COMMERCIAL METALS CO
Form DEF 14A
December 18, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A
(Rule 14a-101)

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x
Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement
o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
x Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to §240.14a-12

COMMERCIAL METALS COMPANY

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.
o Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

1) Title of each class of securities to which transaction applies:

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3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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1) Amount Previously Paid:

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NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To Be Held January 24, 2008

The Annual Meeting of Stockholders of Commercial Metals Company, a Delaware corporation, will be held in the Las Colinas Ballroom of the Four Seasons conference center, 4150 North MacArthur Boulevard, Irving, Texas, on January 24, 2008, at 10:00 a.m., Central Standard Time. If you are planning to attend the meeting in person, please check the appropriate space on the enclosed proxy card. A map is included on the back cover of the attached Proxy Statement. The meeting will be held for the following purposes:

(1) To elect four persons to serve as directors until the 2011 annual meeting of stockholders and until their successors are elected;

(2) To ratify the appointment of Deloitte & Touche LLP as the Company s independent registered public accounting firm for the fiscal year ending August 31, 2008;

(3) If presented at the annual meeting, to vote on a stockholder proposal requesting the addition of sexual orientation to the Company s written non-discrimination policy; and

(4) To transact such other business as may properly come before the meeting or any adjournments of the meeting.

Only stockholders of record on November 26, 2007, are entitled to notice of and to vote at the meeting or any adjournments of the meeting.

You are cordially invited to attend the annual meeting. Whether or not you plan to attend the meeting in person, you are urged to fill out, sign and mail promptly the enclosed proxy card in the accompanying envelope on which no postage is required if mailed in the United States. Alternatively, you may vote your shares via telephone or the internet as described on the enclosed proxy card. Proxies forwarded by or for brokers or fiduciaries should be returned as requested by them. The prompt return of proxies will save the expense involved in further communication.

By Order of the Board of Directors,

David M. Sudbury
Senior Vice President, Secretary
and General Counsel

Irving, Texas
December 18, 2007

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PROXY STATEMENT
ANNUAL MEETING OF STOCKHOLDERS

COMMERCIAL METALS COMPANY
6565 North MacArthur Boulevard
Irving, Texas 75039
Telephone (214) 689-4300

PROXY STATEMENT

FOR

ANNUAL MEETING OF STOCKHOLDERS

To Be Held January 24, 2008

This proxy statement is furnished in connection with the solicitation of proxies by the Board of Directors of Commercial Metals Company for use at the annual meeting of our stockholders to be held on January 24, 2008, and at any and all adjournments of the meeting. The approximate date on which this proxy statement and accompanying proxy card are first being sent or given to stockholders is December 18, 2007.

Shares represented by each proxy, if properly executed and returned to us prior to the meeting, will be voted as directed, but if not otherwise specified, will be voted for the election of four directors, to ratify the appointment of Deloitte & Touche LLP as the Company s independent registered public accounting firm, and, if presented, against the stockholder proposal requesting the addition of sexual orientation to the Company s written non-discrimination policy, all as recommended by our Board of Directors. A stockholder executing the proxy may revoke it at any time before it is voted by giving written notice to the Secretary of Commercial Metals Company, by subsequently executing and delivering a new proxy or by voting in person at the meeting (although attending the meeting without executing a ballot or executing a subsequent proxy will not constitute revocation of a proxy).

Stockholders of record can simplify their voting and reduce our cost by voting their shares via telephone or the Internet. The telephone and Internet voting procedures are designed to authenticate stockholders identities, allow stockholders to vote their shares and to confirm that their instructions have been properly recorded. If a stockholder s shares are held in the name of a bank or broker, the availability of telephone and Internet voting will depend upon the voting processes of the bank or broker. Accordingly, stockholders should follow the voting instructions on the form they receive from their bank or broker.

Stockholders who elect to vote via the Internet may incur telecommunications and Internet access charges and other costs for which they are solely responsible. The Internet and telephone voting facilities for stockholders of record will close at 11:59 p.m., Eastern Standard Time, on the evening before the annual meeting. Instructions for voting via telephone or the Internet are contained in the enclosed proxy card.

OUTSTANDING VOTING SECURITIES

On November 26, 2007, the record date for determining stockholders entitled to vote at the annual meeting, we had outstanding 116,921,377 shares of our common stock, par value $.01 per share, not including 12,139,287 treasury shares. Each share of our common stock is entitled to one vote for each director to be elected and upon all other matters to be brought to a vote. We had no shares of preferred stock outstanding at November 26, 2007.

The presence of a majority of our outstanding common stock represented in person or by proxy at the meeting will constitute a quorum. Shares represented by proxies that are marked abstain will be counted as shares present for purposes of determining the presence of a quorum. Proxies relating to street name shares that are voted by brokers on

some matters will be treated as shares present for purposes of determining the presence of a quorum, but will not be treated as shares entitled to vote at the annual meeting on those matters as to which authority to vote is withheld by the broker. Such shares as to which authority to vote is withheld are called broker non-votes.

The four nominees receiving the highest vote totals will be elected as directors. Accordingly, broker non-votes will not affect the outcome of the election of directors.

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All other matters to be voted on will be decided by the affirmative vote of a majority of the shares present or represented at the meeting and entitled to vote. On any such matter, an abstention will have the same effect as a negative vote. A broker non-vote on such matters will not be counted as an affirmative vote or a negative vote because shares held by brokers will not be considered entitled to vote on matters as to which the brokers withhold authority.

Management has designated the proxies named in the accompanying form of proxy.

We will appoint one or more inspectors of election to act at the annual meeting and to make a written report on the voting. Prior to the annual meeting, the inspectors will sign an oath to perform their duties in an impartial manner and to the best of their abilities. The inspectors will ascertain the number of shares outstanding and the voting power of each of the shares, determine the shares represented at the annual meeting and the validity of proxies and ballots, count all votes and ballots and perform certain other duties as required by law.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

On the basis of filings with the Securities and Exchange Commission and other information, we believe that as of the record date, the following persons, including groups of persons, beneficially owned more than 5% of our outstanding common stock:

Name and Address	Amount and Nature of Beneficial Ownership	Percent of Class
Goldman Sachs Asset Management, L.P. 32 Old Slip New York, New York, 10005	7,731,052(1)	6.6%
FMR Corp. 82 Devonshire Street Boston, Massachusetts, 02109	7,705,888(2)	6.6%
TPG-Axon Capital Management, LP 888 Seventh Avenue 38th Floor New York, New York 10019	7,250,100(3)	6.2%

(1) Based on the Schedule 13G report filed with the Securities and Exchange Commission on February 14, 2007. Goldman Sachs Asset Management, L.P. reported sole voting power over 7,557,276 shares and sole dispositive power over 7,731,052 shares.

(2) Based on the Schedule 13G report filed with the Securities and Exchange Commission on February 14, 2007. FMR Corp. reported sole voting power over 3,018,788 shares and sole dispositive power over 7,705,888 shares.

(3) Based on the Schedule 13G report filed with the Securities and Exchange Commission on November 27, 2007. TPG-Axon Capital Management, LP reported shared voting and dispositive power over 7,250,100 shares.

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The following table sets forth information known to us about the beneficial ownership of our common stock as of November 26, 2007, by each director and nominee for director, the Chief Executive Officer, the other executive officers included in the Summary Compensation Table, and all current directors, nominees for director and executive officers as a group. Unless stated otherwise in the notes to the table, each person named below has sole authority to vote and dispose of the shares listed.

Name	Owned Shares of Common Stock	Option Shares of Common Stock(1)	Total Shares of Common Stock Beneficially Owned	Percentage of Common Stock Beneficially Owned
Adams, Harold L	18,000	6,000	24,000	*
Feldman, Moses(2)	698,992	0	698,992	*
Guido, Robert L	6,112	0	6,112	*
Larson, William B	200,875	243,192	444,067	*
Loewenberg, Ralph E.(3)	42,000	13,410	55,410	*
Massaro, Anthony A	20,000	34,406	54,406	*
McClean, Murray R	125,772	93,832	219,604	*
Neary, Robert D	32,000	0	32,000	*
Owen, Dorothy G	967,521	111,388	1,078,909	*
Rabin, Stanley A	1,859,749	130,533	1,990,282	1.7%
Rinn, Russell B	95,312	214,533	309,845	*
Smith, J. David	14,000	13,670	27,670	*
Sudbury, David M	516,549	83,032	599,581	*
Womack, Robert R	46,682	18,000	64,683	*
Zoellner, Hanns	75,202	77,899	153,101	*
All current directors and executive officers as a group (15 persons)	4,718,767	1,039,895	5,758,662	4.9%

* Less than one percent

(1) Represents shares subject to options exercisable within 60 days of November 26, 2007.

(2) Moses Feldman has sole voting and dispositive power over 178,992 shares and shared voting and dispositive power over 520,000 shares. Includes 250,000 shares owned by the Marital Trust under the Trust Indenture created by the Will of Jacob Feldman of which Moses Feldman is one of four trustees and 270,000 shares owned of record by Moses Feldman Family Foundation of which Moses Feldman is a director. Moses Feldman disclaims beneficial ownership as to all shares held by Moses Feldman Family Foundation and the Marital Trust.

(3) Mr. Loewenberg is one of four trustees of the Marital Trust under the Trust Indenture created by the Will of Jacob Feldman which owns 250,000 shares. Mr. Loewenberg disclaims any beneficial interest as to such shares.

PROPOSAL I

ELECTION OF DIRECTORS

Our restated certificate of incorporation divides the Board of Directors into three classes. The term of office of the three Class I directors previously elected by stockholders expires at this annual meeting of stockholders. Robert L. Guido was elected to a one-year term as a Class I director by the Board on April 17, 2007. Prior to his election we had ten directors. The number of directors was increased to eleven by action of the Board at the time of his election. There are four Class I nominees standing for election. The term of the three Class II directors ends at the 2009 annual meeting of stockholders, and the term of the four Class III directors ends at the 2010 annual meeting of stockholders. Proxies cannot be voted for the election of more than four persons to the Board of Directors at the meeting.

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Each nominee has consented to being named in this proxy statement and to serve if elected. If any nominee becomes unavailable for any reason, the shares represented by the proxies will be voted for the person, if any, as may be designated by our Board of Directors. However, management has no reason to believe that any nominee will be unavailable. All of the nominee Directors, as well as the continuing Directors, plan to attend this year s annual meeting of stockholders. At the 2007 annual meeting, all of the current Directors of the Company were in attendance.

The following table sets forth information about the directors. All directors have been employed in substantially the same positions set forth in the table for at least the past five years except for Messrs. Massaro, Feldman, McClean and Rabin. Mr. Massaro retired as President and Chief Executive Officer of Lincoln Electric Holdings, Inc. in June 2004 and as Chairman of the Board in October 2004. Mr. Feldman was named Chairman of AeroMed, Inc. in July 2005, having previously served as its President and CEO. In July, 2006, Mr. McClean was elected a director and, effective September 1, 2006, Mr. McClean was appointed Chief Executive Officer, succeeding Mr. Rabin who had held the position since 1979. Mr. McClean had previously been employed as our President and Chief Operating Officer from September 20, 2004 to August 31, 2006, and as President of the Marketing and Distribution Segment from September 1, 1999 to September 20, 2004. Mr. McClean continues to serve in his capacity as President in addition to his positions as Chief Executive Officer and Director.

NOMINEES

Name, Principal Occupation and Business	Age	Served as Director Since
Class I Term to Expire in 2011		
Robert L. Guido Retired Former Vice Chair and Chief Executive Officer of Ernst & Young s Assurance and Advisory Practice	61	2007
Dorothy G. Owen Retired Former Chairman of the Board, Owen Steel Company, Inc.; Management of Investments	72	1995
J. David Smith Chairman, President and Chief Executive Officer, Euramax International, Inc., an international producer of aluminum, steel, vinyl, copper and fiberglass products for equipment manufacturers, distributors, contractors and home centers	58	2004
Robert R. Womack Retired Former Chairman and Chief Executive Officer, Zurn Industries, Inc. and Chief Executive of U.S. Industries Bath and Plumbing Products Group, each a manufacturer of plumbing products and accessories	70	1999

DIRECTORS CONTINUING IN OFFICE

Name, Principal		Served as Director

Occupation and Business	Age	Since
Class II Term to Expire in 2009		
Harold L. Adams Chairman Emeritus, RTKL Associates Inc., a global design firm	68	2004
Anthony A. Massaro Retired Former Chairman, President and Chief Executive Officer of Lincoln Electric Holdings, Inc., a manufacturer of welding and cutting equipment	63	1999
Robert D. Neary Retired Former Co-Chairman of Ernst & Young	74	2001

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Name, Principal Occupation and Business	Age	Served as Director Since
Class III Term to Expire in 2010		
Moses Feldman President, AeroMed, Inc., a manufacturer of medical device components	67	1976
Ralph E. Loewenberg President, R. E. Loewenberg Capital Management Corporation	68	1971
Murray R. McClean President and Chief Executive Officer, Commercial Metals Company	59	2006
Stanley A. Rabin Chairman of the Board of Directors, Commercial Metals Company	69	1979

Mr. Adams is a director of Legg Mason, Inc. and Lincoln Electric Holdings, Inc. Mr. Massaro is a director of PNC Financial Services Group, Inc. Mr. Neary is Chairman of the Board of Trustees of Allegiant Funds and Allegiant Advantage Fund. Mr. Smith is a director of Euramax International, Inc. Mr. Guido is a director of Bally Technologies, Inc.

There is no family relationship between any of the directors, executive officers, or any nominee for director.

The Board of Directors recommends a vote FOR the election of the nominees for Director named above.

Vote Required

Directors are elected by plurality vote, and cumulative voting is not permitted.

ADDITIONAL INFORMATION RELATING TO CORPORATE GOVERNANCE AND THE BOARD OF DIRECTORS

Corporate Governance. Our Board of Directors has determined, after considering all the relevant facts and circumstances, that Messrs. Adams, Feldman, Guido, Loewenberg, Massaro, Neary, Smith, and Womack, and Ms. Owen are independent, as independence is defined by the listing standards of the New York Stock Exchange (NYSE), because they have no direct or indirect material relationship with us (either directly or as a partner, shareholder or officer of an organization that has a relationship with the Company).

The Board of Directors has established the following requirements and guidelines to assist it in determining director independence in accordance with the revised listing standards of the New York Stock Exchange:

A director will not be independent if, within the preceding five years, the director or an immediate family member:

(i) received more than $100,000 per year in direct compensation from the Company other than director and committee fees and deferred compensation for prior service (provided such compensation is not contingent in any way on continued service), unless all independent directors unanimously determine that such compensatory relationship is not material;

(ii) was affiliated with or employed in a professional capacity by a present or former internal or external auditor of the Company;

(iii) was employed as an executive officer of another company where any Company employee serves on that company s compensation committee; or

(iv) is an executive officer of another company (a) that accounts for at least 2% or $1 million, whichever is greater, of the Company s consolidated gross revenue or (b) for which the Company accounts for at least 2% or $1 million, whichever is greater, of such other company s consolidated gross revenues.

The following categorical standards for commercial or charitable relationships will not be considered to be material relationships that would impair a director s independence: (i) if the director or immediate family member is an executive officer of a company which is indebted to the Company, or to which the Company is indebted, and the total amount of either entity s indebtedness to the other is less than 1% percent of the total consolidated assets of the other company; and (ii) if a director or immediate family member serves as an officer, director or trustee of a charitable organization, and the Company s discretionary charitable contributions to the organization are less than ten percent of that organization s total annual charitable receipts. A further discussion of the requirements and guidelines we use to assist in determining director independence is available at our website, www.cmc.com.

We have three standing board committees, Audit, Compensation and Nominating and Corporate Governance. Membership of each of these Committees is comprised entirely of independent directors. The Board of Directors has adopted charters for each of these Committees describing the authority and responsibilities delegated to each Committee by the Board. Our Board of Directors has also adopted corporate governance guidelines. The Company has also adopted a policy of business conduct and ethics, which applies to all directors, officers and employees of the Company. All Committee charters, corporate governance guidelines, financial code of ethics, policy of business conduct and ethics and other information is available at our website, www.cmc.com and such information is available in print to any shareholder who requests it.

The Company s Corporate Governance Guidelines permit, when considered appropriate, the designation for an annual term and by the majority vote of independent directors, a Lead Director. The responsibilities of the Lead Director include convening and presiding over executive sessions attended only by independent or independent and non-employee Directors, communicating to the Chief Executive Officer the substance of discussions held during those sessions to the extent requested by the participants, serving as a liaison between the Chairman and the Board s independent Directors on sensitive issues, consulting with the Chairman of the Board on meeting schedules and agendas including the format and adequacy of information the Directors receive and the effectiveness of the Board meeting process and presiding at meetings of the Board in the event of the Chairman s unavailability. The Lead Director is also available to receive direct communications from shareholders through Board approved procedures and periodically, as the Board may decide, be asked to speak for the Company or perform other responsibilities. In January, 2007, Anthony A. Massaro was appointed as the Lead Director for a term to expire at the date of the annual meeting of stockholders in 2008.

Non-management and independent Directors regularly schedule executive sessions in which they meet without the presence of employee Directors or management. The presiding Director at such executive sessions is the Lead Director, currently Mr. Massaro. Interested parties may communicate with Mr. Massaro as Lead Director or any of the non-management and independent directors by submitting a letter addressed to their individual attention or to the attention of Non-management Directors c/o General Counsel at P.O. Box 1046, Dallas, Texas 75221.

Meetings of the Board of Directors. During the fiscal year ended August 31, 2007, the entire Board of Directors met eleven times, of which seven were regularly scheduled meetings and four were special meetings. All directors attended at least seventy-five percent or more of the meetings of the Board and of the Committees on which they served.

Audit Committee. The Board of Directors has a standing Audit Committee which performs the activities more fully described in the Audit Committee Report on pages 46 and 47. The members of the Audit Committee during fiscal year 2007 were Messrs. Adams, Massaro, Neary, Smith, Womack and, following his election as a director in April, 2007,

Mr. Guido. Mr. Neary is Chairman of the Committee. During the fiscal year ended August 31, 2007, the Audit Committee met ten times.

Compensation Committee. The Board of Directors has a standing Compensation Committee that is responsible for the matters described in the Committee s charter including annually reviewing and approving corporate goals and objectives relevant to the CEO s compensation, evaluating the CEO s performance in light of those goals

and objectives and setting the CEO s compensation based on this evaluation as well as assisting the Board in the discharge of its responsibilities relating to the establishment, administration and monitoring of fair and competitive compensation and benefits programs for the Company s executive officers and other executives. Messrs. Feldman, Loewenberg, Neary, Massaro, Womack and Ms. Owen served as members of the Committee during fiscal year 2007. Mr. Womack is Chairman of the Committee. The Compensation Committee met nine times during the fiscal year ended August 31, 2007, to establish the CEO s salary and bonus, to make recommendations to the Board of Directors as to salary and bonus compensation for other executive officers, to review compensation policies, plans and reports related to compensation and benefit matters including the designation of eligible employees and establishment of performance periods and goals for one year and three year performance periods commencing in fiscal year 2007 and certifying the extent to which performance goals for periods ended with fiscal year 2007 were achieved, to approve the issuance of restricted stock awards and grants of stock appreciation rights, to conduct Committee self-assessment, to consider the Committee s charter and to prepare the Compensation Committee Report included in last year s proxy statement.

Nominating and Corporate Governance Committee. The Board of Directors has a standing Nominating and Corporate Governance Committee that is responsible for the matters described in the Committee s charter including efforts to identify and make recommendations as to individuals qualified to be nominated for election to the Board of Directors, reviewing management succession planning, and corporate governance matters. During 2007, the Nominating and Corporate Governance Committee consisted of Messrs. Massaro (Chairman), Adams, Feldman, Loewenberg, Neary, Smith, Womack, Ms. Owen, and following his election as a director in April, 2007, Mr. Guido. The Committee met seven times during the fiscal year ended August 31, 2007, not including one meeting designated as a non-employee Director meeting in compliance with the listing requirements of the NYSE, to consider Board structure, corporate governance matters including governance guidelines and Committee charters, Committee and Board self-assessment process, candidates for directors and executive officer succession. The Committee will consider persons recommended by stockholders for inclusion as nominees for election to our Board of Directors if the names, biographical data and qualifications of such persons are submitted in writing in a timely manner addressed to the attention of the Committee and delivered to the Secretary of Commercial Metals Company at P.O. Box 1046, Dallas, Texas 75221. Directors should possess the highest personal and professional ethics, integrity and values, and be committed to representing the long-term interests of shareholders. They must also have an inquisitive and objective perspective, practical wisdom and mature judgment. Dedication of sufficient time, energy and attention to insure diligent and effective performance of their duties is expected. Directors should be committed to serve on the Board for an extended period of time.

