were no option grants made for the three-month period ended June 30, 2003.

Note 6 ***Earnings Per Share***

Basic earnings per share ("EPS"), which excludes dilution, is computed by dividing income available to common stockholders by the weighted-average number of shares of common stock outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock, which shares in the earnings of the Company. All data with respect to computing earnings per share is retroactively adjusted to reflect stock dividends and the treasury stock method is applied to determine the dilutive effect of stock options in computing diluted EPS.

Note 7 ***Comprehensive Income***

For the Company, total comprehensive income includes net income and unrealized changes in the fair value, net of applicable taxes, of its Available-for-Sale investment securities. Total comprehensive income for the three and six months ended June 30, 2003 and June 30, 2002 was $929,000 and $1,768,000, respectively, and $1,504,000 and $1,920,000, respectively, as shown in the following table.

	For the Three months ended June 30,		For the Six months ended June 30,	
(Dollars in thousands)	**2003**	**2002**	**2003**	**2002**
Net Income	$ 818	$ 812	$ 1,924	$ 1,558
Other Comprehensive Income:				
Change in Unrealized Gain on Available-for-Sale Investment Securities, net of taxes	111	692	(156)	331
Reclassification Adjustment for Loss on Sale of Securities, net of taxes				31
Total Comprehensive Income	$ 929	$ 1,504	$ 1,768	$ 1,920

Note 8 ***Financial Accounting Pronouncements***

In December 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure-an amendment of FASB Statement No. 123" ("SFAS No. 148"). This Statement amends SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions of SFAS No. 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reporting containing financial statements for interim periods beginning after December 15, 2002. Because the Company accounts for the compensation cost associated with its stock option plans under the intrinsic value method, the alternative methods of transition will not apply to the Company. The additional disclosure requirements of the statement are included in these financial statements. Management does not believe that the adoption of this Statement had a material impact on the Company's consolidated financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." This Statement amends and clarifies the accounting for derivative instruments by providing guidance related to circumstances under which a contract with a net investment meets the characteristics of a derivative as discussed in Statement 133. The Statement also clarifies when a derivative contains a financing component. The Statement is intended to result in more consistent reporting for derivative contracts and must be applied prospectively for contracts entered into or modified after June 30, 2003, except for hedging relationships designated after June 30, 2003. Management does not believe that the adoption of this Statement had a material effect on the Company's consolidated financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). This Statement is effective for financial instruments entered into or modified by the Company after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company has previously accounted for its mandatorily redeemable cumulative trust preferred securities in a manner consistent with the Statement and, in management's opinion, adoption of this Statement did not have a material effect on the Company's consolidated financial position or results of operations.

Note 9 ***Reclassifications***

Certain reclassifications have been made to amounts previously reported to conform to current presentation methods. Such reclassifications have no effect on net income or shareholders' equity previously reported.

Note 10 ***Subsequent Events***

On August 11, 2003, the Company entered into a definitive Agreement and Plan of Merger with Humboldt Bancorp. Under the terms of the merger agreement, the Company will merge into Humboldt Bancorp and Feather River State Bank will merge in Humboldt Bank although it will operate as a division of Humboldt Bank retaining its local identity.

Based on the closing value for a share of Humboldt Bancorp as of on the date of the merger agreement, the transaction is valued at approximately $80 million, or $35.50 per share of the Company. Company shareholders may elect to exchange each share held for cash or stock, although elections may be subject to proration if the results of all shareholders' elections differ from Humboldt's targeted stock-cash split of 60%-40%. The aggregate cash consideration will be approximately $32 million, or 40% of the total consideration, and a total of approximately 3.28 million shares of Humboldt common stock will be issued, representing 60% of the total consideration.

The companies anticipate that the transaction will qualify as a tax-free reorganization, and in general, expect that Company shareholders will not recognize income to the extent they exchange all of their shares of common stock of the Company for Humboldt stock and do not receive cash in lieu of any fractional shares, although shareholders should consult their own tax advisors for the consequences of the merger to them.

