PLUMAS BANCORP
Form 10-Q
November 08, 2007

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED September 30, 2007

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

FOR THE TRANSITION PERIOD FROM _________ TO _________

COMMISSION FILE NUMBER: 000-49883

PLUMAS BANCORP

(Exact Name of Registrant as Specified in Its Charter)

California	**75-2987096**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
35 S. Lindan Avenue, Quincy, California	**95971**
(Address of Principal Executive Offices)	(Zip Code)

Registrant s Telephone Number, Including Area Code **(530) 283-7305**

Indicated 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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule12b-2 of the Exchange Act (check one):

Large Accelerated Filer o Accelerated Filer þ Non-Accelerated Filer o

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

Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of November 5, 2007; 4,919,963 shares

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
PLUMAS BANCORP
CONDENSED CONSOLIDATED BALANCE SHEET
(Unaudited)

(In thousands, except share data)

	September 30, 2007	December 31, 2006
Assets		
Cash and due from banks	$ 15,167	$ 11,293
Federal funds sold	8,045	
Cash and cash equivalents	23,212	11,293
Investment securities (fair value of $62,263 at September 30, 2007 and $74,841 at December 31, 2006)	62,252	74,795
Loans, less allowance for loan losses of $4,127 at September 30, 2007 and $3,917 at December 31, 2006 (Notes 3 and 4)	349,291	351,977
Premises and equipment, net	14,799	15,190
Intangible assets, net	1,112	1,337
Bank owned life insurance	9,700	9,449
Accrued interest receivable and other assets	9,355	9,198
Total assets	$ 469,721	$ 473,239
Liabilities and Shareholders Equity		
Deposits:		
Non-interest bearing	$ 119,956	$ 121,464
Interest bearing	296,865	280,712
Total deposits	416,821	402,176
Short-term borrowings		20,000
Accrued interest payable and other liabilities	4,963	4,901
Junior subordinated deferrable interest debentures	10,310	10,310
Total liabilities	432,094	437,387
Commitments and contingencies (Note 4)		
Shareholders equity (Notes 5 and 7):		
Serial preferred stock, no par value; 10,000,000 shares authorized, none issued		
Common stock, no par value; 22,500,000 shares authorized; issued and outstanding 4,933,616 shares at September 30, 2007 and 5,023,205 shares at December 31, 2006	4,987	4,828
Retained earnings	32,965	31,716

Accumulated other comprehensive loss (Note 6)		(325)		(692)
Total shareholders equity		37,627		35,852
Total liabilities and shareholders equity	$	469,721	$	473,239

See notes to unaudited condensed consolidated financial statements.

Table of Contents

PLUMAS BANCORP
CONDENSED CONSOLIDATED STATEMENT OF INCOME
(Unaudited)
(In thousands, except per share data)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
Interest Income:				
Interest and fees on loans	$ 6,898	$ 6,837	$ 20,908	$ 19,221
Interest on investment securities:				
Taxable	448	608	1,413	1,940
Exempt from Federal income taxes	131	133	397	397
Interest on Federal funds sold	83	14	91	158
Total interest income	7,560	7,592	22,809	21,716
Interest Expense:				
Interest on deposits	1,864	1,561	5,348	4,342
Interest on short-term borrowings	29	69	465	108
Interest on junior subordinated deferrable interest debentures	213	215	627	599
Other	6	6	17	15
Total interest expense	2,112	1,851	6,457	5,064
Net interest income before provision for loan losses	5,448	5,741	16,352	16,652
Provision for Loan Losses	125	300	500	900
Net interest income after provision for loan losses	5,323	5,441	15,852	15,752
Non-Interest Income:				
Service charges	1,009	945	2,766	2,731
Earnings on Bank owned life insurance policies	105	100	311	291
Other	314	271	918	831
Total non-interest income	1,428	1,316	3,995	3,853
Non-Interest Expenses:				
Salaries and employee benefits	2,675	2,500	8,142	7,366
Occupancy and equipment	870	827	2,659	2,387
Other	1,139	1,176	3,631	3,579
Total non-interest expenses	4,684	4,503	14,432	13,332
Income before provision for income taxes	2,067	2,254	5,415	6,273
Provision for Income Taxes	789	858	2,055	2,392

Net income	$ 1,278	$ 1,396	$ 3,360	$ 3,881
Basic earnings per share (Note 5)	$ 0.26	$ 0.28	$ 0.67	$ 0.78
Diluted earnings per share (Note 5)	$ 0.26	$ 0.27	$ 0.67	$ 0.76

See notes to unaudited condensed consolidated financial statements.