In April 2007, the Nominating and Corporate Governance Committee established a sub-committee (the IT Sub-committee) to assist the Board s oversight of a significant company-wide enterprise software implementation known as the Process Improvement Project (PIP). The IT Sub-committee is chaired by Mr. Guido with Messrs. Smith and Womack as members. During fiscal year 2007 the IT Sub-committee met 8 times to review reports from management and consultants retained by the sub-committee on PIP progress including the PIP scope, expense, staffing and schedule as well as recommendations to expedite the implementation process. All members attended at least 75% of the IT Sub-committee meetings.

Compensation of Non-employee Directors. None of our employees receive additional compensation for serving as a director. Messrs. Adams, Feldman, Guido, Loewenberg, Massaro, Neary, Smith, and Womack, and Ms. Owen were paid an annual fee of $50,000 and $1,500 for each Board meeting and Committee meeting attended. Chairmen of the Audit, Compensation and Nominating and Corporate Governance Committees and the Lead Director each received an additional fee payment of $10,000 per year. The Chairman of the IT Sub-committee was paid a $10,000 annual retainer, and each other member was paid $3,000 annual retainer at the time the Sub-committee was established. The Chairman and members are paid $1,000 per month but are not paid a meeting fee for service on this Sub-committee. We also reimburse directors for expenses in connection with their attendance at Board and Committee meetings and,

as authorized under the Company s Corporate Governance Guidelines, participation in continuing education programs specifically designed for directors of public companies in order that they stay current and knowledgeable about their roles.

The 1999 Non-Employee Director Stock Plan was approved at the 2000 annual meeting of stockholders and amended by stockholders at the 2005 and 2007 annual meetings. The plan provides that each non-employee director

shall receive on the date of each annual meeting of stockholders either, an option to acquire 14,000 shares or the choice to receive 4,000 shares of restricted stock or 4,000 restricted stock units. During fiscal year 2007, all Directors elected to receive 4,000 shares of restricted stock. Directors elected to fill vacancies between annual meetings receive a grant for a pro rata amount of options, restricted stock or restricted stock units based on their period of service before the next annual meeting. Options, restricted stock and restricted stock units vest in two equal annual installments beginning one year from the date of the award. In addition, each non-employee director may make an irrevocable election prior to January 1 of each year, to accept additional restricted stock units in lieu of all or part of the annual cash fees to be paid for that year. The number of shares subject to restricted stock units as a result of this election shall be the number of shares of Company Common Stock whose fair market value is equal to the dollar amount of fees subject to the election.

The exercise price for all options granted non-employee directors shall be the Fair Market Value on the day of grant. All non-employee director options terminate on the earliest of (i) the seventh anniversary of the date of grant; (ii) one year after termination of service by reason of death or disability; (iii) two years after termination of service by reason of retirement after age sixty-two; or (iv) thirty days following termination of service for any other reason. These options are non-qualified options under §422A of the Internal Revenue Code.

SECTION 16 BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires directors, executive officers and beneficial owners of more than 10% of our common stock to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of our common stock and any of our other equity securities. Based solely upon our review of the copies of such forms received by us or written representations that no forms were required from reporting persons, we believe that all such reports were submitted on a timely basis during the year ended August 31, 2007, except for one late filing by Moses Feldman reporting a gift of shares and change in the nature of ownership of a portion of his shares from direct to indirect status and one late filing by Murray McClean reporting a 400 share purchase under the Company s employee stock purchase plan.

COMPENSATION COMMITTEE REPORT

The Compensation Committee of the Board of Directors has reviewed and discussed the following section of this proxy statement entitled Compensation Discussion and Analysis with management. Based on this review and discussion, the Committee has recommended to the Board of Directors that this Compensation Discussion and Analysis be included in this proxy statement and incorporated by reference into the Company s Annual Report on Form 10-K for the fiscal year ended August 31, 2007.

Robert R. Womack (Chairman)
Moses Feldman
Ralph E. Loewenberg
Anthony A. Massaro
Robert D. Neary
Dorothy G. Owen

COMPENSATION DISCUSSION AND ANALYSIS

Introduction

The Company is primarily engaged in the manufacture, recycling, marketing and distribution of steel and metal products and related materials and services through a network of locations throughout the United States and internationally. The Company employs over 14,000 employees and operates more than two hundred and fifty (250) locations throughout fourteen (14) countries. During our fiscal year ended August 31, 2007, we considered our business to be organized into five segments: domestic mills, CMCZ (our Polish steel mill CMC Zawiercie S.A. and related operations), domestic fabrication, recycling and marketing and distribution. In fiscal year 2007, our net sales year over year increased by sixteen percent (16%) and our net earnings reached $355,431,000, just short of the Company s all-time record results of fiscal year 2006. While slightly short of our record, fiscal year 2007 was a year of remarkable achievement. By almost every measure the Company s performance was outstanding and compared favorably with its business peer group.

The Company s executive team members are the stewards of our competitive resources and decision making. In order to compete effectively in the industry, it is critical that the Company attract, retain, and sustain motivated leaders who can best position the Company to deliver financial and operational results that benefit our stockholders. We believe we have a strong, well-designed compensation program to achieve this objective.

What is the Role of the Compensation Committee in Establishing the Company s Compensation Principles?

The Compensation Committee of the Board of Directors (the Committee) oversees the compensation and benefit programs of the Company s executives. The Committee determines the compensation of the senior leadership group (the Company s officers, key operating and senior staff executives) individually. The Committee is responsible for ensuring that the Company s compensation policies and practices support the successful recruitment, development, and retention of the executive talent required by the Company to achieve its business objectives. The Committee is made up entirely of independent directors, consistent with the current listing requirements of the NYSE.

The executive compensation program is targeted to attract top-caliber, achievement-oriented executives. The Company s executive compensation philosophy is based on the premise that it is in the best interests of the stockholders for the Company to establish and maintain a competitive executive compensation program. Our base salary philosophy consists of maintaining competitive base salaries which we target at approximately the 40th percentile benchmarked against positions of similar responsibility disclosed within the Peer Group as defined

below. Short and long-term variable compensation provides the opportunity, based on performance, to earn in excess of the Peer Group 75th percentile. By placing a significant portion of potential executive compensation in the at risk category based upon financial performance of the Company, executive performance goals are aligned with those of stockholders, and, thus, constitute a larger percentage of an executive s overall compensation opportunity.

We will pay higher compensation when goals are exceeded and reduced compensation when goals are not met, taking into consideration individual ability to influence results.

To that end, the Committee has approved an executive compensation program that:

- facilitates the attraction and retention of top-caliber talent;
- aligns the interests of its executives with those of stockholders in both the short and long-term; and
- offers moderate base salaries and competitive employee benefits coupled with significant annual and long-term at risk incentives dependent upon achieving superior financial performance of the Company.

Within the objectives listed above, the Committee believes that best practices call for the performance metrics by which at risk compensation is:

- largely formulaic;
- designed to compensate based upon both individual and Company performance;
- established and communicated early in the performance period; and
- designed to minimize subjective discretion.

Nevertheless, the Committee strongly believes that some portion of the Company s executive compensation program must remain discretionary. This approach provides the Committee with the flexibility to reward executives for successfully addressing challenges and opportunities not reasonably foreseeable at the beginning of a performance period, thereby encouraging executives to seek the best answer on behalf of the Company. Discretionary compensation also allows the Committee to evaluate and reward executive performance in areas such as employee development and training, leadership and succession planning which strictly objective criteria may not adequately address. Absent this flexibility, the Committee s ability to modify executive compensation as a result of events not contemplated by a static incentive design would be reduced.

How Does the Committee Operate?

The Committee reviews annually the Company s executive compensation program in total and each program feature specifically. The review includes an analysis of market compensation practices and developments, external regulatory requirements, the competitive market for executive talent, the evolving culture and demands of the business, and the Company s compensation philosophy. The Committee periodically adjusts the various compensation elements to best align the goals of its executives with those of stockholders as well as with the requirements of the Company s business and regulatory environment.

Does the Committee or the Company Use External Compensation Advisors?

Since 2005, the Committee has engaged Ernst & Young LLP (E&Y) on an ongoing basis to consult on compensation matters. All work performed by E&Y with regard to the Company s executive compensation program is tasked and overseen directly by the Committee. The Company s management works with E&Y, and occasionally other external advisors hired by management to ensure that the information, analysis, and recommendations given to the Committee provide a thorough and accurate basis for its decisions. In addition, the Company participates in and purchases various compensation surveys and studies which management uses to analyze compensation for employees other than the

executives listed in the Summary Compensation Table on page 30. This information is also made available to the Committee. The Company believes that utilizing information from multiple external consulting firms and surveys ensures an objective and well-rounded view of executive compensation practices. Management has periodically called upon the services of Mercer Management Consulting (Mercer) to assist management in making recommendations to the Committee and to assist the Committee and management in benchmarking compensation for executive positions when little or no publicly available data exists for comparable positions. During fiscal year 2007 Mercer provided a study regarding the Company s retirement programs.

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What is the Role of Management in Compensation Decisions?

The Company believes strongly that the best answer for aligning executive and stockholder interests is through an executive compensation program designed with input from management in an ongoing dialogue with the Committee and, as appropriate, the compensation advisors listed above regarding internal, external, cultural, business and motivational challenges and opportunities facing the Company and its executives. To that end, the executive team analyzes, with assistance from the compensation advisors, trends and recommends improvements to the compensation programs. Specifically, Mr. McClean, President and Chief Executive Officer, reviews with the Committee his recommendations (without any recommendation as to his own compensation) regarding base salary adjustment, annual bonus, long-term bonus and equity awards for his executive leadership group (approximately 25-30 executives) to ensure alignment of stockholder interests and executive goals as well as reward for performance. All final decisions regarding compensation for these employees which include the executives listed in the Summary Compensation Table on page 30 are made by the Committee.

As periodically invited by the Committee, the following have attended meetings or portions of meetings of the Committee: Stanley A. Rabin, Chairman, Mr. McClean, William B. Larson, Senior Vice President and Chief Financial Officer, David M. Sudbury, Senior Vice President, Secretary and General Counsel and James B. Alleman, Vice President of Human Resources as well as employees of the external compensation advisors listed above.

Who are the Participants in the Executive Compensation Programs?

The executive compensation program discussed herein applies to larger groups of executives than the six Named Executive Officers (as defined below) included in the Summary Compensation Table on page 30.

The various individuals and groups who participate in our executive compensation program are:

Named Executive Officers (the NEOs):

Stanley A. Rabin, Chairman of the Board

Murray R. McClean, President & Chief Executive Officer

Russell B. Rinn, Executive Vice President & President CMC Americas Division

Hanns K. Zoellner, Executive Vice President & President CMC International Division

William B. Larson, Senior Vice President & Chief Financial Officer

David M. Sudbury, Senior Vice President, Secretary & General Counsel

Senior Executives:

Approximately twenty five (25) senior executives, including the NEOs

Senior Managers:

All other business, branch, and staff unit managers approximately 200 positions excluding Senior Executives.

How is the Competitiveness of the Company s Compensation Program Established?

The Company s executive compensation program is designed so that total short-term and long-term compensation are competitive with comparable positions at comparable companies which have achieved comparable results. Annually, with regard to NEOs, the Committee selects what it considers to be the most comparable companies with emphasis on their industry focus, size, scope, and complexity of operations. Compensation at this selected group of companies (the Peer Group) is used as a benchmark against which the Company s compensation practices for NEOs and all Senior Executives are tested. The Peer Group does not vary significantly one year to the next to ensure a stable basis of comparison. However, with the consolidations currently occurring in the steel industry, it is anticipated that revisions to the list due to acquisitions within the industry will periodically be

required. The Committee selected the following companies to comprise the Peer Group used for evaluation of compensation attributable to fiscal year 2007.

AK Steel Holding Corporation
Allegheny Technologies Incorporated
Chaparral Steel Company(1)
Mueller Industries, Inc.
.Nucor Corporation
Oregon Steel Mills Inc.(2)
Phelps Dodge Corporation(2)
Quanex Corporation
Reliance Steel & Aluminum Co.
Ryerson Inc.
Schnitzer Steel Industries, Inc.
Steel Dynamics, Inc.
The Timken Company
United States Steel Corporation
Worthington Industries

(1) Chaparral Steel was acquired in September, 2007 and has been deleted from the Peer Group.

(2) Oregon Steel Mills Inc. and Phelps Dodge Corporation have been removed from the Peer Group as a result of their acquisition during fiscal year 2007. Gerdau Ameristeel Corporation was added to the Peer Group to be used in evaluating fiscal 2008 compensation.

What are the Components and Objectives of Short and Long-Term Compensation?

Compensation Mix

In accordance with the Company s overall compensation philosophy and program, executives are provided with a mix of base salary, employee benefits, short-term incentives, long-term incentives, and health and welfare benefits. The following charts provide a pictorial description of the various components of fiscal year 2007 compensation for Mr. McClean as Chief Executive Officer (CEO) as well as all NEOs as a group, excluding Mr. Rabin due to his unique compensation program in light of his impending retirement. The equity portion is based on the fair value of awards on the date of grant computed in accordance with FAS 123R.

The allocation of values across these components is also consistent with the Company s compensation philosophy to place a greater portion of the potential compensation for each Senior Executive at risk . The concept of compensation placed at risk is applied to the compensation structure for most of our employees, but it is reflected in greater proportion in the NEO compensation. The following charts provide a pictorial description of the percentages of compensation considered at risk and not at risk for the CEO and all NEOs as a group, excluding Mr. Rabin.

Similar to the Senior Executives, including the NEOs, most employees of the Company are eligible to earn a performance-based bonus that is potentially significant and material in relation to their base salary. The table on the following pages displays the overall mix of compensation and the objectives for each component:

PROGRAM	DESCRIPTION	PARTICIPANTS	OBJECTIVES
	ANNUAL COMPENSATION:		
Base Salary	Annual Cash Compensation	All salaried employees	Retention. Recognition of individual performance.
Annual Cash Incentive Bonus: annual bonuses under the Commercial Metals Company 2006 Cash Incentive Plan* (the Cash Incentive Plan)	Bonus plan based on performance periods set by the Committee with formula-driven target awards based upon performance goals. Bonus payout may be reduced below (but not increased above) formula result at the discretion of the Committee.	Senior Executives	Focus executives on achieving return, operating profit and/or other pre-established performance goals.
Annual Discretionary Bonus	Cash bonuses awarded at the discretion of the Committee. The Committee may consider circumstances not contemplated when performance goals were established under the Cash Incentive Plan including evaluation of individual performance utilizing such criteria as the Committee considers appropriate.	Senior Executives, Senior Managers and certain exempt employees	Provides the Committee with flexibility to reward individual performance not contemplated in formulaic metrics. Focus named employees on performance. Reviewed annually for individual contribution in context of Company performance.
Performance and Productivity Bonus	Established annually by management at their discretion based on various criteria including productivity and profitability at discrete operating units during the year.	Most employees except Senior Executives and Senior Managers	Focus non-executive employees on job and Company performance and productivity.
	LONG-TERM COMPENSATION		
Equity Awards under the Commercial Metals Company 2006 Long-Term Equity Incentive Plan* (the Equity Incentive Plan)	Discretionary equity awards which may include Stock Appreciation Rights, Restricted Stock, Stock Options or other forms of equity-based incentives.	Senior Executives, Senior Managers and employees designated by the Committee	Drives long-term Company financial performance and focus on long-term success. Retention. Employee alignment with stockholders via stock ownership.

Long-Term Bonus under the Cash Incentive Plan	A cash incentive using a multi year performance period, currently based on the average growth in EBITDA over a three year period in excess of the Company s highest one year EBITDA.	Senior Executives and Senior Managers	Focus on corporate/stockholder values. Focus on increasing long-term earnings.

* **Denotes plan approved by stockholders**

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PROGRAM	DESCRIPTION	PARTICIPANTS	OBJECTIVES
	RETIREMENT PROGRAMS		
Profit Sharing and 401(k) Plan	ERISA qualified defined contribution plan that allows most U.S. employees to elect pre-tax deferrals, receive a discretionary Company match on a portion of elective deferrals and participate in discretionary Company contributions subject to IRS limits.	Most U.S. employees with greater than one year of service	Attract qualified employees. Retention. Provide vehicle for retirement.
Benefit Restoration Plan	A non-qualified plan designed to restore the benefits that would otherwise have been received by an eligible employee under the Profit Sharing and 401(k) Plan but for the applicable IRS limits.	Employees designated by the Committee	Attract qualified employees. Retention. Provide vehicle for retirement.
Discretionary Pension Plan	A pension retirement plan in those countries where neither the Profit Sharing and 401(k) Plan nor the Benefit Restoration Plan is applicable.	Senior Executives and Senior Managers in foreign location	Attract qualified employees Retention. Provide vehicle for retirement.
	OTHER EXECUTIVE BENEFITS		
Perquisites and Executive Benefits	Company provided automobiles and related insurance and maintenance. Lunch club memberships.	Senior Executives Based on business needs	Attract qualified employees. Facilitates business meetings. Retention.
Other Benefits	Medical, dental, vision, life insurance, Social Security or their foreign equivalents, and other welfare benefits.	All employees	Attract qualified employees. Retention.

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Base Salary

The Company pays an annual base salary to each of our NEOs in order to provide them with a not at risk fixed rate of cash compensation during the year. The Committee establishes a base salary for our NEOs based upon a number of factors, including the underlying scope of their responsibilities, their individual performance, their experience, internal equity, competitive market compensation and retention concerns.

The base salary target of the 40th percentile is only an approximate target, given that many factors impact whether the Company, or an individual executive, is positioned precisely at the 40th percentile of the market within the Peer Group. The Committee strives to maintain salaries at a level that will attract top talent, but with a significant portion of an executive s total compensation based on the Company s success. The Committee exercised this discipline during the annual review of executive salaries for the 2008 fiscal year in conjunction with a review of the results of fiscal year 2007, when the Committee decided not to increase the salaries of approximately half of the Company s Senior Executives, including four of the NEOs.

Upon an evaluation of a material change in an executive s responsibilities during a fiscal year, the Committee may increase or decrease an executive s compensation accordingly. For example, the base salary for Murray R. McClean was increased from $475,000 to $600,000 (26.32%) upon his promotion to President and CEO effective September 1, 2006. In August of 2007, the Committee further determined that his base pay will remain unchanged until reviewed for adjustment by the Committee in August 2008.

William B. Larson and David M. Sudbury each received a 6.06% base pay increase to $350,000 in September 2006 to maintain a competitive base salary near the 40th percentile. Their respective promotions to Senior Vice President were effective January 25, 2007, at which time they received no increase in base salary. After reviewing the compensation of these two executives in total, the Committee determined in August of 2007 that their current base pay was appropriate and will not be reviewed again for adjustment until September 1, 2008.

Hanns K. Zoellner and Russell B. Rinn received, in September 2006, base salary increases of 5.33% to $395,000 and 10.29% to $375,000, respectively, in accordance with their annual salary review based upon Peer Group review. As a result of their promotions to Executive Vice President and President of their respective business units, part of the Company s internal reorganization which was effective September 1, 2007, (the start of the 2008 fiscal year), Messrs. Zoellner and Rinn each received base salary increases to $415,000. Mr. Zoellner is the President of our International Division and a resident of Switzerland. His salary is set at the beginning of each fiscal year in U.S. Dollars; however, he is paid in Swiss Francs based on the average exchange rate twelve months prior to the date that his salary is approved by the Committee. His Swiss Francs salary remains constant until the following year when it is evaluated based on then current exchange rates in U.S. Dollars and reviewed for internal equity and external market appropriateness, re-set in U.S. Dollars and again converted to Swiss Francs at the average exchange rate for the prior twelve months.