Subject to receipt of regulatory and shareholder approval, CIB expects this transaction will be completed during the first quarter of 2004.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

California Independent Bancorp ("CIB") is a California corporation and the holding company for Feather River State Bank ("the Bank"), located in Yuba City, California. The Bank was incorporated as a California state banking corporation on December 1, 1976, and commenced operations on April 6, 1977. CIB was incorporated on October 28, 1994, and became the holding company for the Bank on May 2, 1995. The Bank engages in a broad range of financial services activities, and its primary market is located in the Sacramento Valley, with a total of nine branches. The main source of income for the Bank is from lending activities, including commercial, agricultural, real estate, consumer, and installment loans and leases. CIB formed a nonbank subsidiary, CIB Capital Trust on October 2, 2002, for the sole purpose of issuing trust preferred securities.

Certain statements in the quarterly report on Form 10-Q and in Management's Discussion and Analysis of Financial Condition and Results of Operations (excluding statements of fact or historical financial information) involve forward-looking information within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the "safe harbor" created by those sections. These forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Such risks and uncertainties include, but are not limited to, the following factors: competitive pressure in the banking industry increases significantly; changes in the interest rate environment reduce net interest margins; general economic conditions, either nationally or regionally, are less favorable than expected, resulting in, among other things, a deterioration in credit quality and an increase in the provision for possible loan and lease losses; the loss of key personnel; change in the regulatory environment; changes in business conditions; volatility of rate sensitive deposits; operational risks including data processing system failures or fraud; lending concentration in real estate; volatility in agricultural lending; and asset/liability matching risks and liquidity risks.

The following discussion and analysis is designed to provide a better understanding of the significant changes and trends related to California Independent Bancorp's and Feather River State Bank's (CIB and the Bank are collectively, the "Company") financial condition, operating results, asset and liability management, and liquidity and capital resources; and should be read in conjunction with the Consolidated Financial Statements of the Company and its accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002.

OVERVIEW OF CHANGES IN THE FINANCIAL STATEMENTS

Total assets at June 30, 2003 were $377,552,000, an increase of 2.9% over $367,083,000 at December 31, 2002 and an increase of 16.0% over $325,400,000 at June 30, 2002.

Gross loans and leases were $205,208,000 at June 30, 2003, a decrease of 4.3% from $214,428,000 at December 31, 2002, and an increase of 2.1% over $201,059,000 at June 30, 2002. The increase in loans over the past twelve-month period is attributable to successful business development efforts and the Bank's strategic decision to further diversify its overall loan portfolio by promoting growth primarily in the commercial and real estate sectors. The decrease from year-end is due to refinancing of loans, resulting from the current decreasing interest rate environment, the intensification of competitive pressure in the loan market, and the Bank's continued emphasis on credit quality, high underwriting standards, and conservative pricing.

The Company's investment portfolio at June 30, 2003 was $139,580,000, compared to $100,239,000 at December 31, 2002, and $96,451,000 at June 30, 2002. Increases in the Company's investment portfolio during the first six months of 2003 were in large part due to continuing the implementation of the Company's investment strategy whereby the Company has invested its excess funds in qualified

Available-for-Sale Securities rather than federal funds sold. Cash and cash equivalents, which consisted of cash and due from banks and federal funds sold, were $15,486,000 at June 30, 2003, $40,046,000 at December 31, 2002, and $15,217,000 at June 30, 2002. The increased balance of cash and cash equivalents at December 31, 2002 was primarily due to the growth in total deposits. The decrease in cash and cash equivalents from December 31, 2002 to June 30, 2003 was primarily due to the Company utilizing the excess funds to purchase available-for-sale investment securities.

Total deposits of the Company were $310,710,000, $306,726,000, and $271,458,000 at June 30, 2003, December 31, 2002, and June 30, 2002, respectively. The increase at June 30, 2003 from December 31, 2002 and June 30, 2002, is primarily due to the Bank's focus on customer service and relationship banking, as well as new customer-centered product development.

The ratio of gross loans to deposits was 66.0%, 69.9%, and 74.1% at June 30, 2003, December 31, 2002, and June 30, 2002, respectively.

Loans and Leases

The Company continues to emphasize real estate, real estate construction, commercial, agricultural, and consumer lending activities. The Company has proactively intensified its focus on real estate secured and commercial lending to meet customers' needs in its geographic market segments. The Company lends primarily to small and medium sized businesses, small to large-sized farms, professionals, and consumers within its market area, which is principally comprised of Sutter, Yuba, Colusa, Yolo, and Placer counties; and, secondarily, Sacramento, El Dorado, Butte, and Glenn counties.