Table of Contents

PLUMAS BANCORP
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited)
(In thousands)

	For the Nine Months Ended September 30,	
	2007	**2006**
Cash Flows from Operating Activities:		
Net income	$ 3,360	$ 3,881
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	500	900
Change in deferred loan origination costs/fees, net	357	(398)
Depreciation and amortization	1,665	1,582
Stock-based compensation expense	209	130
Amortization of investment security premiums	125	312
Accretion of investment security discounts	(47)	(67)
Net loss on disposal/sale of premises and equipment	32	6
Gain on sale of vehicles owned	(24)	(6)
Earnings on Bank owned life insurance policies	(311)	(291)
Expenses on Bank owned life insurance policies	60	55
Increase in accrued interest receivable and other assets	(456)	(673)
Increase (decrease) in accrued interest payable and other liabilities	62	(349)
Net cash provided by operating activities	5,532	5,082
Cash Flows from Investing Activities:		
Proceeds from matured and called available-for-sale investment securities	21,375	14,346
Proceeds from matured and called held-to-maturity investment securities	435	45
Purchases of available-for-sale investment securities	(11,009)	
Purchases of held-to-maturity investment securities		(155)
Proceeds from principal repayments from available-for-sale government-guaranteed mortgage-backed securities	2,288	2,782
Net decrease (increase) in loans	1,295	(28,591)
Proceeds from sale of other vehicles	354	124
Purchase of bank owned life insurance		(200)
Purchase of premises and equipment	(835)	(4,035)
Net cash provided by (used in) investing activities	13,903	(15,684)

Continued on next page.

Table of Contents

PLUMAS BANCORP
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited)
(In thousands)
(Continued)

	For the Nine Months Ended September 30,	
	2007	**2006**
Cash Flows from Financing Activities:		
Net decrease in demand, interest bearing and savings deposits	$ (15,973)	$ (1,779)
Net increase (decrease) in time deposits	30,618	(6,768)
Net (decrease) increase in short-term borrowings	(20,000)	9,500
Net proceeds from exercise of stock options	40	108
Payment of cash dividends	(750)	(651)
Repurchase and retirement of common stock	(1,451)	
Net cash (used in) provided by financing activities	(7,516)	410
Increase (decrease) in cash and cash equivalents	11,919	(10,192)
Cash and Cash Equivalents at Beginning of Year	11,293	24,596
Cash and Cash Equivalents at End of Period	$ 23,212	$ 14,404
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest expense	$ 5,995	$ 4,945
Income taxes	$ 2,475	$ 2,585
Non-Cash Investing Activities:		
Vehicles acquired through foreclosure	$ 352	$ 117
Real estate acquired through foreclosure	$ 182	$
Loan transferred to other assets	$	$ 230
Net decrease in unrealized loss on available-for-sale securities	$ 367	$ 227
Non-Cash Financing Activities:		
Common stock retired in connection with the exercise of stock options	$ 49	$ 354

See notes to unaudited condensed consolidated financial statements.

Table of Contents

PLUMAS BANCORP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. GENERAL

During 2002, Plumas Bancorp (the Company) was incorporated as a bank holding company for the purpose of acquiring Plumas Bank (the Bank) in a one bank holding company reorganization. This corporate structure gives the Company and the Bank greater flexibility in terms of operation expansion and diversification. The Company formed Plumas Statutory Trust I for the sole purpose of issuing trust preferred securities on September 26, 2002. The Company formed Plumas Statutory Trust II for the sole purpose of issuing trust preferred securities on September 28, 2005.

The Bank is a California state-chartered bank that was incorporated in July 1980 and opened for business in December 1980. The Bank operates thirteen branches in California, including branches in Alturas, Chester, Fall River Mills, Greenville, Kings Beach, Loyalton, Portola, Quincy, Redding, Susanville, Tahoe City, Truckee and Westwood. The bank also has commercial lending offices in Auburn, California and Reno, Nevada. The Bank s deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to applicable legal limits. The Bank s primary source of revenue is generated from providing loans to customers who are predominately small and middle market businesses and individuals residing in the surrounding areas.

2. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements include the accounts of the Company and the accounts of its wholly-owned subsidiary, Plumas Bank. Plumas Statutory Trust I and Plumas Statutory Trust II are not consolidated into the Company s consolidated financial statements and, accordingly, are accounted for under the equity method. In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the Company s financial position at September 30, 2007 and December 31, 2006 and its results of operations for the three-month and nine-month periods ended September 30, 2007 and 2006 and its cash flows for the nine-month periods ended September 30, 2007 and 2006. Certain reclassifications have been made to prior period s balances to conform to classifications used in 2007.

The unaudited condensed consolidated financial statements of the Company have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) for interim reporting on Form 10-Q. Accordingly, certain disclosures normally presented in the notes to the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The Company believes that the disclosures are adequate to make the information not misleading. These interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s 2006 Annual Report to Shareholders on Form 10-K. The results of operations for the three-month and nine-month periods ended September 30, 2007 and 2006 may not necessarily be indicative of future operating results. In preparing such financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the periods reported. Actual results could differ significantly from those estimates.

Management has determined that because all of the commercial banking products and services offered by the Company are available in each branch of the Bank, all branches are located within the same economic environment and management does not allocate resources based on the performance of different lending or transaction activities, it is appropriate to aggregate the Bank branches and report them as a single operating segment. No single customer accounts for more than 10% of the revenues of the Company or the Bank.

Table of Contents

3. LOANS

Outstanding loans are summarized below, in thousands:

	September 30, 2007	December 31, 2006
Commercial	$ 37,319	$ 36,182
Agricultural	37,429	35,577
Real estate mortgage	120,733	116,329
Real estate construction and land development	80,281	75,930
Consumer	76,831	90,694
	352,593	354,712
Deferred loan costs, net	825	1,182
Allowance for loan losses	(4,127)	(3,917)
	$ 349,291	$ 351,977

4. COMMITMENTS AND CONTINGENCIES

The Company is party to claims and legal proceedings arising in the ordinary course of business. In the opinion of the Company s management, the amount of ultimate liability with respect to such proceedings will not have a material adverse effect on the financial condition or result of operations of the Company taken as a whole.

In the normal course of business, there are various outstanding commitments to extend credit which are not reflected in the financial statements, including loan commitments of $92,652,000 and $101,759,000 and stand-by letters of credit of $403,000 and $564,000 at September 30, 2007 and December 31, 2006, respectively.

Of the loan commitments outstanding at September 30, 2007, $25,563,000 are real estate construction loan commitments that are expected to fund within the next twelve months. The remaining commitments primarily relate to revolving lines of credit or other commercial loans, and many of these are expected to expire without being drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements. Each loan commitment and the amount and type of collateral obtained, if any, are evaluated on an individual basis. Collateral held varies, but may include real property, bank deposits, debt or equity securities or business assets.

Stand-by letters of credit are conditional commitments written to guarantee the performance of a customer to a third party. These guarantees are primarily related to the purchases of inventory by commercial customers and are typically short-term in nature. Credit risk is similar to that involved in extending loan commitments to customers and accordingly, evaluation and collateral requirements similar to those for loan commitments are used. The deferred liability related to the Company s stand-by letters of credit was not significant at September 30, 2007 or December 31, 2006.

Table of Contents

5. EARNINGS PER SHARE

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share 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. The treasury stock method has been applied to determine the dilutive effect of stock options in computing diluted earnings per share.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
Earnings Per Share:				
Basic earnings per share	$ 0.26	$ 0.28	$ 0.67	$ 0.78
Diluted earnings per share	$ 0.26	$ 0.27	$ 0.67	$ 0.76
Weighted Average Number of Shares Outstanding:				
(in thousands)				
Basic shares	4,945	5,005	4,980	4,998
Diluted shares	4,976	5,090	5,025	5,090

Stock options not included in the computation of diluted earnings per share, due to their antidilutive effect, were 276,000 and 10,000 for the three months ended September 30, 2007 and 2006, respectively and 186,000 and 10,000 for the nine months ended September 30, 2007 and 2006, respectively.