Overall, the average base salary increase for the six NEOs was 9.01% in fiscal year 2007. Mr. Rabin s salary is not benchmarked against the Peer Group because his role, with emphasis on succession transition and pending retirement, is unique among the Peer Group. His salary recognizes the transition work and strategic assistance he provides to Mr. McClean and the Company in view of his retirement at the end of fiscal year 2008 Further, in setting his salary for fiscal year 2007, the Committee considered that Mr. Rabin would not participate in the Annual Cash Incentive Bonus (as defined below) under the Cash Incentive Plan for the fiscal year 2007 performance period or the Long-term Cash Incentive (as defined below) for the performance period beginning with fiscal year 2007 and ending in fiscal year 2009, nor will he participate in either of these incentives for fiscal year 2008. Mr. Rabin s 2008 salary remains the same as in 2007. Salaries for all NEOs are listed in the Summary Compensation Table on page 30.

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Annual Cash Incentive Bonus

At the January 2007 Annual Meeting of Stockholders, the Company s stockholders approved the Commercial Metals Company 2006 Cash Incentive Plan (the Cash Incentive Plan), the purpose of which is to advance the interests of the Company and its stockholders by:

- providing those employees designated by the Committee, which may include NEOs, Senior Executives, Senior Managers and other employees of the Company, incentive compensation tied to stockholder goals for Company and individual performance;
- identifying and rewarding superior performance;
- providing competitive compensation to attract, motivate, and maintain outstanding employees who achieve superior financial performance for the Company; and
- fostering accountability and teamwork throughout the Company.

In accordance with the terms of the Cash Incentive Plan, the Committee establishes appropriate annual or longer term performance periods, designates those executives eligible to participate, sets the level of potential awards and determines the financial or other performance measures which, if attained, result in awards being paid (the performance goals). Management may periodically make recommendations as to these matters but the Committee makes all decisions for implementation of the Cash Incentive Plan. In establishing performance goals the Committee reviews both past and forecasted performance levels for the Company applicable to those executives with overall Company responsibilities and, with respect to Messrs. Rinn and Zoellner, each business unit for which they are responsible. The Committee then exercises its judgment to establish levels of performance needed to achieve targets in the context of the overall industry conditions and projected general economic conditions.

The Committee has elected to establish both an annual and a long-term performance period (discussed below under Long-Term Cash Incentive) under the Cash Incentive Plan. The performance period for the annual bonus (the Annual Cash Incentive Bonus) is the Company s fiscal year. The Annual Cash Incentive Bonus is designed to focus the Company executives on short-term return and operating profit goals. The two goals in concert, we believe, help ensure that executives are focused on fully leveraging their existing assets and maximizing operational efficiencies.

For the performance period fiscal year 2007, twenty five of the Senior Executives, including five of the NEOs (excluding Mr. Rabin), were designated by the Committee as participants eligible to receive an Annual Cash Incentive Bonus. For each participating NEO, the Committee established written performance goals for the Company, business unit or a combination of each and assigned an appropriate weighting to each goal. For the designated NEOs, except Messrs. Rinn and Zoellner, overall Company performance goals (weighted equally) composed 100% of the measurement matrix for awards during the fiscal year 2007 performance period. For Messrs. Rinn and Zoellner, overall Company performance goals (weighted equally) composed 40% and their respective business unit performance goals (weighted equally) composed 60% of the measurement matrix for their awards. Mr. Rinn s business unit goals for the domestic mill and domestic fabrication segments under his management were combined into one set of goals. Mr. Zoellner s were weighted equally between the respective goals for each of the Marketing and Distribution and CMCZ segments under his management. The Annual Cash Incentive Bonus payout opportunity set for threshold, target and maximum, performance and established as a

percentage of each participating NEOs base salary, applicable to the fiscal year 2007 performance period are shown in the following table.

2007 Annual Cash Incentive Bonus Opportunity
Expressed as a Percentage of Base Salary at Beginning of Fiscal Year 2007

Name	Threshold	Target(1)	Maximum
Murray R. McClean	50%	100%	300%
Russell B. Rinn	30%	60%	205%
Hanns K. Zoellner	30%	60%	205%
William B. Larson	30%	60%	205%
David M. Sudbury	30%	60%	205%

(1) Target incentive is designed to achieve, when combined with base salary and target Long-Term Cash Incentive, approximately the 50th percentile, or slightly higher, of Peer Group comparable position annual cash compensation.

The fiscal year 2007 performance period goals for threshold, target and maximum of the Company and business unit components established for the Annual Cash Incentive Bonus are listed in the following three tables. Threshold is the minimum performance required to obtain the minimum incentive amount. Target is the expected performance level of the executive, and maximum is exceptional performance. When referenced in the following tables, ROIC, FIFO, RONA and Operating Profit have the following meanings:

Return on Invested Capital or ROIC means net earnings before interest expense divided by the sum of commercial paper, notes payable, current maturities of long-term debt, debt and stockholders equity.

FIFO Net Earnings means net earnings calculated using the first in, first out inventory costing principle for all inventories.

Return on Net Assets or RONA means for the Company or applicable business unit, the percentage obtained by dividing Operating Profit by the value of average net assets, determined by using the first in, first out (FIFO) method of inventory valuation.

Operating Profit means FIFO Net Earnings for the Company or applicable business unit, before income taxes, interest (both internal and external) and program/discount fees and expenses.

2007 Company Performance Matrix

Commercial Metals Company	Threshold	Target	Maximum
ROIC	12.6%	16.00%	23.00%
FIFO Net Earnings	$200,000,000	$250,000,000	$348,000,000

2007 Business Unit Performance Matrix
Applicable to 60% of Mr. Zoellner s Annual Cash Incentive Bonus

Business Unit Performance Goal	**Threshold**	**Target**	**Maximum**
Marketing & Distribution:			
RONA	15%	18%	21%
Operating Profit	$48,000,000	$65,000,000	$90,000,000
CMCZ:			
RONA	15%	17%	20%
Operating Profit	$25,000,000	$35,000,000	$50,000,000

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2007 Business Unit Performance Matrix
Applicable to 60% of Mr. Rinn s Annual Cash Incentive Bonus

Business Unit Performance Goal	Threshold	Target	Maximum
Combined Domestic Mills and Domestic Fabrication			
RONA	18%	27%	40%
Operating Profit	$250,000,000	$340,000,000	$405,000,000

The Company s overall performance in fiscal year 2007 was the second best in its history, and fiscal year 2007 performance calculations for Company and business unit performance resulted in all but one of the NEOs receiving the maximum Annual Cash Incentive Bonus. Mr. Rinn s Annual Cash Incentive Bonus was lower than maximum due to attainment of less than the maximum performance of one of the business units under his supervision.

The amount of each executive s Annual Cash Incentive Bonus for the fiscal year 2007 performance period was established after review of the audited financial statements for that period, presentation of a report by management calculating the extent of achievement of the applicable performance goals and certification of the award amounts by the Committee pursuant to the terms of the Cash Incentive Plan. All payments under the Cash Incentive Plan, including the Annual Cash Incentive Bonuses, are subject to reduction (but not increase) by the Committee in its sole discretion. The Annual Cash Incentive Bonus for the fiscal year 2007 performance period for each of the NEOs was paid in November 2007, without reduction by the Committee. Fiscal year 2007 Annual Cash Incentive Bonus payments to NEOs pursuant to the Cash Incentive Plan are listed in the Summary Compensation Table on page 30.

The Committee reviews the Company performance goal metrics annually to ensure that the metrics selected are those most likely to improve the overall value of the Company over the fiscal year. To that end, the Committee has reviewed and established performance goals for each of the NEOs (excluding Mr. Rabin) and 19 other Senior Executives participating in the Annual Cash Incentive Bonus for the fiscal year 2008 performance period. Like 2007, the 2008 goals are based on overall Company performance, business unit performance or a combination of each. For the designated NEOs, except Messrs. Rinn and Zoellner, overall Company performance goals (weighted equally) compose 100% of the measurement matrix for awards for the fiscal year 2008 performance period. For Messrs. Rinn and Zoellner, overall Company performance goals (weighted equally) compose 40% and their respective business unit performance goals (weighted equally) composed 60% of the measurement matrix for their awards.

The Annual Cash Incentive Bonus payout opportunity set for threshold, target and maximum, performance and established as a percentage of each participating NEOs base salary, for the fiscal year 2008 performance period are shown in the following table. These performance targets do not correspond to any financial guidance that the Company has provided or may provide for future periods and should not be considered as statements of the Company s expectations or estimates of results. The Company specifically cautions investors not to apply these statements to other contexts.

2008 Annual Cash Incentive Bonus Opportunity
Expressed as a Percentage of Base Salary at Beginning of Fiscal Year 2007

Name	Threshold	Target(1)	Maximum
Stanley A. Rabin	N/A	N/A	N/A

Murray R. McClean	50%	100%	300%
Russell B. Rinn	37.5%	75%	210%
Hanns K. Zoellner	37.5%	75%	210%
William B. Larson	37.5%	75%	195%
David M. Sudbury	37.5%	75%	195%

(1) Target incentive is designed to achieve, when combined with base salary and target Long-Term Cash Incentive, approximately the 50th percentile, or slightly higher, of Peer Group comparable position annual cash compensation.

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The fiscal year 2008 performance goals for threshold, target and maximum of the Company and business unit components established for the 2008 Annual Cash Incentive Bonus are listed in the following three tables. The performance matrix for business units applicable to Messrs. Rinn and Zoellner are tied to performance of their respective business units.

The amount of each executive s Annual Cash Incentive Bonus for the fiscal year 2008 performance period will be calculated based on fiscal year-end audited financial statements. All Annual Cash Incentive Bonus amounts are subject to reduction (but not increase) by the Committee in its discretion.

2008 Company Performance Matrix

Commercial Metals Company	Threshold	Target	Maximum
ROIC	12.5%	15%	23%
FIFO Net Earnings	$250,000,000	$300,000,000	$370,000,000

2008 Business Unit Performance Matrix
Applicable to 60% of Mr. Zoellner s Annual Cash Incentive Bonus

Business Unit Performance Goal	Threshold	Target	Maximum
International Division			
RONA	15%	20%	22%
Operating Profit	$60,000,000	$90,000,000	$130,000,000

2008 Business Unit Performance Matrix
Applicable to 60% of Mr. Rinn s Annual Cash Incentive Bonus

Business Unit Performance Goal	Threshold	Target	Maximum
Americas Division			
RONA	15%	25%	33%
Operating Profit	$400,000,000	$480,000,000	$540,000,000

How and Why are Discretionary Bonuses Awarded To Executives?

Separate from, and in addition to the Annual Cash Incentive Bonus under the Cash Incentive Plan, the Committee may in its discretion, approve an additional discretionary cash award to employees, including the NEOs (the Annual Discretionary Incentive). This Annual Discretionary Incentive is generally established as a percentage of the executive s base salary, but the method of calculation of all Annual Discretionary Incentive awards is solely at the discretion of the Committee. The Committee believes that it is important to maintain discretionary authority over a portion of its executive s annual cash incentives in order to respond to circumstances unforeseen at the beginning of the year when metrics are established for performance goals, and to reward the achievement of more subjective goals and objectives which may not be capable of adequate measurement to qualify as performance goals under the Cash Incentive Plan. At the end of each fiscal year the Committee determines whether any discretionary awards are deemed

warranted, and, if so, the amount of the Annual Discretionary Incentive to be granted. Each discretionary cash award is based on the Committee s evaluation of the individual s overall job performance including progress toward non-financial or less objective goals such as people development, training and succession planning as well as a qualitative assessment of the business and competitive conditions in which the Company operates.

The fiscal year 2007 Annual Discretionary Incentive to Murray R. McClean was 60% of his base salary, and was awarded following superior performance during his first year as Chief Executive Officer, including but not limited to the successful assumption of CEO duties while achieving transition objectives, setting of corporate strategy, commencement of PIP (a substantial enterprise software implementation project), a major reorganization

of the business units, and the achievement of the second best yearly financial performance in the Company s history. In fiscal year 2007, the Committee awarded to the NEOs (excluding Mr. Rabin who received none) Annual Discretionary Incentive Bonuses ranging from approximately 30% to 60% of base salary. Annual Discretionary Incentive Bonus awards for the NEOs were reflective of the performance of the executive team and, except in the case of the CEO, the CEO s recommendations. No management recommendation is made with regard to any compensation, including Annual Discretionary Incentive Bonus, for the CEO. Discretionary Incentive Bonus amounts for all NEOs are listed in the Summary Compensation Table on page 30.

Long-Term Cash Incentive

As discussed above under Annual Cash Incentive Bonus, the Committee has elected to establish both annual and longer term performance periods under the Cash Incentive Plan. In accordance with the objectives of the Cash Incentive Plan and those of the Key Employee Long-Term Incentive Plan (the Plan utilized prior to adoption of the Cash Incentive Plan which operated similarly to the Cash Incentive Plan) the Company provides Senior Executives, including participating NEOs, the opportunity for cash payments (Long-Term Cash Incentive) contingent on the attainment of multi-year performance goals. At the beginning of each three year performance period, the Committee establishes performance goals and sets threshold, target and maximum achievement levels for award opportunities for each participant expressed as a percentage of that participant s base salary in effect at the beginning of the period. Results are measured over the ensuing three-year period. Participants are paid cash awards following the end of each three year period only if the Company achieves the performance goals. A minimum level (threshold) is established below which no payment will be made to any participant as well as a target and maximum award payment for each participant.

During each of the performance periods consisting of fiscal years 2005 through 2007, 2006 through 2008, 2007 through 2009 and 2008 through 2010, growth in net earnings before interest (including accounts receivable securitization program expense), taxes, depreciation, amortization and accrual for Long-Term Cash Incentives, which we call LTI-EBITDA, was used as the sole performance goal. An increase or continuation of the Company s record high annual LTI-EBITDA in existence at the beginning of each three year performance period and averaged over the ensuing three year performance period, has been established as the minimum hurdle to reach a threshold Long-Term Cash Incentive payment. Increases to the prior record high LTI-EBITDA have been required over each three year performance period to attain target and maximum payments. The Committee does not consider individual business unit results or individual performance in establishing this performance goal for the Long-Term Cash Incentive.

The Committee considers the establishment of high, yet attainable, results over a three-year performance period to be a significant factor in balancing short-term and longer term cash incentives as part of the executive compensation program. The Committee believes the use of growth in LTI-EBITDA over a three year period as a performance goal drives the Company s participating executives to focus on activities that cause the Company to generate earnings growth, a key factor in increasing stockholder value. Jointly, the Annual Cash Incentive Bonus, the Annual Discretionary Incentive, and the Long-Term Cash Incentive provide balanced cash incentives rewarding executive focus on delivering short-term results and yet managing in such a way to ensure long-term growth.

At the end of each three year performance period, the Committee reviews the management report as to the level of achievement of the performance goal for the period, approves the calculations of the awards based on achievement of the previously established threshold, target and maximum award levels and authorizes payment of the awards to those executives that were designated as participants at the beginning of the three year performance period. Additionally, the Committee approves the group of Senior Executives (including the participating NEOs) and Senior Managers who are designated to participate in the three-year performance period then beginning as well as establishing the applicable LTI-EBITDA performance goal for the period.

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The following tables describe the payout opportunity set for threshold, target and maximum performance (expressed as a percentage of base salary at the beginning of each respective three year period) for the performance period ended in 2007 and each of the periods ending in 2008, 2009 and 2010. When serving as Chief Executive Officer Mr. Rabin was designated a participant in the performance period ended with fiscal year 2007 and the performance period ending in 2008 but was not a participant in subsequent periods. Long-Term Cash Incentive payments attributable to the three year performance period ended August 31, 2007, are listed in the Summary Compensation Table on page 30.

Fiscal Year 2005 through 2007 Long-Term Cash Incentive Opportunity
Expressed as a Percentage of Base Salary at Beginning of Fiscal Year 2005

Name	Threshold LTI-EBITDA $330,796,440	Target(1) LTI-EBITDA $343,048,160	Maximum LTI-EBITDA $355,299,880
Stanley A. Rabin	40%	80%	120%
Murray R. McClean	30%	60%	90%
Russell B. Rinn	25%	50%	75%
Hanns K. Zoellner	25%	50%	75%
William B. Larson	22.5%	45%	67.5%
David M. Sudbury	22.5%	45%	67.5%

These performance targets for the following performance periods not yet ended do not correspond to any financial guidance that the Company has provided or may provide for future periods and should not be considered as statements of the Company s expectations or estimates of results. The Company specifically cautions investors not to apply these statements to other contexts.

Fiscal Year 2006 through 2008 Long-Term Cash Incentive Opportunity
Expressed as a Percentage of Base Salary at Beginning of Fiscal Year 2006

Name	Threshold LTI-EBITDA $563,699,000	Target(1) LTI-EBITDA $597,520,940	Maximum LTI-EBITDA $620,068,900
Stanley A. Rabin	40%	80%	120%
Murray R. McClean	35%	70%	105%
Russell B. Rinn	30%	60%	90%
Hanns K. Zoellner	30%	60%	90%
William B. Larson	22.5%	45%	67.5%
David M. Sudbury	22.5%	45%	67.5%

Fiscal Year 2007 through 2009 Long-Term Cash Incentive Opportunity
Expressed as a Percentage of Base Salary at Beginning of Fiscal Year 2007

Name	Threshold LTI-EBITDA $670,830,000	Target(1) LTI-EBITDA $711,079,800	Maximum LTI-EBITDA $724,496,400
Stanley A. Rabin	N/A	N/A	N/A
Murray R. McClean	40%	80%	120%
Russell B. Rinn	30%	60%	90%
Hanns K. Zoellner	30%	60%	90%
William B. Larson	30%	60%	90%
David M. Sudbury	30%	60%	90%

Fiscal Year 2008 through 2010 Long-Term Cash Incentive Opportunity
Expressed as a Percentage of Base Salary at Beginning of Fiscal Year 2008

Name	Threshold LTI-EBITDA $691,629,000	Target(1) LTI-EBITDA $733,126,740	Maximum LTI-EBITDA $746,959,320
Stanley A. Rabin	N/A	N/A	N/A
Murray R. McClean	40%	80%	120%
Russell B. Rinn	35%	70%	105%
Hanns K. Zoellner	35%	70%	105%
William B. Larson	30%	60%	90%
David M. Sudbury	30%	60%	90%

(1) Target Long-Term Cash Incentive is designed to achieve, when combined with base salary and the target Annual Cash Incentive Bonus, approximately the 50th percentile, or slightly higher, of Peer Group comparable position annual cash compensation.

How Does Equity Based Compensation Operate as a Component of Overall Compensation?

Equity based compensation along with cash incentive compensation is used to afford the executive the opportunity, when achieving maximum performance, to reach the upper quartile or better of Peer Group comparable position compensation.

Commercial Metals Company 2006 Long-Term Equity Incentive Plan (the Equity Incentive Plan)

In January of 2007, stockholders approved the Equity Incentive Plan the purpose of which is to attract and retain the services of key management and employees of the Company and its subsidiaries and to provide such persons with a proprietary interest in the Company through the granting of equity incentives which, as determined by the Committee, may include incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards, and other awards, whether granted singly, or in combination, or in tandem, that will:

drive participants to achieve superior financial performance of the Company;

incent executives to increase stockholder value equal to or in excess of the average steel industry performance; and

provide a retention tool for the Company.

Grants Pursuant to the Equity Incentive Plan

In accordance with the Equity Incentive Plan, the Committee approves annual equity awards. The grant date is either the same date as the Committee approves the grant or a specifically designated future date established by the Committee when it acts. The Committee does not grant equity compensation awards or options in anticipation of the release of material non-public information and the Company does not time the release of such information based on equity award grant dates. The grant price for all equity awards under the Equity Incentive Plan is the fair market value as defined in the Equity Incentive Plan which is the closing sales price per share of the Company s common stock on the NYSE Consolidated Tape on the date of the award or in the absence of reported sales on such day, the most recent previous day for which sales were reported. The Committee has never approved an option or other equity award with a grant price different from the fair market value as defined under the applicable plan on the date of grant.

The Committee has established guidelines for its use in determining the number of equity-based shares to grant to the Company executives. The Committee determined that equity awards should, in part, be granted with an eye toward superior Company performance relative to the Peer Group, and determined that more equity-based awards should be granted in years where the Company s total stockholder return ranked higher amongst the Peer Group, and fewer or no equity-based awards in years where the Company ranked lower. While the Committee also considers each executive s individual performance, internal equity and external equity when granting equity based awards, it believes that the tenet of at-risk compensation should also apply to equity grants.