Due to the loan and lease portfolio's composition, the Company sustains moderate variations in outstanding loan totals. More specifically, certain seasonal variations are expected to occur in the agricultural and construction loan portfolios. The table below sets forth the composition of the Company's loan and lease portfolio as of June 30, 2003, December 31, 2002, and June 30, 2002.

COMPOSITION OF LOAN AND LEASE PORTFOLIO
(Dollars in thousands)

Loan Category	**June 30, 2003**	**December 31, 2002**	**June 30, 2002**

Commercial	$ 19,878	$ 25,375	$ 24,227
Agricultural	20,209	17,536	19,161
Real Estate Construction	31,941	35,287	29,336
Real Estate Mortgage	124,181	125,094	113,746
Leases	4,220	5,891	8,582
Consumer	3,934	4,391	4,531
Other	1,702	1,905	2,368
	$ 206,065	$ 215,479	$ 201,951
Deferred Loan Fees, Net	(857)	(1,051)	(892)
Allowance for Loan and Lease Losses	(5,963)	(6,532)	(5,817)
Total	$ 199,245	$ 207,896	$ 195,242

The principal changes in the loan and lease portfolio between June 30, 2003, December 31, 2002, and June 30, 2002 are discussed below:

The Bank makes commercial and small business loans (including lines of credit) that are secured by the assets of the business. Commercial loans decreased $5,497,000, or 21.7%, from December 31, 2002, and decreased $4,349,000, or 18.0%, from June 30, 2002. The decrease in the first six months of

2003, as well as the decrease over the year is due to increased refinancing of existing loans outside the Bank and the softening of commercial loan market demand in the Bank's core market areas.

The Bank provides agricultural production lines of credit and other agricultural loans that are secured by crops, crop proceeds, and other collateral. Agricultural loans increased $2,673,000, or 15.2%, over December 31, 2002 and increased $1,048,000, or 5.5% over June 30, 2002. The increase since December 31, 2002 is due to the seasonality of agricultural loan demand resulting from the agricultural cycle.

The Bank makes real estate construction loans, primarily to finance a variety of commercial, office, and retail projects, as well as for the construction of single-family homes. At June 30, 2003, real estate construction loans decreased $3,346,000, or 9.5%, from December 31, 2002, but increased $2,605,000, or 8.9%, over June 30, 2002. The decline from December 31, 2002 is due to increased competition resulting from the interest rate environment and decreased activity in the construction real estate market in the Bank's core market area. The increase over June 30, 2002 is due to the Bank's business development efforts in its primary market area.

Mortgage loans secured by commercial, residential, and agricultural real estate decreased $913,000, or 0.7%, from December 31, 2002, and increased $10,435,000, or 9.2%, over June 30, 2002. The increase from June 30, 2002 is primarily the result of successful business development efforts and an intensified focus on Placer County as a primary market area. At June 30, 2003, the real estate mortgage portfolio was 60.3% of the total loan portfolio. Increased portfolio limits have been approved as a result of enhanced monitoring analysis and limitations set on the sub-classifications within this portfolio segment.

Lease financing receivables declined $4,362,000, or 50.8%, between June 30, 2002 and June 30, 2003 and $1,671,000, or 28.4%, from December 31, 2002. This decline is the direct result of the Bank's decision in the first quarter of 2000 to discontinue originating and purchasing leases through E.P.I. Leasing Company, Inc. Consequently, the reduction of the Bank's lease portfolio was primarily due to scheduled lease portfolio principal reductions.

The Company makes consumer loans, including secured and unsecured loans and lines of credit, to finance a variety of consumer needs. Consumer loans decreased $597,000, or 13.2%, between June 30, 2002 and June 30, 2003 and $457,000, or 10.4%, from December 31, 2002. The decrease in this loan category was due to increased competition in the Bank's core market area and special pricing programs for new car financing by other financial institutions. Further, the Bank's Consumer lending group has focused on home equity and home improvement loans through a promotional product that are recorded in the real estate loan category.

During the first six months of 2003, there were no significant changes in the Bank's loan management, lending philosophy, or credit delivery procedures. The Company continues to emphasize high credit quality and superior customer service as two key components of its strategic direction.