6. COMPREHENSIVE INCOME

Total comprehensive income for the three months ended September 30, 2007 and 2006 totaled $1,558,000 and $1,977,000, respectively. Comprehensive income is comprised of unrealized gains, net of taxes, on available-for-sale investment securities, which were $280,000 and $581,000 for the three months ended September 30, 2007 and 2006, respectively, together with net income.

Total comprehensive income for the nine months ended September 30, 2007 and 2006 totaled $3,727,000 and $4,108,000, respectively. Comprehensive income is comprised of unrealized gains, net of taxes, on available-for-sale investment securities, which were $367,000 and $227,000 for the nine months ended September 30, 2007 and 2006, respectively, together with net income.

At September 30, 2007 and December 31, 2006, accumulated other comprehensive loss, net of taxes, totaled $325,000 and $692,000, respectively, and is reflected as a component of shareholders equity.

7. STOCK-BASED COMPENSATION

In 2001 and 1991, the Company established Stock Option Plans for which 894,860 shares of common stock remain reserved for issuance to employees and directors and 490,030 shares are available for future grants under incentive and nonstatutory agreements as of September 30, 2007. The Company granted 155,700 and 7,500 options during the nine months ended September 30, 2007 and 2006 respectively. The weighted average grant date fair value of options granted for the nine months ended September 30, 2007 and 2006 was $4.53 and $4.56 respectively. Compensation cost related to stock options recognized in operating results under SFAS No. 123R was $78,000 and $43,000 for the quarters ended September 30, 2007 and 2006, respectively. The associated future income tax benefit recognized was $7,000 and $4,000 for the quarters ended September 30, 2007 and 2006, respectively. Compensation cost related to stock options recognized in operating results under SFAS No. 123R was $209,000 and $130,000 in the nine months ended September 30, 2007 and 2006, respectively. The associated future income tax benefit recognized was $19,000 and $15,000 for the nine months ended September 30, 2007 and 2006, respectively.

Table of Contents

The following table summarizes information about stock option activity for the nine months ended September 30, 2007:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Options outstanding at December 31, 2006	290,914	$11.62		
Options granted	155,700	16.37		
Options exercised	(11,091)	8.10		
Options cancelled	(30,693)	15.74		
Options outstanding at September 30, 2007	404,830	$13.23	6.3	$ 302
Options exercisable at September 30, 2007	175,993	$10.60	5.2	$ 288
Expected to vest after September 30, 2007	228,837	$15.25	7.1	$ 14

The total intrinsic value of options (which is the amount by which the stock price exceeded the exercise price of the options on the date of exercise) exercised during the nine months ended September 30, 2007 was $84,000. During the nine months ended September 30, 2007, the amount of cash received from the exercise of stock options was $41,000. At September 30, 2007, there was $729,000 of total unrecognized compensation cost related to non-vested stock option awards which is expected to be recognized over a weighted-average period of 3.0 years. The total fair value of options vested during the nine months ended September 30, 2007 was $12,000.

8. INCOME TAXES

In July 2006, the Financial Accounting Standards Board (FASB) issued Financial Accounting Standards Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 also prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. The Company adopted FIN 48 on January 1, 2007.

The Company previously recognized income tax positions based on management s estimate of whether it is reasonably possible that a liability has been incurred for unrecognized income tax benefits by applying FASB Statement No. 5, *Accounting for Contingencies*.

The provisions of FIN 48 have been applied to all tax positions of the Company as of January 1, 2007. There was no cumulative effect of applying the provisions of FIN 48 and there was no significant effect on the Company s provision for income taxes for the nine months ended September 30, 2007. The Company recognizes interest accrued related to unrecognized tax benefits and accruals for penalties in income tax expense.

Table of Contents

9. RECENT ACCOUNTING DEVELOPMENTS

Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued Statement No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*. This standard permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. The entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option: (a) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments. The provisions of SFAS 159 are effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. Management did not elect to early adopt SFAS 159 and has not yet completed its evaluation of the impact that SFAS 159 will have.

10. SUBSEQUENT EVENTS

On October 17, 2007, the Company declared a common stock cash dividend of $0.15 per share. The dividend will be payable on November 16, 2007 to its shareholders of record on November 2, 2007.