Equity awards support the Company s overall compensation strategy by providing executives with variable compensation incentives that drive long-term performance focus, balancing shorter term incentives and thus closely aligning the executive s variable compensation with the interests of the stockholders.

Under the Equity Incentive Plan, the Committee meets annually to consider equity awards utilizing a look-back basis to determine the appropriate number of awards based on the Peer Group total stockholder return comparison described above. In June 2007, equity awards were made by the Committee following a practice that the Committee considers grants of equity awards for NEOs and other Senior Executives annually after a review of Company performance and stockholder return compared to Peer Group performance

In calendar year 2006, the look back year for granting equity awards in fiscal year 2007, the Company ranked at the 82nd percentile on a total stockholder return basis against its Peer Group. Based on an evaluation of each executive s responsibilities, ability to influence long-term growth and the profitability and performance achieved, the Committee authorized awards of stock appreciation rights (SARs) to five of our six NEOs during fiscal year 2007. A total of 307 other employees also received either SARs and/or restricted stock awards. The Committee believes equity based incentives align stockholder interest with compensation levels and intends to continue issuing equity incentives, when and in the form it considers appropriate. Fiscal year 2007 grants of plan based awards for each NEO are listed in the Grants of Plan Based Awards Table on page 31.

For fiscal year 2007, the combination of base salary, short-term cash, long-term cash and equity incentives resulted in the NEOs, excluding Mr. Rabin, achieving approximately the 75th percentile of total direct compensation among the Peer Group.

What are the Other Elements of Compensation?

The Company also provides retirement benefits in the form of a Profit Sharing and 401(k) Plan and a Benefit Restoration Plan, as well as similar plans for internationally based management employees, and medical, Social Security (or its foreign equivalent) and other welfare benefits. Mr. Zoellner does not participate in either of the Plans

described below but does participate in retirement plans available to certain Swiss employees described on page .

Retirement and Nonqualified Deferred Compensation Benefits

Profit Sharing and 401(k) Plan

The primary tax qualified long-term compensation retirement plan we have for our employees in the United States is the Commercial Metals Company s Profit Sharing and 401(k) Plan (the PS/401(k) Plan).

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The PS/401(k) Plan is a defined contribution plan and all Company payments to the plan are discretionary. Under the terms of this Plan, participating employees may elect to contribute, up to a federally mandated maximum, a portion of their compensation on a pre-tax basis. For fiscal year 2007, the Company matched one-half of the first three percent of employee deferral contributions for a maximum Company paid match of one and one-half percent of participating employee contributions. During fiscal year 2007 the Company made two additional types of discretionary Company contributions to the Plan for the benefit of participants. The first, a safe harbor contribution, was equal to 3% of each participant s eligible compensation. The second type of Company contribution was the Company profit sharing contribution which was 8.5% of each participant s eligible compensation. The NEOs participate in the PS/401(k) Plan although their elective contributions and those of the Company are restricted in amount by law. Other than a Swiss pension plan applicable only to employees based in Switzerland as described on pages 34 and 35, the Company has one defined benefit pension plan for a small number of employees at one U.S. operation that was recently acquired. The amounts contributed to the PS/401(k) Plan account of each NEO are listed in the Summary Compensation Table on page 30.

Benefit Restoration Plan

As a result of limitations mandated by federal tax law and regulations that limit defined contribution plan retirement benefits of more highly compensated employees, the Board of Directors in fiscal year 1996 approved the Benefit Restoration Plan (BRP). The BRP is a non-qualified plan for certain executives, including each of the NEOs, designated by the Committee, who are subject to federally mandated benefit limits in the PS/401(k) Plan. Following each fiscal year-end the Company credits to the participant s account under the BRP a dollar amount equal to the amount of Company contribution the participant would have received under the PS/401(k) Plan but for the limit imposed by law on Company contributions to that plan. A BRP participant may also elect to defer up to fifty percent of compensation into his or her BRP account.

Although not required to do so under the BRP, the Company may segregate assets equal to a portion of the BRP amount credited to participant accounts in a trust created for BRP participants. Each BRP participant is a general unsecured creditor of the Company to the extent of his or her BRP account benefit and the assets of the trust are subject to claims of Company creditors in general. The amount the Company credits to the accounts of BRP participants, including NEOs, vest under the same terms and conditions as the PS/401(k) Plan. All NEOs participating in the BRP are fully vested as a result of their years of service with the Company. The investment options available to BRP participants are mutual funds similar to those offered in the PS/401(k) Plan. There is no Company guaranteed or above market rate of return on BRP accounts. The Committee believes these payments are an important element in our long-term compensation program because they restore a reasonable level of retirement benefits for key employees, including NEOs. The specific contributions into the BRP plan accounts for each of the NEOs are listed in the Summary Compensation Table on page 30.

Perquisites

The Company provides limited perquisites to Senior Executives, including the NEOs, in order to facilitate the successful achievement of their and the Company s performance. These perquisites include company provided leased cars and lunch club memberships. The value of these perquisites is listed as part of the Summary Compensation Table. The Company does not own or provide corporate aircraft, security services, personal tax or financial planning, an executive dining room or similar perquisites to Senior Executives.

Medical and Other Welfare Benefits

The Company s executives, along with all other employees, are eligible to participate in medical, dental, vision, life, accidental death and disability, long-term disability, short-term disability, and any other employee benefit made

available to employees.

Do the NEOs Employment Contracts Contain Termination, Severance and Change in Control Benefits?

As of August 31, 2007, the Company has employment contracts with two executive officers, Messrs. McClean and Zoellner, and executive employment continuity agreements with Messrs. Rinn, Zoellner, Larson and Sudbury.

Employment Contracts

We entered into an employment agreement with Murray R. McClean on May 23, 2005, following his election as Executive Vice President and Chief Operating Officer which was amended effective September 1, 2006, when named CEO. This agreement terminates August 31, 2009, unless earlier terminated as provided and will automatically renew for one year terms thereafter unless terminated by either party. Mr. McClean s minimum base salary is $600,000 per year. He is also eligible to earn a bonuses under the Company s compensation program but has no guaranteed bonus amount. Mr. McClean is also eligible to participate in or receive benefits under any plan or arrangement made generally available to our employees. In the event of Mr. McClean s death, the Company shall make a one time payment of $50,000 to his estate. If we terminate Mr. McClean s employment for cause, or for nonperformance due to disability, or if Mr. McClean terminates his own employment, then we have no further payment obligations. If we terminate Mr. McClean s employment without cause, then we must pay 150% of his then current annual base salary plus an amount equal to 150% of his average annual bonus payments over the prior 5 years. At such time as we do not renew the agreement after the initial term, we shall pay Mr. McClean $100,000. Upon a change in control accompanied by his termination without cause by the Company or for good reason by Mr. McClean, Mr. McClean s will be entitled to a lump sum payment equal to two times his then current annual base salary as well as a cash payment equal to two times the average annual discretionary bonus received by Mr. McClean for the five year period ending with the Company s last complete fiscal year prior to the change in control. Mr. McClean has agreed that for eighteen months after his termination, he will not participate in any business that is competitive with our business.

Termination for cause is defined in his agreement as a breach of the agreement or his fiduciary duty to the Company as well as a criminal act or act of moral turpitude or dishonest acts which materially harm the Company, or chemical dependency. Termination for good reason by Mr. McClean is defined as the Company s breach of the agreement, a significant reduction in Mr. McClean s responsibilities, or the Company s requiring him to work at a location more than 50 miles from its current location.

We entered into an employment agreement with Hanns Zoellner on January 2, 1998. The original term of the agreement ended January 2, 2006, but the agreement provides for automatic annual renewal unless either party gives notice to the other to terminate employment. The agreement establishes Mr. Zoellner s minimum annual base salary at 380,000 Swiss Francs, approximately $340,000 at recent exchange rates. He is also eligible to earn annual or other bonus compensation as authorized by the Committee and is eligible to participate in or receive benefits under any plan or arrangement made generally available to our employees. If we terminate Mr. Zoellner s employment for cause under Swiss law, or for nonperformance of duties due to disability, or if Mr. Zoellner terminates his own employment, then we have no further payment obligations. If we terminate Mr. Zoellner s employment without cause under Swiss law, then we must pay Mr. Zoellner a severance payment equal to his base salary at the time of termination. For a period of two years after his termination, he will not participate in any business that is competitive with our business.

Change in Control Agreements

Our Change in Control Agreements are known as Executive Employment Continuity Agreements (EECAs). In April, 2006, the Board of Directors of the Company authorized the execution of a form of EEAC (the Agreement) with certain key executives, including each of the NEOs with the exception of Messrs. Rabin and McClean. The Agreement is intended to ensure that the Company will have the continued attention and dedication of the executive in the event of a Change in Control of the Company (as defined below). Should a Change in Control occur, the Company has agreed to continue to employ each executive for a period of two years thereafter (the Employment Period). The EECAs terminate two years after a Change in Control.

During the Employment Period, each executive will continue to receive (i) an annual base salary equal to at least the executive s base salary before the Change in Control; (ii) cash bonus opportunities equivalent to that available to the

executive under the Company s annual and long-term cash incentive plans in effect immediately preceding the Change in Control; and (iii) continued participation in all incentive, including equity incentive, savings, deferred compensation, retirement plans, welfare benefit plans and other employee benefits on terms no less favorable than those in effect during the 90-day period immediately preceding the Change in Control.

Should the executive s employment be terminated during the Employment Period for other than cause or disability (including Constructive Termination) the Agreement requires the Company to pay certain severance benefits to the executive. The severance benefits for Messrs. Larson, Rinn, Zoellner and Sudbury include an amount equal to four times the highest base salary in effect at any time during the twelve month period prior to the Change in Control as well as unpaid salary, vacation pay and certain other amounts considered to have been earned prior to termination. Constructive Termination is defined in the Agreement as the failure to maintain the executive in the position held by him prior to the Change in Control, a material adverse change in the executive s responsibilities, the failure to pay the amounts due him under the Agreement, or requiring the executive to relocate more than 50 miles from his workplace. Company contributions to retirement plans and participation, including that of the executive s eligible dependents, in Company provided welfare plan benefits will either be continued for two years following termination or their cash equivalent for such period paid to the executive. All un-exercised and un-vested equity incentives including restricted stock awards, stock appreciation rights and stock options previously granted to such executive will become immediately vested and exercisable.

The Agreement does not provide for a tax gross up reimbursement payment by the Company to the executive for taxes, including Section 4999 excise taxes, the employee may owe as a result of receipt of payments under the Agreement. The Agreement does require the Company to determine if the payments to an executive under the Agreement combined with any other payments or benefits to which the executive may be entitled (in aggregate the Change in Control Payments) would result in the imposition on the executive of the excise tax under Section 4999 of the Internal Revenue Code of 1986, as amended (the Code). The Company will either reduce the Change in Control Payments to the maximum amount which would not result in imposition of the Section 4999 excise tax or pay the entire Change in Control Payment to the executive if, even after the executive s payment of the Section 4999 excise tax, the executive would receive a larger net amount.

The Agreement does not provide for any employment or severance benefit prior to an actual or, in some circumstances shortly before, a Change in Control. In the event the executive is terminated more than two years following a Change in Control no severance benefits are provided under the Agreement. The Agreement provides that the executive not disclose any confidential information relating to the Company and, for a period of one year following termination of employment, not compete with the business as conducted by the Company within 100 miles of a Company facility nor solicit or hire employees of the Company or knowingly permit (to the extent reasonably within the executive s control) any business or entity that employs the executive or in which the executive has an ownership interest to hire Company employees. If a court rules that the executive has violated these provisions, the rights of the executive under the Agreement will terminate.

The Agreement defines a Change in Control to be either (i) the acquisition of 25% or more of the outstanding voting securities of the Company, (ii) the replacement of a majority of the members of the Board of Directors by Directors not approved by the incumbents, (iii) the sale of substantially all the assets of the Company to an entity of which the Company owns less than 50% of the voting securities, or (iv) the merger of the Company resulting in the pre-merger shareholders of the Company not controlling at least 50% of the post-merger voting securities.

Acceleration of Plan Awards

In addition to the EECAs, our equity incentive plans also provide for accelerated vesting of stock-based awards regardless of whether a termination occurs as a result of a Change in Control. Further, the Cash Incentive Plan provides that in the event of a Change in Control, the Committee has discretion to take action to determine the extent to which incentive compensation is considered earned and payable during any performance period, consistent with the requirements of Section 162(m) of the Code, and further consistent with the best interests of the Company.

Both the cash and equity incentive plans contain the same change of control definitions as the EECAs. The only definition of change in control that differs from the EECAs is Mr. McClean s employment agreement which defines a change in control to be: either (i) the merger of the Company resulting in the pre-merger stockholders not having the same proportionate ownership of stock in the surviving corporation, (ii) the sale of substantially all the assets of the Company, (iii) stockholder approval of the Company s liquidation, (iv) the replacement of a majority of the members of the Board of Directors by Directors not approved by the incumbents, or (v) the acquisition of 25% or more of the outstanding voting securities of the Company.

The Payment Upon Termination or Change-in-Control Tables and narrative on pages 37 through 43 provide a description of the compensation to NEOs in the event of their termination following a change in control, as well as other events resulting in termination of employment. In all cases the amounts of equity awards were valued at the Company s per share stock closing price on August 31, 2007, of $28.89.

What are the Considerations with Regard to Deductibility of Executive Compensation?

Section 162(m) of the Code, limits the amount of compensation paid to the NEOs that may be deducted by the Company for federal income tax purposes in any fiscal year to $1,000,000. Performance-based compensation that has been approved by the Company s stockholders is not subject to the Code s $1,000,000 deduction limit. The Company s Cash Incentive Plan and Equity Incentive Plan have been approved by its stockholders and awards under those plans constitute performance-based compensation that is not subject to the Code Section 162(m) deductions limit. In part as a result of voluntary employee deferrals of compensation to the PS/401(k) Plan and the BRP Plan, it is believed that all compensation paid to NEOs attributable to fiscal year 2007 will be tax deductible to the Company.

While the Committee believes that it is important for compensation paid to our NEOs to be tax deductible under the Code, it does not think this should be the sole determining factor in establishing the Company s compensation program. The Committee believes that we must balance the emphasis on maximizing deductibility against the need to retain executive talent and the need to incent executives.

What is the Relationship between Prior Compensation and Current Compensation?

The Committee periodically reviews tally sheets and wealth accumulation information considering all forms of Company paid compensation paid to NEOs, but does not specifically consider this information when making changes in base salary, cash compensation or equity compensation.

What is the Company s Stock Ownership Policy and Policy Regarding Hedging of Company Stock?

Stock Ownership Guidelines and Transactions

The Board of Directors in April, 2006, approved stock ownership guidelines for directors, all NEOs, other officers and certain designated employees. The Board of Directors believes adoption of minimum ownership levels serve to further align the interests of those covered by the guidelines with the Company s stockholders. All directors, officers and employees designated as subject to the guidelines are to be in compliance no later than April 5, 2009. Individuals who are elected, hired or promoted into positions covered by the guidelines have three years following such date to attain the minimum ownership level. The guidelines require ownership of Company stock with a market value, as determined on January 31 of each year, of not less than the following amounts:

Non-employee Directors five times the annual retainer paid to all non-employee directors

President and Chief Executive Officer five times base salary

Most Vice Presidents including each Company business segment President, the Chief Financial Officer and the General Counsel three times base salary

Controller, Treasurer and Vice President and Chief Information Officer two times base salary

Other executives as may be designated by the Compensation Committee of the Board of Directors one times base salary.

The value of unvested restricted shares of Company Common Stock is included when determining the amount of stock ownership, but unexercised options, stock appreciation rights or similar equity incentives, vested or unvested, are not included. Many of those covered by the guidelines presently own Company stock in amounts substantially in excess of these minimum requirements. As of November 26, 2007, all NEOs and non-employee directors own Company stock in excess of the guideline minimums with the exception of Robert L. Guido who, as a result of his election as a director in April, 2007, is not required to be in compliance until 2010.

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The Board of Directors in 2002 adopted an expanded policy on insider trading prohibiting all employees from buying or selling Company stock while aware of material nonpublic information, or the disclosure of material nonpublic information to others who then trade in the Company s securities. The policy is available on the Company s website, www.cmc.com, in the Corporate Governance section. As part of this policy certain other Company stock related transactions by directors, officers and employees are also prohibited or subject to specific notice and pre-approval requirements. The policy is premised on the belief that even in those circumstances where the proposed transaction may not constitute a violation of law or applicable regulations it is nonetheless considered inappropriate for any director, officer or other employee of the Company to engage in short-term or speculative transactions in the Company s securities which may be viewed as reducing their incentive to improve the Company s performance or inconsistent with the objectives of the Company s shareholders in general. Therefore it is the Company s policy that directors, officers and other employees may not engage in any transactions involving the Company s securities which constitute short sales, puts, calls or other similar derivative securities. The policy discourages certain other transactions including hedging or monetization transactions, such as zero-cost collars, forward sale contracts and arrangements pledging Company securities as collateral for a loan (without adequate assurance of other available assets to satisfy the loan). Prior to entering into such transactions the policy requires notice to, review of the facts and circumstances by, and the pre-approval of, the Company s General Counsel.

EXECUTIVE COMPENSATION

The following tables, footnotes and narratives, found on pages 30 to 36, provide information regarding the compensation, benefits and equity holdings in the Company for the NEOs.

SUMMARY COMPENSATION TABLE

Using a Measurement Date of August 31, 2007

				Non-Equity Incentive Plan Compensation ($)(5)		
Salary ($)	Bonus ($)(2)	Stock Awards ($)(3)	Option Awards ($)(4)	Annual Incentive	Cash LTI	Total
$ 650,000	$ 0	$ 84,842	$ 60,149	$ 0	$ 720,000	$ 720,000
$ 600,000	$ 360,000	$ 140,754	$ 303,842	$ 1,800,000	$ 360,000	$ 2,160,000
$ 375,000	$ 157,500	$ 103,376	$ 176,881	$ 682,907	$ 243,750	$ 926,657

2	(439)	138	123,370	(1,919)	241	199,572	(2,358)
2	(166)	22	119,513	(2,215)	27	133,445	(2,381)
01	$(737)	161	$ 243,084	$(4,139)	273	$352,685	$ (4,876)

The following table provides information about the amount of interest income earned on investment securities which is fully taxable and which is exempt from regular federal income tax:

	For the Three Months Ended June 30,		For the Six Months	
	2015	2014	2015	2014
	(In thousands)			
Taxable	$8,393	$5,876	$15,946	$11,559
Tax-exempt	5,997	6,740	12,131	13,720
Total interest income from investment securities	$14,390	$12,616	$28,077	$25,279

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Note 4: Loans and Allowance for Credit Losses

A summary of the major categories of loans outstanding is shown in the following tables.