Loan and Lease Quality

The Company places loans and leases on nonaccrual status when either principal or interest has been past due for 90 days or more. Exceptions to this policy can be made if the loan or lease is well secured and in the process of collection. The Company also places loans and leases on nonaccrual when payment in full of principal or interest is not expected, or the financial condition of the borrower has significantly deteriorated. At the time that a loan or lease is placed on nonaccrual, any accrued but uncollected interest is reversed and additional income is recorded on a cash basis as payments are received as long as principal is not impaired. Loans or leases that are in the process of renewal in the normal course of business, or that are well secured and in the process of collection may not be placed on nonaccrual status at the discretion of Management. A nonaccrual loan or lease may be restored to

an accrual basis when interest and principal payments are current and the prospects for future payments are no longer in doubt.

Nonperforming loans and leases consist of accruing loans and leases past due 90 days or more and nonaccrual loans and leases. The table below summarizes the composition of nonperforming loans and leases as of June 30, 2003, December 31, 2002, and June 30, 2002, as well as the changes between the periods. There were no loans and leases that were accruing interest that were past due as to principal or interest for 90 days or more at June 30, 2003, December 31, 2002, or June 30, 2002.

Nonperforming Assets
(Dollars in thousands)

	June 30, 2003	% Change From December 31, 2002 to June 30, 2003	December 31, 2002	% Change From June 30, 2002 To June 30, 2003	June 30, 2002
Nonaccrual Loans and Leases					
Commercial	$ 129	n/a	$	n/a	$ 3
Agricultural	25	(78.3)%	115	(88.8)%	224
Real Estate Construction	1,119	(56.3)%	2,560	n/a	2,443
Real Estate Mortgage	1,011	(40.6)%	1,702	(58.5)%	2,439
Leases		0.0%		0.0%	32
Consumer	12	(20.0)%	15	(29.4)%	17
Total Nonperforming Loans and Leases	$ 2,296	(47.7)%	$ 4,392	(55.5)%	$ 5,158
Other Real Estate	$ 2,729	n/a	$	291.0%	$ 698
Total Nonperforming Assets	$ 5,025	14.4%	$ 4,392	(14.2)%	$ 5,856

Total nonperforming loans and leases have decreased $2,862,000, or 55.5%, since June 30, 2002 and $2,096,000, or 47.7%, since December 31, 2002. Although nonperforming loans and leases decreased from December 31, 2002, nonperforming assets increased due to one large commercial real estate secured loan transitioning to other real estate from nonperforming loans. Management continues its emphasis on reducing classified assets and enhancing quality control in the management of the loan and lease portfolios.

The composition of the Company's nonaccrual loans and leases remain limited primarily to two borrowers. At June 30, 2003, 87.4% of the Company's total nonaccrual loans and leases were concentrated with these two borrowers. One of the relationships totaling $1,119,000, or 48.7%, is a commercial construction real estate relationship while the other totaling $889,000, or 38.7%, is a commercial real estate relationship. Each of these nonaccrual loan relationships is in the process of collection and is believed to be adequately supported by collateral.

As of December 31, 2002, $4,108,000, or 93.5%, of the Company's total nonaccrual loans and leases were concentrated in three relationships, consisting of a real estate construction loan relationship totaling $2,443,000, or 55.6%, a agricultural loan relationship for $747,000, or 17.0%, and a commercial real estate loan relationship for $918,000, or 20.9%.

The Company maintains an allowance for loan and lease losses ("ALLL") to absorb probable losses inherent in the loan and lease portfolio and is based upon management's estimated range of

those losses. The ALLL is established through a provision for loan and lease losses and is increased by provisions charged against current earnings and reduced by net charge-offs. Actual losses for these loans can vary significantly from this estimate. The methodology and assumptions used to calculate the allowance are continually reviewed as to their appropriateness given the most recent losses realized and other factors that influence the estimation process. The model assumptions and resulting allowance level are adjusted accordingly as these factors change. The Company's ALLL totaled $5,963,000, or 2.9% of gross loans and leases, as of June 30, 2003. This amount compares to $6,532,000, or 3.0% of gross loans and leases, as of June 30, 2002.

The adequacy of the ALLL and the level of the related provision for loan and lease losses is determined based on management's judgment after consideration of numerous factors including but not limited to: (i) local and regional economic conditions, (ii) borrowers' financial condition, (iii) loan impairment and the related level of expected charge-offs, (iv) evaluation of industry trends, (v) industry and other concentrations, (vi) loans which are contractually current as to payment terms but demonstrate a higher degree of risk as identified by management, (vii) continuing evaluations of the performing loan portfolio, (viii) ongoing review and evaluation of problem loans identified as having loss potential, (ix) quarterly review by the Board of Directors, and (x) assessments by banking regulators and other third parties. Management and the Board of Directors evaluate the ALLL and determine its desired level considering objective and subjective measures, such as knowledge of the borrowers' business, valuation of collateral, the determination of impaired loans or leases and exposure to potential losses.