Table of Contents

PART I FINANCIAL INFORMATION
ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain matters discussed in this Quarterly Report are forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, among others, (1) significant increases in competitive pressures in the financial services industry; (2) changes in the interest rate environment resulting in reduced margins; (3) general economic conditions, either nationally or regionally, maybe less favorable than expected, resulting in, among other things, a deterioration in credit quality; (4) changes in regulatory environment; (5) loss of key personnel; (6) fluctuations in the real estate market; (7) changes in business conditions and inflation; (8) operational risks including data processing systems failures or fraud; and (9) changes in securities markets. Therefore, the information set forth herein should be carefully considered when evaluating the business prospects of Plumas Bancorp.

When the Company uses in this Quarterly Report the words anticipate , estimate , expect , project , intend , comm believe and similar expressions, the Company intends to identify forward-looking statements. Such statements are not guarantees of performance and are subject to certain risks, uncertainties and assumptions, including those described in this Quarterly Report. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, expected, projected, intended, committed or believed. The future results and stockholder values of the Company may differ materially from those expressed in these forward-looking statements. Many of the factors that will determine these results and values are beyond the Company s ability to control or predict. For those statements, the Company claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

INTRODUCTION

The following discussion and analysis sets forth certain statistical information relating to Plumas Bancorp (the Company) as of September 30, 2007 and December 31, 2006 and for the three and nine month periods ended September 30, 2007 and 2006. This discussion should be read in conjunction with the condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and the consolidated financial statements and notes thereto included in Plumas Bancorp s Annual Report filed on Form 10-K for the year ended December 31, 2006.

Plumas Bancorp trades on The NASDAQ Capital Market under the ticker symbol PLBC .

CASH DIVIDEND

On October 17, 2007, the Company declared a semi-annual common stock cash dividend of $0.15 per share. The dividend is payable on November 16, 2007 to its shareholders of record on November 2, 2007.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

There have been no changes to the Company s critical accounting policies from those disclosed in the Company s 2006 Annual Report to Shareholders on Form 10-K.

This discussion should be read in conjunction with our unaudited condensed consolidated financial statements, including the notes thereto, appearing elsewhere in this report.

Table of Contents

RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007

OVERVIEW

The Company s net income declined by $521 thousand, or 13%, to $3.36 million for the nine months ended September 30, 2007 from $3.88 million for the same period in 2006. This decline in net income resulted from an increase in non-interest expense of $1.1 million and a decline in net interest income of $300 thousand which were partially offset by an increase in non-interest income of $142 thousand and decreases in the provision for loan losses of $400 thousand and the provision for income taxes of $337 thousand. The increase in non-interest expense included an increase of $776 thousand in salaries and employee benefit expense and $272 thousand in occupancy and equipment costs.

Total assets declined $3.5 million from $473.2 million at December 31, 2006 to $469.7 million at September 30, 2007. Net loans declined by $2.7 million from $352.0 million at December 31, 2006 to $349.3 million at September 30, 2007. A decline of $12.5 million in investment securities and an increase of $14.6 million in deposits provided funding to repay short-term borrowings which declined by $20 million with the excess funds invested in federal funds sold which increased by $8.0 million. Total shareholders equity increased by $1.8 million from $35.8 million at December 31, 2006 to $37.6 million at September 30, 2007.

The annualized return on average assets was 0.96% for the nine months ended September 30, 2007 down from 1.11% for the same period in 2006. The annualized return on average equity was 12.2% for the nine months ended September 30, 2007 down from 15.7% for the same period in 2006.

Net interest income before provision for loan losses. Net interest income, on a nontax-equivalent basis, was $16.4 million for the nine months ended September 30, 2007, a decrease of $300 thousand, or 2%, from $16.7 million for the same period in 2006. The decrease in net interest income was primarily attributed to increases in both the rates paid and average balances of the Company s time certificates of deposit and an increase in the average balance of short-term borrowings. This increase in interest expense was mostly offset by an increase in interest income related to an increase in average loans outstanding and an increase in the yield on those loans.

Interest income increased $1.1 million, or 5%, to $22.8 million for the nine months ended September 30, 2007. Interest and fees on loans increased by $1.7 million from $19.2 million for the nine months ended September 30, 2006 to $20.9 million during the current nine month period. The Company s average loan balances were $354 million for the nine months ended September 30, 2007, up $24 million, or 7%, from the $330 million during the same period in 2006. The average rate earned on the Company s loan balances increased 11 basis points to 7.89% during the first nine months of 2007 versus 7.78% during the first nine months of 2006. The increase in yield reflects the continued effect of the Company s decision to decrease the level of auto dealer loans which generally yield significantly less than other loans in the Company s loan portfolio.