	At June 30, 2015					
	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment & Other	Total
	(In thousands)					
Originated loans	$370,997	$548,610	$ 6,762	$134,421	$364,257	$1,425,047
Purchased covered loans:						
Gross purchased covered loans	-	-	-	2,520	12,786	15,306
Purchased loan discount	-	-	-	(133)	(64)	(197)
Purchased non-covered loans:						
Gross purchased non-covered loans	16,292	143,722	995	706	37,180	198,895
Purchased loan discount	(1,168)	(5,089)	-	(262)	(1,261)	(7,780)
Total	$386,121	$687,243	$ 7,757	$137,252	$412,898	$1,631,271

	At December 31, 2014					
	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment & Other	Total
	(In thousands)					
Originated loans	$374,005	$567,594	$ 11,003	$146,925	$370,842	$1,470,369
Purchased covered loans:						
Gross purchased covered loans	-	-	-	2,626	14,920	17,546
Purchased loan discount	-	-	-	(434)	(34)	(468)
Purchased non-covered loans:						
Gross purchased non-covered loans	19,166	157,502	2,919	972	41,656	222,215
Purchased loan discount	(1,356)	(6,492)	(50)	(262)	(1,212)	(9,372)
Total	$391,815	$718,604	$ 13,872	$149,827	$426,172	$1,700,290

Changes in the carrying amount of impaired purchased loans were as follows:

	For the Six Months	For the Year Ended

Impaired purchased loans	Ended June 30, 2015	December 31, 2014
	(In thousands)	
Carrying amount at the beginning of the period	$4,672	$ 4,936
Reductions during the period	(32)	(264)
Carrying amount at the end of the period	$4,640	$ 4,672

Changes in the accretable yield for purchased loans were as follows:

Accretable yield:	For the Six Months Ended June 30, 2015	For the Year Ended December 31, 2014
	(In thousands)	
Balance at the beginning of the period	$2,261	$ 2,505
Reclassification from nonaccretable difference	1,365	5,016
Accretion	(1,835)	(5,260)
Balance at the end of the period	$1,791	$ 2,261
Accretion	$(1,835)	$ (5,260)
Change in FDIC indemnification	230	1,110
(Increase) in interest income	$(1,605)	$ (4,150)

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The following summarizes activity in the allowance for loan losses:

Allowance for Loan Losses
For the Three Months Ended June 30, 2015

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Purchased Non-covered Loans	Purchased Covered Loans	Unallocated	Total
	(In thousands)								
Allowance for loan losses:									
Balance at beginning of period	$5,470	$ 4,123	$ 730	$ 2,140	$ 7,031	$ 2,339	$ -	$ 9,354	$31,187
Additions:									
Provision	1,704	758	(327)	(82)	350	(921)	-	(1,482)	-
Deductions:									
Chargeoffs	(401)	-	-	-	(576)	(396)	-	-	(1,373)
Recoveries	334	15	-	-	443	222	-	-	1,014
Net loan (losses) recoveries	(67)	15	-	-	(133)	(174)	-	-	(359)
Total allowance for loan losses	$7,107	$ 4,896	$ 403	$ 2,058	$ 7,248	$ 1,244	$ -	$ 7,872	$30,828

Allowance for Loan Losses
For the Six Months Ended June 30, 2015

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Purchased Non-covered Loans	Purchased Covered Loans	Unallocated	Total
	(In thousands)								
Allowance for loan losses:									
Balance at beginning of period	$5,460	$ 4,245	$ 644	$ 2,241	$ 7,717	$ 2,120	$ -	$ 9,058	$31,485
Additions:									
Provision	1,594	621	(241)	(183)	69	(674)	-	(1,186)	-
Deductions:									
Chargeoffs	(461)	-	-	-	(1,571)	(431)	-	-	(2,463)
Recoveries	514	30	-	-	1,033	229	-	-	1,806
Net loan recoveries (losses)	53	30	-	-	(538)	(202)	-	-	(657)
Total allowance for loan losses	$7,107	$ 4,896	$ 403	$ 2,058	$ 7,248	$ 1,244	$ -	$ 7,872	$30,828

Allowance for Credit Losses
For the Three Months Ended June 30, 2014

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Purchased Non-covered Loans	Purchased Covered Loans	Unallocated	Total
	(In thousands)								
Allowance for loan losses:									
Balance at beginning of period	$4,243	$11,259	$ 445	$ 491	$2,813	$ 2,574	$ -	$10,284	$32,109
Additions:									
Provision	1,085	(610)	(3)	(52)	(75)	115	-	540	1,000
Deductions:									
Chargeoffs	(150)	-	-	(30)	(1,301)	-	-	-	(1,481)
Recoveries	119	15	-	-	618	18	-	-	770
Net loan (losses) recoveries	(31)	15	-	(30)	(683)	18	-	-	(711)
Balance at end of period	5,297	10,664	442	409	2,055	2,707	-	10,824	32,398
Liability for off-balance sheet credit exposure	1,733	24	165	-	465	243	23	40	2,693
Total allowance for credit losses	$7,030	$10,688	$ 607	$ 409	$2,520	$ 2,950	$ 23	$10,864	$35,091

FDIC indemnification expired February 6, 2014 for County Bank non-single-family residential collateralized purchased loans; accordingly, such loans have been reclassified from purchased covered loans to purchased non-covered loans as well as the related allowance for credit losses.

Allowance for Credit Losses
For the Six Months Ended June 30, 2014

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Purchased Non-covered Loans	Purchased Covered Loans	Unallocated	Total
	(In thousands)								
Allowance for loan losses:									
Balance at beginning of period	$4,005	$12,070	$ 602	$ 405	$3,198	$ -	$1,561	$9,852	$31,693
Additions:									
Provision	1,215	(1,584)	(163)	34	139	1,387	-	972	2,000
Deductions:									
Chargeoffs	(210)	-	-	(30)	(2,300)	(260)	-	-	(2,800)
Recoveries	287	178	3	-	1,018	19	-	-	1,505

Net loan recoveries (losses)	77	178	3	(30)	(1,282)	(241)	-	-	(1,295)
Indemnification expiration	-	-	-	-	-	1,561	(1,561)	-	-
Balance at end of period	5,297	10,664	442	409	2,055	2,707	-	10,824	32,398
Liability for off-balance sheet credit exposure	1,733	24	165	-	465	243	23	40	2,693
Total allowance for credit losses	$ 7,030	$ 10,688	$ 607	$ 409	$ 2,520	$ 2,950	$ 23	$ 10,864	$ 35,091

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The allowance for credit losses and recorded investment in loans were evaluated for impairment as follows:

Allowance for Loan Losses and Recorded Investment in Loans Evaluated for Impairment
At June 30, 2015

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Purchased Non-covered Loans	Purchased Covered Loans	Unallocated	Total
	(In thousands)								
Allowance for loan losses:									
Individually evaluated for impairment	$2,533	$1,034	$-	$-	$-	$-	$-	$-	$3,567
Collectively evaluated for impairment	4,574	3,862	403	2,058	7,248	1,244	-	7,872	27,261
Purchased loans with evidence of credit deterioration	-	-	-	-	-	-	-	-	-
Total	$7,107	$4,896	$403	$2,058	$7,248	$1,244	$-	$7,872	$30,828
Carrying value of loans:									
Individually evaluated for impairment	$12,417	$5,806	$-	$-	$-	$11,712	$-	$-	$29,935
Collectively evaluated for impairment	358,580	542,804	6,762	134,421	364,257	174,980	14,892	-	1,596,696
Purchased loans with evidence of credit deterioration	-	-	-	-	-	4,423	217	-	4,640
Total	$370,997	$548,610	$6,762	$134,421	$364,257	$191,115	$15,109	$-	$1,631,271

Allowance for Credit Losses and Recorded Investment in Loans Evaluated for Impairment
At December 31, 2014

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Purchased Non-covered Loans	Purchased Covered Loans	Unallocated	Total
	(In thousands)								

Allowance for credit losses:									
Individually evaluated for impairment	$496	$-	$-	$-	$-	$-	$-	$-	$496
Collectively evaluated for impairment	7,372	4,245	988	2,241	8,154	2,120	-	8,562	33,682
Purchased loans with evidence of credit deterioration	-	-	-	-	-	-	-	-	-
Total	$7,868	$4,245	$988	$2,241	$8,154	$2,120	$-	$8,562	$34,178
Carrying value of loans:									
Individually evaluated for impairment	$11,811	$2,970	$-	$574	$599	$12,364	$-	$-	$28,318
Collectively evaluated for impairment	362,194	564,624	11,003	146,351	370,243	196,034	16,851	-	1,667,300
Purchased loans with evidence of credit deterioration	-	-	-	-	-	4,445	227	-	4,672
Total	$374,005	$567,594	$11,003	$146,925	$370,842	$212,843	$17,078	$-	$1,700,290

The Bank's customers are small businesses, professionals and consumers. Given the scale of these borrowers, corporate credit rating agencies do not evaluate the borrowers' financial condition. The Bank maintains a Loan Review Department which reports directly to the Board of Directors. The Loan Review Department performs independent evaluations of loans and assigns credit risk grades to evaluated loans using grading standards employed by bank regulatory agencies. Loans judged to carry lower-risk attributes are assigned a "pass" grade, with a minimal likelihood of loss. Loans judged to carry higher-risk attributes are referred to as "classified loans," and are further disaggregated, with increasing expectations for loss recognition, as "substandard," "doubtful," and "loss." Loan Review Department evaluations occur every calendar quarter. If the Bank becomes aware of deterioration in a borrower's performance or financial condition between Loan Review Department examinations, assigned risk grades are re-evaluated promptly. Credit risk grades assigned by the Loan Review Department are subject to review by the Bank's regulatory authorities during regulatory examinations.

The following summarizes the credit risk profile by internally assigned grade:

Credit Risk Profile by Internally Assigned Grade
At June 30, 2015

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Purchased Non-covered Loans	Purchased Covered Loans [1]	Total
	(In thousands)							
Grade:								
Pass	$354,025	$518,410	$ 6,762	$132,116	$363,193	$ 161,919	$13,621	$1,550,046
Substandard	16,961	30,200	-	2,305	812	36,902	1,685	88,865
Doubtful	11	-	-	-	9	74	-	94
Loss	-	-	-	-	243	-	-	243
Purchased loan discount	-	-	-	-	-	(7,780)	(197)	(7,977)
Total	$370,997	$548,610	$ 6,762	$134,421	$364,257	$ 191,115	$15,109	$1,631,271

[1] Credit risk profile reflects internally assigned grade of purchased covered loans without regard to FDIC indemnification.

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Credit Risk Profile by Internally Assigned Grade
At December 31, 2014

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Purchased Non-covered Loans	Purchased Covered Loans [1]	Total
	(In thousands)							
Grade:								
Pass	$366,487	$527,980	$ 11,003	$144,902	$369,618	$ 182,644	$15,509	$1,618,143
Substandard	7,506	39,614	-	2,023	734	39,473	2,037	91,387
Doubtful	12	-	-	-	12	77	-	101
Loss	-	-	-	-	478	21	-	499
Purchased loan discount	-	-	-	-	-	(9,372)	(468)	(9,840)
Total	$374,005	$567,594	$ 11,003	$146,925	$370,842	$ 212,843	$17,078	$1,700,290

[1] Credit risk profile reflects internally assigned grade of purchased covered loans without regard to FDIC indemnification.

The following tables summarize loans by delinquency and nonaccrual status:

Summary of Loans by Delinquency and Nonaccrual Status
At June 30, 2015

	Current and Accruing	30-59 Days Past Due and Accruing	60-89 Days Past Due and Accruing	Past Due 90 days or More and Accruing	Nonaccrual	Total Loans
	(In thousands)					
Commercial	$367,250	$3,053	$ 533	$ -	$ 161	$370,997
Commercial real estate	534,629	6,554	1,308	-	6,119	548,610
Construction	6,762	-	-	-	-	6,762
Residential real estate	132,049	2,044	328	-	-	134,421
Consumer installment and other	360,943	2,617	476	221	-	364,257
Total originated loans	1,401,633	14,268	2,645	221	6,280	1,425,047
Purchased non-covered loans	177,690	2,401	1,082	-	9,942	191,115
Purchased covered loans	15,076	30	-	-	3	15,109
Total	$1,594,399	$16,699	$ 3,727	$ 221	$ 16,225	$1,631,271

Summary of Loans by Delinquency and Nonaccrual Status
At December 31, 2014

	Current and Accruing	30-59 Days Past Due and Accruing	60-89 Days Past Due and Accruing	Past Due 90 days or More and Accruing	Nonaccrual	Total Loans
	(In thousands)					
Commercial	$372,235	$1,704	$ 36	$ -	$ 30	$374,005
Commercial real estate	557,041	6,500	-	-	4,053	567,594
Construction	11,003	-	-	-	-	11,003
Residential real estate	144,021	1,513	817	-	574	146,925
Consumer installment and other	365,753	3,310	625	502	652	370,842
Total originated loans	1,450,053	13,027	1,478	502	5,309	1,470,369
Purchased non-covered loans	196,150	4,204	491	-	11,998	212,843
Purchased covered loans	16,389	389	3	-	297	17,078
Total	$1,662,592	$17,620	$ 1,972	$ 502	$ 17,604	$1,700,290

The following is a summary of the effect of nonaccrual loans on interest income:

	For the Three Months		For the Six Months	
	Ended June 30,			
	2015	2014	2015	2014
	(In thousands)			
Interest income that would have been recognized had the loans performed in accordance with their original terms	$342	$276	$654	$534
Less: Interest income recognized on nonaccrual loans	(118)	(25)	(324)	(69)
Total reduction of interest income	$224	$251	$330	$465

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There were no commitments to lend additional funds to borrowers whose loans were on nonaccrual status at June 30, 2015 and December 31, 2014.

The following summarizes impaired loans:

	Impaired Loans At June 30, 2015		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(In thousands)		
Impaired loans with no related allowance recorded:			
Commercial	$2,756	$2,821	$ -
Commercial real estate	17,161	22,374	-
Construction	-	-	-
Residential real estate	240	270	-
Consumer installment and other	664	711	-
Impaired loans with an allowance recorded:			
Commercial	9,860	9,860	2,533
Commercial real estate	5,109	5,109	1,034
Construction	-	-	-
Residential real estate	-	-	-
Consumer installment and other	-	-	-
Total:			
Commercial	$12,616	$12,681	$ 2,533
Commercial real estate	22,270	27,483	1,034
Construction	-	-	-
Residential real estate	240	270	-
Consumer installment and other	664	711	-

	Impaired Loans At December 31, 2014		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(In thousands)		
Impaired loans with no related allowance recorded:			
Commercial	$2,031	$2,095	$ -
Commercial real estate	19,478	25,519	-
Construction	1,834	1,884	-
Residential real estate	574	574	-

Consumer installment and other	1,518	1,628	-
Impaired loans with an allowance recorded:			
Commercial	9,910	9,910	496
Commercial real estate	-	-	-
Construction	-	-	-
Residential real estate	-	-	-
Consumer installment and other	-	-	-
Total:			
Commercial	$ 11,941	$ 12,005	$ 496
Commercial real estate	19,478	25,519	-
Construction	1,834	1,884	-
Residential real estate	574	574	-
Consumer installment and other	1,518	1,628	-

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Impaired loans include troubled debt restructured loans. Impaired loans at June 30, 2015, included $6,594 thousand of restructured loans, none of which were on nonaccrual status. Impaired loans at December 31, 2014, included $4,837 thousand of restructured loans, none of which were on nonaccrual status.

	Impaired Loans							
	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2015		2014		2015		2014	
	Average Recorded Investment	Recognized Interest Income	Average Recorded Investment	Recognized Interest Income	Average Recorded Investment	Recognized Interest Income	Average Recorded Investment	Recognized Interest Income
	(In thousands)							
Commercial	$12,564	$ 147	$4,437	$ 60	$12,395	$ 293	$4,639	$ 127
Commercial real estate	19,715	147	19,800	153	19,017	404	19,549	270
Construction	-	-	2,035	-	459	-	2,147	-
Residential real estate	693	8	162	-	776	14	162	-
Consumer installment and other	797	7	1,324	7	1,026	13	1,520	15
Total	$33,769	$ 309	$27,758	$ 220	$33,673	$ 724	$28,017	$ 412

The following table provides information on troubled debt restructurings:

	Troubled Debt Restructurings At June 30, 2015			
	Number of Contracts	Pre-Modification Carrying Value	Period-End Carrying Value	Period-End Individual Impairment Allowance
	(In thousands)			
Commercial	6	$ 2,813	$ 2,557	$ -
Commercial real estate	6	3,975	3,797	-
Residential real estate	1	241	237	-
Consumer installment and other	1	18	3	-
Total	14	$ 7,047	$ 6,594	$ -

	Troubled Debt Restructurings At June 30, 2014			
	Number of Contracts	Pre-Modification Carrying Value	Period-End Carrying Value	Period-End Individual Impairment Allowance
	(In thousands)			

Commercial	4	$	3,299	$ 2,992	$ 262
Commercial real estate	2		2,291	2,326	-
Consumer installment and other	1		18	14	-
Total	7	$	5,608	$ 5,332	$ 262

During the three and six months ended June 30, 2015, the Company modified one loan with a carrying value of $100 thousand and six loans with an aggregate carrying value of $1,830 thousand, respectively, that were considered troubled debt restructurings. The concessions granted in the six restructurings completed in the first six months of 2015 consisted of modification of payment terms to extend the maturity date to allow for deferred principal repayment and under-market terms. During the three and six months ended June 30, 2014, the Company modified one loan with a carrying value of $98 thousand and two loans with a total carrying value of $115 thousand, respectively, that were considered troubled debt restructurings. The concessions granted in the two restructurings completed in the first six months of 2014 consisted of modification of payment terms to extend the maturity date to allow for deferred principal repayment. During the three and six months ended June 30, 2015 and 2014, no troubled debt restructured loans defaulted. A troubled debt restructuring is considered to be in default when payments are ninety days or more past due.

The Company repaid $20,015 thousand of Federal Home Loan Bank (“FHLB”) advances in January 2015, which had been collateralized by loans; the collateral requirements expired upon repayment of the debt. At December 31, 2014, the Company pledged loans to secure borrowings with a carrying value of $20,015 thousand from the FHLB. The loans restricted due to collateral requirements approximated $18,366 thousand at December 31, 2014.

There were no loans held for sale at June 30, 2015 and December 31, 2014.

At June 30, 2015 and June 30, 2014, the Company held total other real estate owned (OREO) of $9,260 thousand and $8,543 thousand, respectively, of which $486 thousand and $585 thousand, respectively, were foreclosed residential real estate properties. The amount of consumer mortgage loans outstanding secured by residential real estate properties for which formal foreclosure proceedings were in process totaled $-0- thousand and $705 thousand at June 30, 2015 and June 30, 2014, respectively.

Note 5: Concentration of Credit Risk

Under the California Financial Code, loans to any one person owing to a commercial bank at any one time shall not exceed the following limitations: (a) unsecured loans shall not exceed 15 percent of the sum of the shareholders' equity, allowance for loan losses, capital notes, and debentures of the bank, or (b) secured and unsecured loans in all shall not exceed 25 percent of the sum of the shareholders' equity, allowance for loan losses, capital notes, and debentures of the bank. At June 30, 2015, Westamerica Bank did not have loans to any one customer exceeding these limits; Westamerica Bank had 41 borrower relationships with aggregate loans exceeding $5 million. The Company has significant credit arrangements that are secured by real estate collateral. In addition to real estate loans outstanding as disclosed in Note 4, the Company had loan commitments and standby letters of credit related to real estate loans of $63,076 thousand and $66,086 thousand at June 30, 2015 and December 31, 2014, respectively. The Company requires collateral on all real estate loans with loan-to-value ratios at origination generally no greater than 75% on commercial real estate loans and no greater than 80% on residential real estate loans.

Note 6: Other Assets

Other assets consisted of the following:

	At June 30, 2015	At December 31, 2014
	(In thousands)	
Cost method equity investments:		
Federal Reserve Bank stock [1]	$ 14,069	$ 14,069
Federal Home Loan Bank stock [2]	-	940
Other investments	201	241
Total cost method equity investments	14,270	15,250
Life insurance cash surrender value	47,717	46,479
Net deferred tax asset	50,669	50,903
Limited partnership investments	16,695	18,673
Interest receivable	19,340	19,394

Prepaid assets	5,195	5,609
Other assets	11,627	10,150
Total other assets	$165,513	$166,458

(1) A bank applying for membership in the Federal Reserve System is required to subscribe to stock in the Federal Reserve Bank of San Francisco (FRB) in a sum equal to six percent of the bank’s paid-up capital stock and surplus. One-half of the amount of the bank's subscription shall be paid to the FRB and the remaining half will be subject to call when deemed necessary by the Board of Governors of the Federal Reserve System.

(2) Borrowings from the FHLB must be supported by capital stock holdings. The minimum activity-based requirement is 4.7% of the outstanding advances. The requirement may be adjusted from time to time by the FHLB within limits established in the FHLB's Capital Plan.

The Company invests in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for low-income housing tax credits. At June 30, 2015, this investment totaled $16,695 thousand and $2,310 thousand of this amount represents outstanding equity capital commitments. These commitments are expected to be paid as follows, $464 thousand in 2015, $763 thousand in 2016, and $1,083 thousand in 2017 or thereafter.