The Company establishes general reserves in accordance with Statement of Accounting Standards ("SFAS") No. 5., "Accounting for Contingencies," and specific reserves in accordance with SFAS No. 114, "Accounting by Creditors for Impairment of a Loan." The ALLL is maintained by categories of the loan portfolio based on loan type and loan rating; however, the entire allowance is available to cover actual loan and lease losses. While Management uses available information to recognize possible losses on loans and leases, future additions to the allowance may be necessary, based on changes in economic conditions and other matters. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's ALLL. Such agencies may require the Company to provide additions to the allowance based on their judgment of information available to them at the time of their examination.

The adequacy of the ALLL is determined based on three components. First is the dollar weighted risk rating of the loan portfolio, including all outstanding loans and leases. Every extension of credit has been assigned a risk rating based upon a comprehensive definition intended to measure the inherent risk of lending money. Each rating has an assigned risk factor expressed as a reserve percentage. Secondly, established specific reserves consistent with SFAS No. 114 "Accounting by Creditors for Impairment of a Loan" are assigned to individually impaired and adversely graded loans. These are estimated potential losses associated with specific borrowers based upon estimated cash flows or collateral value and events affecting the risk rating. Thirdly, the Company maintains a reserve for qualitative factors that may affect the portfolio as a whole, such as those factors described above, including a reserve for model imprecision consistent with SFAS No. 5 "Accounting for Contingencies."

Provisions to the ALLL are made to maintain an ALLL level deemed adequate by management. No provision to the ALLL was made during the three-month period ended June 30, 2003, while a provision to the ALLL of $150,000 was made for the three-month period ended June 30, 2002. Provisions to the ALLL totaled $10,000 and $300,000 for the six-month periods ended June 30, 2003 and June 30, 2002, respectively. Total provisions to the ALLL for the year ended December 31, 2002 equaled $550,000. Loan and lease charge-offs for the three months ended June 30, 2003 totaled $35,000, compared to $159,000 for the three months ended June 30, 2002. Loan and lease charge-offs for the six months ended June 30, 2003 totaled $693,000, compared to $196,000 for the six months ended June 30, 2002. Loan and lease recoveries were $60,000 for the three months ended June 30,

2003, compared to $36,000 for the three months ended June 30, 2002. For the six months ended June 30, 2003 and June 30, 2002, loan and lease recoveries were $114,000 and $215,000, respectively. The following table illustrates the activity in the Bank's ALLL for the three and six months ended June 30, 2003 and June 30, 2002.

Activity in Allowance for Loan and Lease Losses
(Dollars in thousands)

	For the Three months ended June 30,		For the Six months ended June 30,	
	2003	2002	2003	2002
Beginning Balance	$ 5,938	$ 5,790	$ 6,532	$ 5,498
Charge-offs by Loan Category:				
Commercial				
Agricultural				
Real Estate		20	581	20
Leases	33	136	106	170
Consumer	2	3	6	6
Total	35	159	693	196
Recoveries by Loan Category:				
Commercial	11	3	20	10
Agricultural		1	1	154
Real Estate				
Leases	48	31	92	50
Consumer	1	1	1	1
Total	60	36	114	215
Net Charge-offs (Recoveries)	(25)	123	579	(19)
Provision Charged to Expense		150	10	300
Balance, June 30	$ 5,963	$ 5,817	$ 5,963	$ 5,817

Investments

The Company's investment portfolio was $139,580,000 at June 30, 2003, compared to $100,239,000 at December 31, 2002, and $96,451,000 at June 30, 2002. The increase of $43,129,000, or 44.7%, from June 30, 2002 to June 30, 2003, is primarily due to the Company investing its excess funds in qualified Available-for-Sale Securities rather than federal funds sold.

As of June 30, 2003, the Company's "available-for-sale" category adjustment reflected a net unrealized gain of $791,000, net of taxes. The approximate market value of the Company's investment portfolio at June 30, 2003 was $139,640,000. As of June 30, 2002, the Company's "available-for-sale" category adjustment reflected a net unrealized gain of $892,000, net of taxes, and the approximate market value of the Company's investment portfolio was $96,536,000. The $101,000 change in the unrealized gain/loss between the two periods is primarily the result of the interest rate environment and changes in the portfolio's composition.