Interest on investment securities decreased by $527 thousand, as an increase in yield of 19 basis points was offset by a decline in average investment securities of $23.2 million. Interest earned on federal funds sold declined by $67 thousand. Average federal funds sold were $2.4 million for the nine months ended September 30, 2007, a decline of $2.3 million from $4.7 million outstanding during the same period in 2006. This decline in average balance was partially offset by an increase in yield from 4.51% during the nine months ended September 30, 2006 to 5.10% during the current nine month period.

Interest expense increased $1.4 million to $6.5 million for the nine months ended September 30, 2007, up from $5.1 million for the same period in 2006. This increase includes $1.4 million in interest on time deposits and a $357 thousand increase in interest expense on short-term borrowings. The Company has experienced increases in the average balance of its time deposits but declines in non-interest bearing demand deposit accounts, NOW, savings and money market accounts. We continue to experience significant competition for deposits from both banking and non-banking sources. Rather than increasing the rate paid on our lower yielding interest bearing transaction and money market accounts to attract deposits and thereby increasing the rate paid on the entire balance of these accounts, the Company has chosen to fund loan growth through increases in its level of short-term time deposits and to a lesser extent through short-term borrowings. This has resulted in an increase in both the volume and rate components of time deposit interest expense and the volume variance of short-term borrowings.

Table of Contents

Average NOW account balances decreased by $2.2 million and the average rate paid decreased by 2 basis points. Included in average NOW accounts are Money Fund Plu$ balances. Money Fund Plu$ is a high interest bearing checking account designed to pay rates comparable to those available on a typical brokerage account. Average Money Fund Plu$ accounts were $41.2 million for the nine months ended September 30, 2007 compared to $38.9 million during the first nine months of 2006. The average rate paid on Money Fund Plu$ accounts declined from 3.54% during the 2006 period to 3.23% during the nine months ended September 30, 2007. The effect of the decrease in the average rate paid on Money Fund Plu$ balances on the average rate paid on NOW accounts was offset by an increase in Money Fund Plu$ account balances as a percentage of total NOW account balances.

The increase in the average rate paid on time deposits and the decrease in lower rate deposit sources as a percentage of total interest-bearing deposits has resulted in an increase in the average rate paid on the Company s interest bearing deposits of 49 basis points from 1.99% for the nine months ended September 30, 2006 to 2.48% for the current nine month period. The average rate paid on time deposits increased 88 basis points from 3.44% during the nine months ended September 30, 2006 to 4.32% during the current nine month period. This increase includes an increase in market rates in the Company s service area and the effect of a promotional certificate of deposit program introduced during the fourth quarter of 2006. The average rate paid on promotional certificate of deposits during the nine months ended September 30, 2007 was 5.12% and the average balance was $39 million. This product provides a higher rate of return for our more interest rate sensitive customers, whose deposits we may have lost to competition, while providing a highly competitive rate to attract new deposits.

Interest expense on money market and savings accounts declined by $397 thousand related to both a decline in the average rate paid on these accounts and a decline in the average balance. Interest on short-term borrowings increased primarily as a result of an increase in average borrowings. Interest expense paid on junior subordinated debentures fluctuates with changes in the 3-month London Interbank Offered Rate (LIBOR) rate which increased during the comparison period resulting in an increase of $28 thousand on these borrowings.

As a result of the changes noted above, the net interest margin for the nine months ended September 30, 2007 decreased slightly by 8 basis points to 5.20%, from 5.28% for the same period in 2006.

Table of Contents

The following table presents for the nine-month periods indicated the distribution of consolidated average assets, liabilities and shareholders equity. It also presents the amounts of interest income from interest-earning assets and the resultant annualized yields expressed in both dollars and annualized yield percentages, as well as the amounts of interest expense on interest-bearing liabilities and the resultant cost expressed in both dollars and annualized rate percentages. Average balances are based on daily averages. Nonaccrual loans are included in the calculation of average loans while nonaccrued interest thereon is excluded from the computation of yields earned:

For the Nine