The amounts recognized in net income for these investments include:

	For the Three Months		For the Six Months	
	Ended June 30,			
	2015	2014	2015	2014
	(In thousands)			
Investment loss included in pre-tax income	$750	$750	$1,425	$1,450
Tax credits recognized in provision for income taxes	658	771	1,316	1,542

Note 7: Goodwill and Identifiable Intangible Assets

The Company has recorded goodwill and other identifiable intangibles associated with purchase business combinations. Goodwill is not amortized, but is periodically evaluated for impairment. The Company did not recognize impairment during the three and six months ended June 30, 2015 and year ended December 31, 2014. Identifiable intangibles are amortized to their estimated residual values over their expected useful lives. Such lives and residual values are also periodically reassessed to determine if any amortization period adjustments are indicated. During the six months ended June 30, 2015 and year ended December 31, 2014, no such adjustments were recorded.

The carrying values of goodwill were:

	At June 30,	At December 31,
	2015	2014
	(In thousands)	
Goodwill	$121,673	$121,673

The gross carrying amount of identifiable intangible assets and accumulated amortization was:

	At June 30, 2015		At December 31, 2014	
	Gross Carrying	Accumulated	Gross Carrying	Accumulated

	Amount	Amortization	Amount	Amortization
	(In thousands)			
Core Deposit Intangibles	$56,808	$ (45,008)	$56,808	$ (43,188)
Merchant Draft Processing Intangible	10,300	(9,769)	10,300	(9,633)
Total Identifiable Intangible Assets	$67,108	$ (54,777)	$67,108	$ (52,821)

As of June 30, 2015, the current year and estimated future amortization expense for identifiable intangible assets was:

	Core Deposit Intangibles	Merchant Draft Processing Intangible	Total
	(In thousands)		
Six months ended June 30, 2015 (actual)	$1,820	$ 136	$1,956
Estimate for year ended December 31, 2015	3,594	262	3,856
2016	3,292	212	3,504
2017	2,913	164	3,077
2018	1,892	29	1,921
2019	538	-	538
2020	287	-	287

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Note 8: Deposits and Borrowed Funds

The following table provides additional detail regarding deposits.

	Deposits	
	At June 30, 2015	At December 31, 2014
	(In thousands)	
Noninterest-bearing	$1,930,551	$1,910,781
Interest-bearing:		
Transaction	795,793	792,448
Savings	1,287,859	1,260,819
Time deposits less than $100 thousand	160,953	169,959
Time deposits $100 thousand through $250 thousand	106,183	113,023
Time deposits more than $250 thousand	73,505	102,161
Total deposits	$4,354,844	$4,349,191

Demand deposit overdrafts of $3,271 thousand and $3,173 thousand were included as loan balances at June 30, 2015 and December 31, 2014, respectively. Interest expense for aggregate time deposits with individual account balances in excess of $100 thousand was $182 thousand and $379 thousand in the second quarter of and first six months of 2015, respectively and $233 thousand and $464 thousand in the second quarter of and first six months of 2014, respectively.

The following table provides additional detail regarding short-term borrowed funds.

	Repurchase Agreements (Sweep) Accounted for as Secured Borrowings	
	At June 30, 2015	At December 31, 2014
	Remaining Contractual Maturity of the Agreements	
	Overnight and Continuous	Overnight and Continuous
Repurchase agreements:	(In thousands)	
Securities of U.S. Government sponsored entities	$90,336	$ 80,827
Obligations of states and political subdivisions	4,915	14,251

Corporate securities	54,766	52,936
Total collateral carrying value	$ 150,017	$ 148,014
Total short-term borrowed funds	$ 82,747	$ 89,784

FHLB advances matured and were repaid in full in January 2015. At December 31, 2014, FHLB advances with a carrying value of $20,015 thousand were secured by residential real estate loans and securities of approximately $26,484 thousand.

The Company has a $35,000 thousand unsecured line of credit which had no outstanding balance at June 30, 2015 and December 31, 2014. The line of credit has a variable interest rate, which was 2.0% per annum at June 30, 2015, with interest payable monthly on outstanding advances. Advances may be made up to the unused credit limit through March 18, 2016.

Note 9: Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Available for sale investment securities are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as other real estate owned, impaired loans, certain loans held for investment, investment securities held to maturity, and other assets. These nonrecurring fair value adjustments typically involve the lower-of-cost-or-fair value accounting of individual assets.

In accordance with the Fair Value Measurement and Disclosure topic of the Codification, the Company bases its fair values on the price that would be received to sell an asset or paid to transfer a liability in the principal market or most advantageous market for an asset or liability in an orderly transaction between market participants on the measurement date under current market conditions. A fair value measurement reflects all of the assumptions that market participants would use in pricing the asset or liability, including assumptions about the risk inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset, and the risk of nonperformance.

The Company groups its assets and liabilities measured at fair value into a three-level hierarchy, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. When the valuation assumptions used to measure the fair value of the asset or liability are categorized within different levels of the fair value hierarchy, the asset or liability is categorized in its entirety within the lowest level of the hierarchy. These levels are:

Level 1 – Valuation is based upon quoted prices for identical instruments traded in active exchange markets, such as the New York Stock Exchange. Level 1 includes U.S. Treasury and equity securities, which are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. Level 2 includes federal agency securities, mortgage-backed securities, corporate securities, asset-backed securities, municipal bonds and residential collateralized mortgage obligations.

Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company’s estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The Company relies on independent vendor pricing services to measure fair value for investment securities available for sale and investment securities held to maturity. The Company employs three pricing services. To validate the pricing of these vendors, the Company compares vendors’ pricing for each of the securities for consistency; significant pricing differences, if any, are evaluated using all available independent quotes with the quote closely affecting the market is generally used as the fair value estimate. In addition, the Company conducts “other than temporary impairment (OTTI)” analysis on a quarterly basis; securities selected for OTTI analysis include all securities at a market price below 95 percent of par value and with a market to book ratio below 95:100. As with any valuation technique used to estimate fair value, changes in underlying assumptions used could significantly affect the results of current and future values. Accordingly, these fair value estimates may not be realized in an actual sale of the securities.

The Company regularly reviews the valuation techniques and assumptions used by its vendors and determines which valuation techniques are utilized based on observable market inputs for the type of securities being measured. The Company uses the information to determine the placement in the fair value hierarchy as level 1, 2 or 3. When the Company changes its valuation assumptions for measuring financial assets and financial liabilities at fair value, either due to changes in current market conditions or other factors, or reevaluates the valuation techniques and assumptions used by its vendors, it may need to transfer those assets or liabilities to another level in the hierarchy based on the new information. The Company recognizes these transfers at the end of the reporting period that the transfers occur. During the six months ended June 30, 2015, the Company reevaluated the valuation techniques and assumptions used

by its vendors in valuing the Company’s available for sale securities, and based on the evaluation, transferred $437,715 thousand out of level 1 and transferred $437,715 thousand into level 2. There were no transfers into level 1 or into or out of level 3. For the year ended December 31, 2014, there were no transfers into or out of levels 1, 2 or 3.

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Assets Recorded at Fair Value on a Recurring Basis

The table below presents assets measured at fair value on a recurring basis.

	At June 30, 2015			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In thousands)			
U.S. Treasury securities	$3,503	$ 3,503	$-	$ -
Securities of U.S. Government sponsored entities	431,936	-	431,936	-
Residential mortgage-backed securities	22,415	-	22,415	-
Commercial mortgage-backed securities	2,632	-	2,632	-
Obligations of states and political subdivisions	168,252	-	168,252	-
Residential collateralized mortgage obligations	202,750	-	202,750	-
Asset-backed securities	2,659	-	2,659	-
FHLMC and FNMA stock	5,789	10	5,779	-
Corporate securities	792,121	-	792,121	-
Other securities	2,821	963	1,858	-
Total securities available for sale	$1,634,878	$ 4,476	$1,630,402	$ -

	At December 31, 2014			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In thousands)			
U.S. Treasury securities	$3,505	$3,505	$ -	$ -
Securities of U.S. Government sponsored entities	635,188	635,188	-	-
Residential mortgage-backed securities	26,407	-	26,407	-
Commercial mortgage-backed securities	2,919	-	2,919	-
Obligations of states and political subdivisions	181,799	-	181,799	-
Residential collateralized mortgage obligations	222,457	-	222,457	-
Asset-backed securities	8,313	-	8,313	-
FHLMC and FNMA stock	5,168	5,168	-	-
Corporate securities	512,239	-	512,239	-

Other securities	2,786	910	1,876	-
Total securities available for sale	$ 1,600,781	$ 644,771	$ 956,010	$ -

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Assets Recorded at Fair Value on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost or fair-value accounting of individual assets. For assets measured at fair value on a nonrecurring basis that were recorded in the balance sheet at June 30, 2015 and December 31, 2014, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets at period end.

	At June 30, 2015				For the Six Months Ended June 30, 2015
	Fair Value	Level 1	Level 2	Level 3	Total Losses
	(In thousands)				
Other real estate owned	$9,260	$ -	$ -	$9,260	$(243)
Impaired loans	17,732	-	-	17,732	-
Total assets measured at fair value on a nonrecurring basis	$26,992	$ -	$ -	$26,992	$(243)

Level 3 – Valuation is based upon independent market prices, estimated liquidation values of loan collateral or appraised value of the collateral as determined by third-party independent appraisers, less 10% for selling costs, generally. Level 3 includes other real estate owned that has been measured at fair value upon transfer to foreclosed assets and impaired loans collateralized by real property and other business asset collateral where a specific reserve has been established or a chargeoff has been recorded. Losses on other real estate owned represent losses recognized in earnings during the period subsequent to its initial classification as foreclosed assets. The unobservable inputs and qualitative information about the unobservable inputs are not presented due to the unavailability from third party evaluators.

	At December 31, 2014				For the Year Ended December 31, 2014
	Fair Value	Level 1	Level 2	Level 3	Total Losses
	(In thousands)				
Other real estate owned	$6,374	$ -	$6,374	$-	$(358)
Impaired loans	17,085	-	7,670	9,415	(884)
Total assets measured at fair value on a nonrecurring basis	$23,459	$ -	$14,044	$9,415	$(1,242)

Level 2 – Valuation is based upon independent market prices or appraised value of the collateral, less 10% for selling costs, generally. Level 2 includes other real estate owned that has been measured at fair value upon transfer to foreclosed assets and impaired loans collateralized by real property where a specific reserve has been established or a chargeoff has been recorded. Losses on other real estate owned represent losses recognized in earnings during the period subsequent to its initial classification as foreclosed assets.

Level 3 – Valuation is based upon estimated liquidation values of loan collateral. The value of level 3 assets can also include a component of real estate, which is valued as described for level 2 inputs, when collateral for the impaired loan includes both business assets and real estate. Level 3 includes impaired loans where a specific reserve has been established or a chargeoff has been recorded.

Disclosures about Fair Value of Financial Instruments

The following section describes the valuation methodologies used by the Company for estimating fair value of financial instruments not recorded at fair value in the balance sheet.

Cash and Due from Banks Cash and due from banks represent U.S. dollar denominated coin and currency, deposits at the Federal Reserve Bank and correspondent banks, and amounts being settled with other banks to complete the processing of customers' daily transactions. Collectively, the Federal Reserve Bank and financial institutions operate in a market in which cash and due from banks transactions are processed continuously in significant daily volumes honoring the face value of the U.S. dollar.

Investment Securities Held to Maturity The fair values of investment securities were estimated using quoted prices as described above for Level 1 and Level 2 valuation.

Loans Loans were separated into two groups for valuation. Variable rate loans, except for those described below, which reprice frequently with changes in market rates were valued using historical cost. Fixed rate loans and variable rate loans that have reached their minimum contractual interest rates were valued by discounting the future cash flows expected to be received from the loans using current interest rates charged on loans with similar characteristics. Additionally, the allowance for loan losses of $30,828 thousand at June 30, 2015 and $31,485 thousand at December 31, 2014 and the purchased loan discount associated with purchased covered and purchased non-covered loans of $197 thousand and $7,780 thousand, respectively at June 30, 2015 and of $468 thousand and $9,372 thousand, respectively at December 31, 2014 were applied against the estimated fair values to recognize estimated future defaults of contractual cash flows. The Company does not consider these values to be a liquidation price for the loans.

Deposit Liabilities Deposits with no stated maturity such as checking accounts, savings accounts and money market accounts can be readily converted to cash or used to settle transactions at face value through the broad financial system operated by the Federal Reserve Bank and financial institutions. The fair value of deposits with no stated maturity is equal to the amount payable on demand. The fair values of time deposits were estimated by discounting estimated future contractual cash flows using current market rates for financial instruments with similar characteristics.

Short-Term Borrowed Funds The carrying amount of securities sold under agreement to repurchase and other short-term borrowed funds approximate fair value due to the relatively short period of time between their origination and their expected realization.

Federal Home Loan Bank Advances The fair values of FHLB advances were estimated by using redemption amounts quoted by the Federal Home Loan Bank of San Francisco.

The table below is a summary of fair value estimates for financial instruments and the level of the fair value hierarchy within which the fair value measurements are categorized, excluding financial instruments recorded at fair value on a recurring basis. The values assigned do not necessarily represent amounts which ultimately may be realized for assets or paid to settle liabilities. In addition, these values do not give effect to adjustments to fair value which may occur when financial instruments are sold or settled in larger quantities. The carrying amounts in the following table are recorded in the balance sheet under the indicated captions.

The Company has not included assets and liabilities that are not financial instruments, such as goodwill, long-term relationships with deposit, merchant processing and trust customers, other purchased intangibles, premises and equipment, deferred taxes and other assets and liabilities. The total estimated fair values do not represent, and should not be construed to represent, the underlying value of the Company.

At June 30, 2015

	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:	(In thousands)				
Cash and due from banks	$289,606	$289,606	$289,606	$-	$ -
Investment securities held to maturity	1,159,581	1,164,603	-	1,164,603	-
Loans	1,600,443	1,613,443	-	-	1,613,443
Financial Liabilities:					
Deposits	$4,354,844	$4,354,172	$-	$4,014,203	$ 339,969
Short-term borrowed funds	82,747	82,747	-	82,747	-

	At December 31, 2014				
	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:	(In thousands)				
Cash and due from banks	$380,836	$380,836	$380,836	$-	$ -
Investment securities held to maturity	1,038,658	1,048,562	1,077	1,047,485	-
Loans	1,668,805	1,685,048	-	-	1,685,048
Financial Liabilities:					
Deposits	$4,349,191	$4,348,958	$-	$3,964,048	$ 384,910
Short-term borrowed funds	89,784	89,784	-	89,784	-
Federal Home Loan Bank advances	20,015	20,014	20,014	-	-
					-

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The majority of the Company’s standby letters of credit and other commitments to extend credit carry current market interest rates if converted to loans. No premium or discount was ascribed to these commitments because virtually all funding would be at current market rates.

Note 10: Commitments and Contingent Liabilities

Loan commitments are agreements to lend to a customer provided there is no violation of any condition established in the agreement. Commitments generally have fixed expiration dates or other termination clauses. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future funding requirements. Loan commitments are subject to the Company’s normal credit policies and collateral requirements. Unfunded loan commitments were $304,499 thousand and $312,694 thousand at June 30, 2015 and December 31, 2014, respectively. Standby letters of credit commit the Company to make payments on behalf of customers when certain specified future events occur. Standby letters of credit are primarily issued to support customers’ short-term financing requirements and must meet the Company’s normal credit policies and collateral requirements. Financial and performance standby letters of credit outstanding totaled $26,969 thousand and $29,002 thousand at June 30, 2015 and December 31, 2014, respectively. The Company also had commitments for commercial and similar letters of credit of $40 thousand at June 30, 2015 and December 31, 2014. At June 30, 2015 and December 31, 2014, the Company had a reserve for unfunded commitments of $2,693 thousand included in other liabilities.

Due to the nature of its business, the Company is subject to various threatened or filed legal cases. Based on the advice of legal counsel, the Company does not expect such cases will have a material, adverse effect on its financial position or results of operations. Legal liabilities are accrued when obligations become probable and the amount is reasonably estimable.

Note 11: Earnings Per Common Share

The table below shows earnings per common share and diluted earnings per common share. Basic earnings per common share are computed by dividing net income by the average number of common shares outstanding during the period. Diluted earnings per common share are computed by dividing net income by the average number of common shares outstanding during the period plus the impact of common stock equivalents.

	For the Three Months		For the Six Months	
	Ended June 30,			
	2015	2014	2015	2014
	(In thousands, except per share data)			
Net income applicable to common equity (numerator)	$14,761	$15,157	$29,318	$30,464

Basic earnings per common share				
Weighted average number of common shares outstanding - basic (denominator)	25,514	26,175	25,582	26,303
Basic earnings per common share	$0.58	$0.58	$1.15	$1.16
Diluted earnings per common share				
Weighted average number of common shares outstanding - basic	25,514	26,175	25,582	26,303
Add common stock equivalents for options	22	63	13	84
Weighted average number of common shares outstanding - diluted (denominator)	25,536	26,238	25,595	26,387
Diluted earnings per common share	$0.58	$0.58	$1.15	$1.15

For the three and six months ended June 30, 2015, options to purchase 1,376 thousand and 1,575 thousand shares of common stock, respectively, were outstanding but not included in the computation of diluted net income per share because the option exercise price exceeded the fair value of the stock such that their inclusion would have had an anti-dilutive effect.

For the three and six months ended June 30, 2014, options to purchase 1,050 thousand and 929 thousand shares of common stock, respectively, were outstanding but not included in the computation of diluted net income per share because the option exercise price exceeded the fair value of the stock such that their inclusion would have had an anti-dilutive effect.

WESTAMERICA BANCORPORATION

FINANCIAL SUMMARY

	For the Three Months Ended June 30,		For the Six Months	
	2015	2014	2015	2014
	(In thousands, except per share data)			
Net Interest and Fee Income (FTE)[1]	$37,415	$38,582	$74,345	$77,446
Provision for Loan Losses	-	1,000	-	2,000
Noninterest Income	12,269	13,198	24,569	26,188
Noninterest Expense	26,896	26,957	53,623	53,830
Income Before Income Taxes (FTE)[1]	22,788	23,823	45,291	47,804
Income Tax Provision (FTE)[1]	8,027	8,666	15,973	17,340
Net Income	$14,761	$15,157	$29,318	$30,464
Average Common Shares Outstanding	25,514	26,175	25,582	26,303
Diluted Average Common Shares Outstanding	25,536	26,238	25,595	26,387
Common Shares Outstanding at Period End	25,529	26,074		
Per Common Share:				
Basic Earnings	$0.58	$0.58	$1.15	$1.16
Diluted Earnings	0.58	0.58	1.15	1.15
Book Value	$20.58	$20.66		
Financial Ratios:				
Return on Assets	1.17 %	1.24 %	1.17 %	1.25 %
Return on Common Equity	11.50 %	11.57 %	11.47 %	11.61 %
Net Interest Margin (FTE)[1]	3.37 %	3.76 %	3.40 %	3.79 %
Net Loan Losses to Average Loans	0.09 %	0.16 %	0.08 %	0.14 %
Efficiency Ratio[2]	54.1 %	52.1 %	54.2 %	51.9 %
Average Balances:				
Assets	$5,044,361	$4,908,467	$5,051,907	$4,899,255
Earning Assets	4,436,196	4,114,811	4,389,374	4,104,009
Loans	1,655,779	1,802,041	1,669,686	1,811,998
Deposits	4,395,351	4,238,769	4,399,127	4,224,326
Shareholders' Equity	514,768	525,288	515,423	529,202
Period End Balances:				
Assets	$5,031,230	$4,931,095		
Earning Assets	4,425,730	4,131,985		
Loans	1,631,271	1,784,608		
Deposits	4,354,844	4,213,389		
Shareholders' Equity	525,338	538,803		
Capital Ratios at Period End:				

Total Risk Based Capital	13.08	%	15.04	%				
Tangible Equity to Tangible Assets	7.99	%	8.36	%				
Dividends Paid Per Common Share	$0.38		$0.38		$0.76		$0.76	
Common Dividend Payout Ratio	66	%	66	%	66	%	66	%

The above financial summary has been derived from the Company's unaudited consolidated financial statements. This information should be read in conjunction with those statements, notes and the other information included elsewhere herein. Percentages under the heading "Financial Ratios" are annualized with the exception of the efficiency ratio.

[1] Yields on securities and certain loans have been adjusted upward to a "fully taxable equivalent" ("FTE") basis, which is a non-GAAP financial measure, in order to reflect the effect of income which is exempt from federal income taxation at the current statutory tax rate.