RESULTS OF OPERATIONS
Three and Six Months Ended June 30, 2003
Compared with
Three and Six Months Ended June 30, 2002

The Company recognized net income of $1,924,000 for the six-month period ended June 30, 2003, resulting in diluted earnings per share of $0.87. Net income for the three months ended June 30, 2003 was $818,000, resulting in diluted earnings per share of $0.37. Net Income and diluted earnings per share for the three and six-month periods ended June 30, 2003 were higher than the same periods in 2002. Net income for the three and six-month periods ended June 30, 2002 were $812,000 and $1,558,000, respectively. The diluted earnings per share for the same three and six-month periods were $0.36 and $0.70, respectively (all earnings per share calculations have been adjusted for the three and six months ended June 30, 2002, to reflect the Company's 5% stock dividend distributed on September 20, 2002). The return on average equity and the return on average assets for the three-month period ended June 30, 2003 were 11.50% and 0.90%, respectively, as compared to 11.51% and 1.02%, respectively, for the same period in 2002. The return on average equity and the return on average assets for the six-month period ended June 30, 2003 were 13.49% and 1.06%, respectively, as compared to 11.15% and 0.99%, respectively, for the same period in 2002.

Net interest income for the three and six months ended June 30, 2003 were $3,643,000 and $7,587,000, respectively, compared to $3,951,000 and $7,610,000, respectively, for the same three and six-month periods in 2002. The change in net interest income for three and six months ended June 30, 2003 reflects the combined effect of a variety of factors, including the average loan balance and interest rates, affecting interest income and interest expense as shown and described below.

Average Daily Balance Sheets
(Dollars in thousands, except percentages)

	Three Months Ended,					
	June 30, 2003			June 30, 2002		
	Average Balance	Yield/ Rate	Interest Amount	Average Balance	Yield/ Rate	Interest Amount
Assets						
Earning-Assets:						
Short-Term Investments:						
Federal Funds Sold	$ 9,614	1.21%	$ 29	$ 1,588	1.77%	$ 7
Investment Securities:						
Taxable	117,838	3.90%	1,145	95,303	5.59%	1,329
Non-Taxable	2,440	4.44%	27	1,540	4.17%	16
Total	120,278	3.91%	1,172	96,843	5.57%	1,345
Loans and Leases	204,835	7.46%	3,809	195,348	7.74%	3,772
Total Earning Assets	334,727	6.00%	5,010	293,779	7.00%	5,124
Allowance for Possible Loan Losses	(5,959)			(5,785)		
Non Earning Assets:						
Cash and due from banks	13,839			13,343		
Premises and Equipment	6,661			6,777		
Other	15,713			10,741		
Total Non-Earning Assets	36,213			30,860		
Total Assets	$ 364,981			$ 318,855		

Liabilities and Shareholders' Equity

	Three Months Ended,					
Interest-Bearing Liabilities:						
Demand, Savings and Money Market	$ 126,454	0.73%	$ 230	$ 120,951	1.04%	$ 314
Time Certificates	109,301	3.12%	849	89,142	3.08%	684
Other Interest-Bearing Liabilities	27,152	4.25%	288	19,434	3.61%	175
Total Interest-Bearing Liabilities	262,907	2.09%	1,367	229,527	2.05%	1,173
Noninterest-Bearing Liabilities:						
Demand	68,270			57,411		
Other Liabilities	5,358			3,660		
Total Noninterest-Bearing Liabilities	73,628			61,071		
Shareholders' Equity	28,446			28,221		
Total Liabilities and Shareholders' Equity	364,981			318,819		
Net Interest Income			$ 3,643			$ 3,951
Net Interest Margin		4.35%			5.38%	

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Average Daily Balance Sheets
(Dollars in thousands, except percentages)

	Six Months Ended,					
	June 30, 2003			June 30, 2002		
	Average Balance	Yield/ Rate	Interest Amount	Average Balance	Yield/ Rate	Interest Amount
Assets						
Earning Assets:						
Short-Term Investments:						
Federal Funds Sold	$ 17,013	1.19%	$ 100	$ 5,238	1.62%	$ 42
Investment Securities:						
Taxable	109,838	4.34%	2,365	90,466	5.62%	2,523
Non-Taxable	1,999	4.44%	44	1,731	4.19%	36
Total	111,837	4				