[2] The efficiency ratio is defined as noninterest expense divided by total revenue (net interest income on an FTE basis, which is a non-GAAP financial measure, and noninterest income).

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

The Federal Reserve's Federal Open Market Committee has maintained highly accommodative monetary policies to influence interest rates to low levels in order to provide stimulus to the economy following the "financial crisis" recession. The Company's principal source of revenue is net interest and fee income, which represents interest earned on loans and investment securities ("earning assets") reduced by interest paid on deposits and other borrowings ("interest-bearing liabilities"). The relatively low level of market interest rates has reduced the spread between interest rates on earning assets and interest bearing liabilities. The Company's net interest margin and net interest income declined as market interest rates on newly originated loans remain below the yields earned on older-dated loans and on the overall loan portfolio. The Company is reducing its exposure to rising interest rates by purchasing shorter-duration investment securities with lower yields than longer-duration securities. The Company's credit quality continued to improve, as nonperforming assets at June 30, 2015 declined 13 percent compared with June 30, 2014 and net loan losses remained low in the three and six months ended June 30, 2015. The improvement in credit quality has resulted in Management reducing the provision for loan losses to zero in the second quarter and in the first half of 2015 from $1 million in the second quarter 2014 and $2 million in the first half of 2014. The credit quality improvement also contributed to reducing noninterest expenses related to nonperforming assets. Management is focused on controlling all noninterest expense levels, particularly due to market interest rate pressure on net interest income.

Westamerica Bancorporation and subsidiaries (the "Company") reported net income of $14.8 million or $0.58 diluted earnings per common share for the second quarter 2015 and net income of $29.3 million or $1.15 diluted earnings per common share for the six months ended June 30, 2015. These results compare to net income of $15.2 million or $0.58 diluted earnings per common share for the second quarter 2014 and net income of $30.5 million or $1.15 diluted earnings per common share for the six months ended June 30, 2014.

Net Income

Following is a summary of the components of net income for the periods indicated:

	For the Three Months Ended June 30,		For the Six Months	
	2015	2014	2015	2014
	(In thousands, except per share data)			
Net interest income (FTE)	$37,415	$38,582	$74,345	$77,446
Provision for loan losses	-	1,000	-	2,000
Noninterest income	12,269	13,198	24,569	26,188
Noninterest expense	26,896	26,957	53,623	53,830
Income before taxes (FTE)	22,788	23,823	45,291	47,804

Income tax provision (FTE)	8,027	8,666	15,973	17,340
Net income	$14,761	$15,157	$29,318	$30,464
Average diluted common shares	25,536	26,238	25,595	26,387
Diluted earnings per common share	$0.58	$0.58	$1.15	$1.15
Average total assets	$5,044,361	$4,908,467	$5,051,907	$4,899,255
Net income to average total assets (annualized)	1.17 %	1.24 %	1.17 %	1.25 %
Net income to average common stockholders' equity (annualized)	11.50 %	11.57 %	11.47 %	11.61 %

Net income for the second quarter of 2015 was $396 thousand less than the same quarter of 2014, the net result of declines in net interest and fee income (fully taxable equivalent or “FTE”) and noninterest income, partially offset by decreases in the provision for loan losses and income tax provision (FTE). A decrease in net interest and fee income (FTE) was mostly attributed to lower average balances of loans and lower net yield on interest-earning assets, partially offset by higher average balances of investments and a lower average volume of higher-cost funding sources. The provision for loan losses was reduced to zero, reflecting Management's evaluation of losses inherent in the loan portfolio; net losses and nonperforming loan volumes have declined relative to earlier periods. Noninterest income decreased primarily due to reduced levels of service charges on deposit accounts and other income.

Comparing the first half of 2015 to the first half of 2014, net income decreased $1.1 million due to lower net interest and fee income (FTE) and lower noninterest income, partially offset by decreases in the provision for loan losses, noninterest expense and income tax provision (FTE). The lower net interest and fee income (FTE) was primarily caused by a lower average volume of loans and lower net yield on interest earning assets, partially offset by higher average balances of investments and a lower average volume of higher-cost funding sources. The provision for loan losses was reduced to zero, reflecting improved credit quality and Management's evaluation of losses inherent in the loan portfolio. Noninterest income decreased primarily due to reduced levels of service charges on deposit accounts, merchant processing services and other income. Noninterest expense decreased mostly due to lower personnel expenses, partially offset by higher expense for other real estate owned.

Net Interest and Fee Income (FTE)

Following is a summary of the components of net interest and fee income (FTE) for the periods indicated:

	For the Three Months Ended June 30,		For the Six Months	
	2015	2014	2015	2014
	(In thousands)			
Interest and fee income	$34,425	$35,403	$68,342	$70,967
Interest expense	617	900	1,276	1,798
FTE adjustment	3,607	4,079	7,279	8,277
Net interest income (FTE)	$37,415	$38,582	$74,345	$77,446
Average earning assets	$4,436,196	$4,114,811	$4,389,374	$4,104,009
Net interest margin (FTE) (annualized)	3.37 %	3.76 %	3.40 %	3.79 %

Net interest and fee income (FTE) decreased during the second quarter 2015 by $1.2 million from the same period in 2014 to $37.4 million, mainly due to lower average balances of loans (down $146 million) and lower yields on interest-earning assets (down 42 basis points “bp”), partially offset by higher average balances of investments (up $468 million) and lower average balances of higher-costing interest-bearing liabilities.

Comparing the first half of 2015 with the first half of 2014, net interest and fee income (FTE) decreased $3.1 million due to a lower average volume of loans (down $142 million) and lower yields on interest earning assets (down 42 bp), partially offset by higher average balances of investments (up $428 million) and a lower average volume of higher-cost funding sources.

Loan volumes have declined due to problem loan workout activities (such as chargeoffs, collateral repossessions and principal payments), particularly with purchased loans, and reduced volumes of loan originations. In Management's opinion, current levels of competitive loan pricing do not provide adequate forward earnings potential. As a result, the Company has not currently taken an aggressive posture relative to loan portfolio growth. Management has maintained relatively stable interest-earning asset volumes by increasing investment securities as loan volumes have declined.

Yields on interest-earning assets have declined due to relatively low interest rates prevailing in the market. The net interest margin (FTE) was 3.37% and 3.40% in the second quarter and the first half of 2015, respectively, compared with 3.76% and 3.79% in the second quarter and the first half of 2014, respectively. The volume of older-dated higher-yielding loans declined due to principal maturities and paydowns. Newly originated loans have lower yields. The Company, in anticipation of rising interest rates, has been purchasing floating rate and shorter-duration investment securities with lower yields than longer-duration securities to increase liquidity. The Company's high levels of liquidity will provide an opportunity to obtain higher yielding assets once market interest rates start rising. The Company has been replacing higher-cost funding sources with low-cost deposits and interest expense has declined to offset some of the decline in interest income.

Interest and Fee Income (FTE)

Interest and fee income (FTE) for the second quarter of 2015 decreased $1.5 million or 3.7% from the same period in 2014. The decrease was caused by lower average balances of loans and lower net yield on interest-earning assets, partially offset by higher average balances of investments.

The total average balances of loans declined due to decreases in the average balances of commercial real estate loans (down $88 million), consumer loans (down $33 million), residential real estate loans (down $33 million) and tax-exempt commercial loans (down $12 million), partially offset by a $22 million increase in taxable commercial loans. The average investment portfolio increased largely due to higher average balances of corporate securities (up $327 million) and securities of U.S. Government sponsored entities (up $242 million), partially offset by decreases in average balances of collateralized mortgage obligations and mortgage-backed securities (down $49 million) and municipal securities (down $45 million).

The average yield on the Company's earning assets decreased from 3.85% in the second quarter 2014 to 3.43% in the corresponding period of 2015. The composite yield on loans declined 23 bp to 4.95% mostly due to lower yields on taxable commercial loans (down 90 bp), consumer loans (down 20 bp) and tax-exempt commercial loans (down 25 bp). Nonperforming loans are included in average loan volumes used to compute loan yields; fluctuations in nonaccrual loan volumes impact loan yields. The investment yields in general declined due to market rates. The investment portfolio yield decreased 27 bp to 2.53% primarily due to lower yields on municipal securities (down 31 bp), partially offset by higher yields on collateralized mortgage obligations and mortgage-backed securities (up 27 bp) and securities of U.S. Government sponsored entities (up 13 bp) and corporate securities (up 11 bp). The yield on securities of U.S. government sponsored entities and corporate securities rose as securities added to the portfolio in the second quarter 2015 were higher yielding than securities held in the prior period.

Comparing the first half of 2015 with the first half of 2014, interest and fee income (FTE) was down $3.6 million or 4.6%. The decrease resulted from a lower average volume of loans and net lower yield on interest earning assets, partially offset by higher average balances of investments.

In the first half of 2015 the average balance of the loan portfolio decreased compared with the first half of 2014 primarily due to decreases in average balances of commercial real estate loans (down $83 million), consumer loans (down $34 million), residential real estate loans (down $35 million) and tax-exempt commercial loans (down $14 million), partially offset by a $24 million increase in the average balance of taxable commercial loans. The average investment portfolio increased mostly due to higher average balances of U.S. government sponsored entities (up $300 million) and corporate securities (up $260 million), partially offset by lower average balances of collateralized mortgage obligations and mortgage-backed securities (down $76 million) and municipal securities (down $51 million). The average yield on earning assets for the first half of 2015 was 3.46% compared with 3.88% in the first half of 2014. The loan portfolio yield for the first half of 2015 was 4.96% compared with 5.19% for the first half of 2014 mostly due to lower yields on taxable commercial loans (down 113 bp) and consumer loans (down 22 bp), partially offset by higher yields on commercial real estate loans (up 5 bp). Higher yields on commercial real estate loans were attributable to higher interest received on nonaccrual loans and discount accretion on purchased loans. The investment portfolio yield decreased 30 bp to 2.54% primarily due to lower yields on municipal securities (down 31 bp), partially offset by higher yields on collateralized mortgage obligations and mortgage-backed securities (up 21 bp) and securities of U.S. Government sponsored entities (up 19 bp). The yield on securities of collateralized mortgage obligations and mortgage-backed securities rose due to lower levels of premium amortization. The yield on securities of U.S. government sponsored entities added to the portfolio in the first half of 2015 were higher yielding than securities held in the prior period.

Interest Expense

Interest expense has been reduced by lowering rates paid on interest-bearing deposits and borrowings and by reducing the volume of higher-cost funding sources. A $10 million term repurchase agreement was repaid in August 2014. Federal Home Loan Bank advances of $20 million were repaid in January 2015. Average balances of time deposits declined $104 million in the second quarter 2015 compared with the second quarter 2014. Similarly, average balances of time deposits declined $95 million in the first half of 2015 compared with the first half of 2014. Lower-cost checking and savings deposits accounted for 92.1% and 91.7% of total average deposits in the second quarter 2015 and in the first half of 2015, respectively, compared with 89.3% and 89.1% in the second quarter 2014 and in the first half of 2014, respectively.

Interest expense in the second quarter of 2015 decreased $283 thousand or 31.4% compared with the same period in 2014 due to lower average balances of higher-costing interest-bearing liabilities. Interest-bearing liabilities increased due to higher average balances of money market savings (up $58 million), regular savings (up $41 million), money market checking (up $21 million) and securities sold under repurchase agreements (up $26 million), partially offset by lower average balances of time deposits $100 thousand or more (down $78 million), time deposits less than $100 thousand (down $25 million), Federal Home Loan Bank advances (down $20 million) and term repurchase agreement (down $10 million). The average rate paid on interest-bearing liabilities decreased from 0.14% in the second quarter of 2014 compared to 0.10% in the second quarter of 2015. Rates on interest-bearing deposits were 0.10% for the second quarter 2015 compared with 0.12% for the second quarter 2014, respectively.

Comparing the first half of 2015 with the first half of 2014, interest expense declined $522 thousand or 29.0% due to lower average balances of higher-costing interest-bearing liabilities. Average balances of Federal Home Loan Bank advances and term repurchase agreement declined $19 million and $10 million, respectively. Average balances of interest-bearing deposits increased primarily due to higher balances of money market savings (up $63 million), regular savings (up $40 million) and money market checking (up $25 million), partially offset by lower average balances of time deposits $100 thousand or more (down $69 million) and time deposits less than $100 thousand (down $27 million). Rates paid on interest-bearing liabilities averaged 0.10% during the first half of 2015 compared with 0.14% for the first half of 2014. Rates paid on interest-bearing deposits were 0.10% in the first half of 2015 compared with 0.12% in the first half of 2014.

Net Interest Margin (FTE)

The following summarizes the components of the Company's net interest margin for the periods indicated (Percentages are annualized.):

	For the Three Months Ended June 30,		For the Six Months	
	2015	2014	2015	2014
Yield on earning assets (FTE)	3.43%	3.85%	3.46%	3.88%
Rate paid on interest-bearing liabilities	0.10%	0.14%	0.10%	0.14%
Net interest spread (FTE)	3.33%	3.71%	3.36%	3.74%
Impact of noninterest bearing demand deposits	0.04%	0.05%	0.04%	0.05%
Net interest margin (FTE)	3.37%	3.76%	3.40%	3.79%

During the second quarter and the first half of 2015, the net interest margin (FTE) was affected by low market interest rates. The volume of older-dated higher-yielding loans and securities declined due to principal maturities and paydowns. Newly originated loans have lower yields. The Company, in anticipation of rising interest rates, has been purchasing floating rate and shorter-duration investment securities to increase liquidity. The liquidity from the shorter-duration securities can be invested at higher interest rates during a period of rising interest rates. Rates on interest-bearing liabilities were kept low by reducing the volume of higher-cost funding sources. During the second quarter 2015 the net interest margin (FTE) decreased 39 bp compared with the same period in 2014. Lower yields on earning assets were partially offset by lower rates paid on interest-bearing liabilities and resulted in a 38 bp decrease in net interest spread (FTE). During the first half of 2015, the net interest margin (FTE) decreased 39 bp compared with the first half of 2014. The net interest spread (FTE) in the first half of 2015 was 3.36% compared with 3.74% in

the first half of 2014, the net result of a 42 bp decrease in earning asset yield and 4 bp decrease in the cost of interest-bearing liabilities.

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Summary of Average Balances, Yields/Rates and Interest Differential

The following tables present information regarding the consolidated average assets, liabilities and shareholders' equity, the amounts of interest income earned from average interest earning assets and the resulting yields, and the amounts of interest expense incurred on average interest-bearing liabilities and the resulting rates. Average loan balances include nonperforming loans. Interest income includes reversal of previously accrued interest on loans placed on non-accrual status during the period and proceeds from loans on nonaccrual status only to the extent cash payments have been received and applied as interest income and accretion of purchased loan discounts. Yields on tax-exempt securities and loans have been adjusted upward to reflect the effect of income exempt from federal income taxation at the current statutory tax rate. Yields, rates and interest margins are annualized.

Distribution of Assets, Liabilities & Shareholders' Equity and Yields, Rates & Interest Margin

	For the Three Months Ended June 30, 2015		
	Average Balance	Interest Income/ Expense	Yields/ Rates
	(In thousands)		
Assets			
Investment securities:			
Available for sale			
Taxable	$1,559,160	$6,406	1.64%
Tax-exempt(1)	164,966	2,448	5.94%
Held to maturity			
Taxable	361,299	1,987	2.20%
Tax-exempt(1)	694,992	6,767	3.89%
Loans:			
Commercial:			
Taxable	316,426	3,633	4.61%
Tax-exempt(1)	77,594	1,114	5.76%
Commercial real estate	687,221	10,524	6.14%
Real estate construction	11,871	175	5.91%
Real estate residential	141,878	1,205	3.40%
Consumer installment and other	420,789	3,773	3.60%
Total loans (1)	1,655,779	20,424	4.95%
Total Interest-earning assets (1)	4,436,196	$38,032	3.43%
Other assets	608,165		
Total assets	$5,044,361		
Liabilities and shareholders' equity			
Deposits:			
Noninterest-bearing demand	$1,942,124	$-	- %

Savings and interest-bearing transaction	2,104,570	269	0.05%
Time less than $100,000	176,052	150	0.34%
Time $100,000 or more	172,605	182	0.42%
Total interest-bearing deposits	2,453,227	601	0.10%
Short-term borrowed funds	86,967	16	0.07%
Total interest-bearing liabilities	2,540,194	$617	0.10%
Other liabilities	47,275		
Shareholders' equity	514,768		
Total liabilities and shareholders' equity	$5,044,361		
Net interest spread (1) (2)			3.33%
Net interest and fee income and interest margin (1) (3)		$37,415	3.37%

(1) Amounts calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

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

(3) Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets.

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Distribution of Assets, Liabilities & Shareholders' Equity and Yields, Rates & Interest Margin

	For the Three Months Ended June 30, 2014		
	Average Balance	Interest Income/ Expense	Yields/ Rates
	(In thousands)		
Assets			
Investment securities:			
Available for sale			
Taxable	$1,050,267	$4,175	1.59%
Tax-exempt [1]	172,720	2,403	5.57%
Held to maturity			
Taxable	364,952	1,701	1.86%
Tax-exempt [1]	724,831	7,947	4.39%
Loans:			
Commercial:			
Taxable	294,875	4,051	5.51%
Tax-exempt [1]	89,565	1,343	6.01%
Commercial real estate	775,687	11,889	6.15%
Real estate construction	13,109	182	5.55%
Real estate residential	174,791	1,490	3.41%
Consumer	454,014	4,301	3.80%
Total loans [1]	1,802,041	23,256	5.18%
Total Interest-earning assets [1]	4,114,811	$39,482	3.85%
Other assets	793,656		
Total assets	$4,908,467		
Liabilities and shareholders' equity			
Deposits:			
Noninterest-bearing demand	$1,799,994	$-	- %
Savings and interest-bearing transaction	1,986,256	305	0.06%
Time less than $100,000	201,506	216	0.43%
Time $100,000 or more	251,013	233	0.37%
Total interest-bearing deposits	2,438,775	754	0.12%
Short-term borrowed funds	60,876	21	0.14%
Term repurchase agreement	10,000	24	0.98%
Federal Home Loan Bank advances	20,379	101	1.99%
Total interest-bearing liabilities	2,530,030	$900	0.14%
Other liabilities	53,155		
Shareholders' equity	525,288		
Total liabilities and shareholders' equity	$4,908,467		
Net interest spread [1] [2]			3.71%
Net interest and fee income and interest margin [1] [3]		$38,582	3.76%

[1] Amounts calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

[2] Net interest spread represents the average yield earned on interest-earning assets less the average rate incurred on interest-bearing liabilities.

[3] Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets.

Distribution of Assets, Liabilities & Shareholders' Equity and Yields, Rates & Interest Margin

	For the Six Months Ended June 30, 2015		
	Average Balance	Interest Income/ Expense	Yields/ Rates
	(In thousands)		
Assets			
Investment securities:			
Available for sale			
Taxable	$1,513,259	$12,302	1.63%
Tax-exempt[1]	165,490	4,865	5.88%
Held to maturity			
Taxable	341,447	3,644	2.13%
Tax-exempt[1]	699,492	13,773	3.94%
Loans:			
Commercial:			
Taxable	312,334	7,067	4.56%
Tax-exempt[1]	78,246	2,210	5.70%
Commercial real estate	698,784	21,465	6.19%
Real estate construction	12,962	353	5.49%
Real estate residential	144,677	2,435	3.37%
Consumer installment and other	422,683	7,507	3.58%
Total loans[1]	1,669,686	41,037	4.96%
Total Interest-earning assets[1]	4,389,374	$75,621	3.46%
Other assets	662,533		
Total assets	$5,051,907		
Liabilities and shareholders' equity			
Deposits:			
Noninterest-bearing demand	$1,931,034	$-	- %
Savings and interest-bearing transaction	2,103,846	548	0.05%
Time less than $100,000	178,393	316	0.36%
Time $100,000 or more	185,854	379	0.41%
Total interest-bearing deposits	2,468,093	1,243	0.10%
Short-term borrowed funds	86,662	32	0.07%
Federal Home Loan Bank advances	997	1	0.20%
Total interest-bearing liabilities	2,555,752	$1,276	0.10%
Other liabilities	49,698		
Shareholders' equity	515,423		
Total liabilities and shareholders' equity	$5,051,907		
Net interest spread [1] [2]			3.36%
Net interest and fee income and interest margin [1] [3]		$74,345	3.40%

[1] Amounts calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

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

(3) Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets.

Distribution of Assets, Liabilities & Shareholders’ Equity and Yields, Rates & Interest Margin

	For the Six Months Ended June 30, 2014		
	Average Balance	Interest Income/ Expense	Yields/ Rates
	(In thousands)		
Assets			
Investment securities:			
Available for sale			
Taxable	$1,010,610	$8,100	1.60%
Tax-exempt[1]	175,073	4,837	5.53%
Held to maturity			
Taxable	372,133	3,459	1.86%
Tax-exempt[1]	734,195	16,233	4.42%
Loans:			
Commercial:			
Taxable	287,984	8,124	5.69%
Tax-exempt[1]	92,188	2,655	5.81%
Commercial real estate	781,944	23,812	6.14%
Real estate construction	13,125	372	5.72%
Real estate residential	179,582	3,038	3.38%
Consumer	457,175	8,614	3.80%
Total loans[1]	1,811,998	46,615	5.19%
Total Interest-earning assets[1]	4,104,009	$79,244	3.88%
Other assets	795,246		
Total assets	$4,899,255		
Liabilities and shareholders' equity			
Deposits:			
Noninterest-bearing demand	$1,784,316	$-	- %
Savings and interest-bearing transaction	1,980,375	606	0.06%
Time less than $100,000	205,047	437	0.43%
Time $100,000 or more	254,588	465	0.37%
Total interest-bearing deposits	2,440,010	1,508	0.12%
Short-term borrowed funds	61,670	41	0.13%
Term repurchase agreement	10,000	49	0.99%
Federal Home Loan Bank advances	20,449	200	1.98%
Total interest-bearing liabilities	2,532,129	$1,798	0.14%
Other liabilities	53,608		
Shareholders' equity	529,202		
Total liabilities and shareholders' equity	$4,899,255		
Net interest spread [1] [2]			3.74%
Net interest and fee income and interest margin [1] [3]		$77,446	3.79%

[1] Amounts calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

[2] Net interest spread represents the average yield earned on interest-earning assets less the average rate incurred on interest-bearing liabilities.

[3] Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets.

Summary of Changes in Interest Income and Expense due to Changes in Average Asset & Liability Balances and Yields Earned & Rates Paid

The following tables set forth a summary of the changes in interest income and interest expense due to changes in average assets and liability balances (volume) and changes in average interest yields/rates for the periods indicated. Changes not solely attributable to volume or yields/rates have been allocated in proportion to the respective volume and yield/rate components.

Summary of Changes in Interest Income and Expense

	For the Three Months Ended June 30, 2015 Compared with For the Three Months Ended June 30, 2014		
	Volume	Yield/Rate	Total
	(In thousands)		
Increase (decrease) in interest and fee income:			
Investment securities:			
Available for sale			
Taxable	$2,023	$208	$2,231
Tax-exempt[1]	(108)	153	45
Held to maturity			
Taxable	(17)	303	286
Tax-exempt[1]	(327)	(853)	(1,180)
Loans:			
Commercial:			
Taxable	296	(714)	(418)
Tax-exempt[1]	(180)	(49)	(229)
Commercial real estate	(1,356)	(9)	(1,365)
Real estate construction	(17)	10	(7)
Real estate residential	(281)	(4)	(285)
Consumer	(315)	(213)	(528)
Total loans[1]	(1,853)	(979)	(2,832)
Total decrease in interest and fee income[1]	(282)	(1,168)	(1,450)
Increase (decrease) in interest expense:			
Deposits:			
Savings and interest-bearing transaction	18	(54)	(36)
Time less than $100,000	(27)	(39)	(66)
Time $100,000 or more	(73)	22	(51)
Total interest-bearing deposits	(82)	(71)	(153)

Short-term borrowed funds	9	(14)	(5)
Term repurchase agreement	(24)	-	(24)
Federal Home Loan Bank advances	(101)	-	(101)
Total decrease in interest expense	(198)	(85)	(283)
Decrease in net interest and fee income[1]	$(84)	$(1,083)	$(1,167)

[1] Amounts calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

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Summary of Changes in Interest Income and Expense

	For the Six Months Ended June 30, 2015 Compared with For the Six Months Ended June 30, 2014		
	Volume	Yield/Rate	Total
	(In thousands)		
Increase (decrease) in interest and fee income:			
Investment securities:			
Available for sale			
Taxable	$4,029	$ 173	$4,202
Tax-exempt[1]	(265)	293	28
Held to maturity			
Taxable	(285)	470	185
Tax-exempt[1]	(767)	(1,693)	(2,460)
Loans:			
Commercial:			
Taxable	687	(1,744)	(1,057)
Tax-exempt[1]	(402)	(43)	(445)
Commercial real estate	(2,532)	185	(2,347)
Real estate construction	(5)	(14)	(19)
Real estate residential	(590)	(13)	(603)
Consumer	(650)	(457)	(1,107)
Total loans[1]	(3,492)	(2,086)	(5,578)
Total decrease in interest and fee income[1]	(780)	(2,843)	(3,623)
Increase (decrease) in interest expense:			
Deposits:			
Savings and interest-bearing transaction	38	(96)	(58)
Time less than $100,000	(57)	(64)	(121)
Time $100,000 or more	(126)	40	(86)
Total interest-bearing deposits	(145)	(120)	(265)
Short-term borrowed funds	17	(26)	(9)
Term repurchase agreement	(49)	-	(49)
Federal Home Loan Bank advances	(190)	(9)	(199)
Total decrease in interest expense	(367)	(155)	(522)
Decrease in net interest and fee income[1]	$(413)	$ (2,688)	$(3,101)

[1] Amounts calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

Provision for Loan Losses

The Company manages credit costs by consistently enforcing conservative underwriting and administration procedures and aggressively pursuing collection efforts with debtors experiencing financial difficulties. The provision for loan losses reflects Management's assessment of credit risk in the loan portfolio during each of the periods presented.

The Company provided no provision for loan losses in the second quarter 2015 and the first half of 2015 compared with $1.0 million and $2.0 million in the second quarter 2014 and the first half of 2014, respectively. The provision for loan losses is determined based on Management's evaluation of credit quality for the loan portfolio. The reduction in the provision for loan losses in the second quarter and the first half of 2015 reflects the decline in net losses and nonperforming loan volumes during the periods relative to earlier periods. The Company recorded purchased County Bank and Sonoma Valley Bank loans at estimated fair value upon the acquisition dates, February 6, 2009 and August 20, 2010, respectively. Such estimated fair values were recognized for individual loans, although small balance homogenous loans were pooled for valuation purposes. The valuation discounts recorded for purchased loans included Management's assessment of the risk of principal loss under economic and borrower conditions prevailing on the dates of purchase. The purchased County Bank loans secured by single-family residential real estate are "covered" through February 6, 2019 by loss-sharing agreements the Company entered with the FDIC which mitigates losses during the term of the agreements. The FDIC indemnification of purchased County Bank non-single-family residential secured loans expired February 6, 2014. Any deterioration in estimated value related to principal loss subsequent to the acquisition dates requires additional loss recognition through a provision for loan losses. No assurance can be given future provisions for loan losses related to purchased loans will not be necessary. For further information regarding credit risk, the FDIC loss-sharing agreements, net credit losses and the allowance for loan losses, see the "Loan Portfolio Credit Risk" and "Allowance for Loan Losses" sections of this report.

Noninterest Income

The following table summarizes the components of noninterest income for the periods indicated.

	For the Three Months Ended June 30,		For the Six Months	
	2015	2014	2015	2014
	(In thousands)			
Service charges on deposit accounts	$5,694	$6,105	$11,401	$12,115
Merchant processing services	1,783	1,820	3,486	3,744
Debit card fees	1,534	1,534	2,990	2,939
Other service fees	683	688	1,348	1,349
Trust fees	672	615	1,378	1,269
ATM processing fees	627	634	1,212	1,254
Financial services commissions	198	221	351	392
Other	1,078	1,581	2,403	3,126
Total	$12,269	$13,198	$24,569	$26,188

Noninterest income for the second quarter 2015 declined by $929 thousand or 7.0% from the same period in 2014. Service charges on deposits decreased $411 thousand due to declines in fees charged on overdrawn and insufficient funds accounts (down $234 thousand), lower activity on checking accounts (down $91 thousand) and lower fees on analyzed accounts (down $68 thousand).

In the first half of 2015, noninterest income decreased $1.6 million or 6.2% compared with the first half of 2014. Service charges on deposits decreased $714 thousand compared with the first half of 2014 due to declines in fees charged on overdrawn and insufficient funds accounts (down $385 thousand), and lower activity on checking accounts, (down $179 thousand) and lower fees on analyzed accounts (down $135 thousand). Merchant processing services declined $258 thousand primarily due to lower transaction volumes. Trust fees increased $109 thousand mostly due to successful marketing efforts to increase customer accounts.

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Noninterest Expense

The following table summarizes the components of noninterest expense for the periods indicated.

	For the Three Months Ended June 30,		For the Six Months	
	2015	2014	2015	2014
	(In thousands)			
Salaries and related benefits	$13,696	$13,926	$27,034	$28,052
Occupancy	3,726	3,746	7,453	7,473
Outsourced data processing services	2,111	2,115	4,219	4,220
Furniture and equipment	1,158	1,005	2,277	2,010
Amortization of identifiable intangibles	955	1,058	1,956	2,163
Courier service	598	665	1,141	1,275
Professional fees	582	577	1,130	1,007
Other real estate owned	52	(270)	367	(620)
Other	4,018	4,135	8,046	8,250
Total	$26,896	$26,957	$53,623	$53,830

Noninterest expense decreased $61 thousand in the second quarter 2015 compared with the same period in 2014 primarily due to lower personnel costs, lower intangible amortization and other expense, partially offset by increases in other real estate owned (“OREO”) expense, net of disposition gains, and furniture and equipment expense. Salaries and related benefits declined $230 thousand mostly due to employee attrition, partially offset by increases in employee benefits. Amortization of identifiable intangibles decreased $103 thousand as assets are amortized on a declining balance method. OREO expense in the second quarter 2014 was reduced by net gains on disposition of foreclosed assets. Furniture and equipment expense increased $153 thousand primarily due to higher depreciation costs resulting from computer and software upgrades.

In the first half of 2015, noninterest expense decreased $207 thousand compared with the first half 2014 primarily due to lower personnel costs, lower intangible amortization, lower courier service costs and other expense, partially offset by increases in expenses for OREO, furniture and equipment and professional services. Salaries and related benefits decreased $1.0 million primarily due to employee attrition. Amortization of identifiable intangibles decreased $207 thousand as assets are amortized on a declining balance method. Courier expense decreased $134 thousand primarily due to consolidating service runs. OREO expense in the second quarter 2015 included net writedowns while expense in the second quarter 2014 was reduced by net gains on disposition of foreclosed assets. Furniture and equipment expense increased $267 thousand primarily due to higher depreciation costs resulting from computer and software upgrades. Professional services increased $123 thousand primarily due to higher audit fees, partially offset by lower legal fees.

Provision for Income Tax

During the second quarter 2015, the Company recorded an income tax provision (FTE) of $8.0 million, compared with $8.7 million in the second quarter 2014. The second quarter 2015 provision represents an effective tax rate (FTE) of 35.2%, compared with 36.4% for the second quarter 2014. The income tax provision (FTE) was $16.0 million for the first half of 2015 compared with $17.3 million for the corresponding period of 2014. The first half of 2015 effective tax rate (FTE) was 35.3% compared to 36.3% for the same period of 2014. The effective tax rates (FTE) for the second quarter 2015 and the first half of 2015 were lower than prior periods primarily because the second quarter 2015 included $312 thousand in tax benefits from filing an amended 2010 tax return with the California Franchise Tax Board and the first half of 2015 additionally included $273 thousand in tax benefits resulting from an audit settlement with the California Franchise Tax Board.

Investment Portfolio

The Company maintains a securities portfolio consisting of securities issued by U.S. Treasury, U.S. Government sponsored entities, state and political subdivisions, corporations, and asset-backed and other securities. Investment securities are held in safekeeping by an independent custodian.

Management has increased the investment portfolio in response to deposit growth and loan volume declines. The carrying value of the Company’s investment securities portfolio was $2.8 billion as of June 30, 2015, an increase of $155 million compared to December 31, 2014.

Management continually evaluates the Company’s investment securities portfolio in response to established asset/liability management objectives, changing market conditions that could affect profitability, liquidity, and the level of interest rate risk to which the Company is exposed. These evaluations may cause Management to change the level of funds the Company deploys into investment securities, change the composition of the Company’s investment securities portfolio, and change the proportion of investments allocated into the available for sale and held to maturity investment categories.

The Company's positioning of the balance sheet for rising interest rates has resulted in the purchase of floating rate corporate bonds, federal agency bonds, mortgage-backed securities, and short-term state and municipal bonds. As of June 30, 2015, substantially all of the Company's investment securities continue to be investment grade rated by one or more major rating agencies. In addition to monitoring credit rating agency evaluations, Management performs its own evaluations regarding the credit worthiness of the issuer or the securitized assets underlying asset-backed securities.

The Company's procedures for evaluating investments in securities issued by states, municipalities and political subdivisions are in accordance with guidance issued by the Board of Governors of the Federal Reserve System, "Investing in Securities without Reliance on Nationally Recognized Statistical Rating Agencies" (SR 12-15) and other regulatory guidance. Credit ratings are considered in our analysis only as a guide to the historical default rate associated with similarly-rated bonds. There have been no significant differences in our internal analyses compared with the ratings assigned by the third party credit rating agencies.

At June 30, 2015, the Company's investment securities portfolios included securities issued by 740 state and local government municipalities and agencies located within 45 states with a fair value of $865.7 million. None of the Company's investment securities were issued by Puerto Rican government entities. The largest exposure to any one municipality or agency was $5.7 million (fair value) represented by nine general obligation bonds.

The following tables summarize the total general obligation and revenue bonds in the Company's investment securities portfolios as of dates indicated identifying the state in which the issuing government municipality or agency operates.

	At June 30, 2015	
	Amortized Cost	Fair Value
	(In thousands)	
Obligations of states and political subdivisions:		
California	$116,600	$118,583
Texas	63,560	64,234
Pennsylvania	48,652	49,163
Minnesota	32,730	32,927
New Jersey	31,711	31,813
Arizona	28,400	29,048
Other (34 states)	222,765	225,558
Total general obligation bonds	$544,418	$551,326
Revenue bonds:		
California	$51,278	$53,345
Pennsylvania	29,454	29,788
Kentucky	19,900	20,254
Iowa	18,191	18,721
Colorado	18,491	18,656

Other (31 states)	170,591	173,656
Total revenue bonds	$307,905	$314,420
Total obligations of states and political subdivisions	$852,323	$865,746

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At December 31, 2014, the Company’s investment securities portfolios included securities issued by 763 state and local government municipalities and agencies located within 45 states with a fair value of $911.0 million. The largest exposure to any one municipality or agency was $7.4 million (fair value) represented by three revenue bonds.

	At December 31, 2014	
	Amortized Cost	Fair Value
	(In thousands)	
Obligations of states and political subdivisions:		
General obligation bonds:		
California	$107,997	$110,563
Texas	65,292	66,162
Pennsylvania	48,675	49,546
Minnesota	33,524	33,840
New Jersey	30,223	30,598
Arizona	28,492	29,378
Other (34 states)	249,513	254,043
Total general obligation bonds	$563,716	$574,130
Revenue bonds:		
California	$60,473	$62,788
Pennsylvania	29,462	30,101
Kentucky	19,975	20,370
Iowa	18,225	18,898
Colorado	18,532	18,862
Indiana	16,865	16,859
Other (31 states)	164,848	168,972
Total revenue bonds	$328,380	$336,850
Total obligations of states and political subdivisions	$892,096	$910,980

At June 30, 2015, the revenue bonds in the Company’s investment securities portfolios were issued by state and local government municipalities and agencies to fund public services such as water utility, sewer utility, recreational and school facilities, and general public and economic improvements. The revenue bonds were payable from 23 revenue sources. The revenue sources that represent 5% or more individually of the total revenue bonds are summarized in the following table.

	At June 30, 2015	
	Amortized Cost	Fair Value

	(In thousands)	
Revenue bonds by revenue source		
Water	$64,481	$66,596
Sewer	47,977	48,933
Sales tax	34,988	35,861
Lease (renewal)	21,731	21,925
Lease (abatement)	18,437	19,135
College & University	18,457	18,566
Other	101,834	103,404
Total revenue bonds by revenue source	$307,905	$314,420

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At December 31, 2014, the revenue bonds in the Company's investment securities portfolios were issued by state and local government municipalities and agencies to fund public services such as water utility, sewer utility, recreational and school facilities, and general public and economic improvements. The revenue bonds were payable from 25 revenue sources. The revenue sources that represent 5% or more individually of the total revenue bonds are summarized in the following table.

	At December 31, 2014	
	Amortized Cost	Fair Value
	(In thousands)	
Revenue bonds by revenue source		
Water	$66,305	$68,885
Sewer	48,461	49,773
Sales tax	35,045	36,289
Lease (renewal)	21,789	22,091
Lease (abatement)	19,002	19,710
College & University	17,655	17,849
Other	120,123	122,253
Total revenue bonds by revenue source	$328,380	$336,850

See Note 3 to the unaudited consolidated financial statements for additional information related to the investment securities.

Loan Portfolio Credit Risk

The Company extends loans to commercial and consumer customers which expose the Company to the risk borrowers will default, causing loan losses. The Company's lending activities are exposed to various qualitative risks. All loan segments are exposed to risks inherent in the economy and market conditions. Significant risk characteristics related to the commercial loan segment include the borrowers' business performance and financial condition, and the value of collateral for secured loans. Significant risk characteristics related to the commercial real estate segment include the borrowers' business performance and the value of properties collateralizing the loans. Significant risk characteristics related to the construction loan segment include the borrowers' performance in successfully developing the real estate into the intended purpose and the value of the property collateralizing the loans. Significant risk characteristics related to the residential real estate segment include the borrowers' financial wherewithal to service the mortgages and the value of the property collateralizing the loans. Significant risk characteristics related to the consumer loan segment include the financial condition of the borrowers and the value of collateral securing the loans.

The preparation of the financial statements requires Management to estimate the amount of losses inherent in the loan portfolio and establish an allowance for credit losses. The allowance for credit losses is established by assessing a provision for loan losses against the Company's earnings. In estimating credit losses, Management must exercise judgment in evaluating information deemed relevant, such as financial information regarding individual borrowers, overall credit loss experience, the amount of past due, nonperforming and classified loans, recommendations of regulatory authorities, prevailing economic conditions and other information. The amount of ultimate losses on the loan portfolio can vary from the estimated amounts. Management follows a systematic methodology to estimate loss potential in an effort to reduce the differences between estimated and actual losses.

The Company closely monitors the markets in which it conducts its lending operations and follows a strategy to control exposure to loans with high credit risk. The Bank's organization structure separates the functions of business development and loan underwriting; Management believes this segregation of duties avoids inherent conflicts of combining business development and loan approval functions. In measuring and managing credit risk, the Company adheres to the following practices.

- The Bank maintains a Loan Review Department which reports directly to the Board of Directors. The Loan Review Department performs independent evaluations of loans and assigns credit risk grades to evaluated loans using grading standards employed by bank regulatory agencies. Those loans judged to carry higher risk attributes are referred to as "classified loans." Classified loans receive elevated management attention to maximize collection.

- The Bank maintains two loan administration offices whose sole responsibility is to manage and collect classified loans.

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Classified loans with higher levels of credit risk are further designated as “nonaccrual loans.” Management places classified loans on nonaccrual status when full collection of contractual interest and principal payments is in doubt. Uncollected interest previously accrued on loans placed on nonaccrual status is reversed as a charge against interest income. The Company does not accrue interest income on loans following placement on nonaccrual status. Interest payments received on nonaccrual loans are applied to reduce the carrying amount of the loan unless the carrying amount is well secured by loan collateral. “Nonperforming assets” include nonaccrual loans, loans 90 or more days past due and still accruing, and repossessed loan collateral (commonly referred to as “Other Real Estate Owned”).

The former County Bank loans and repossessed loan collateral were purchased from the FDIC with indemnifying loss-sharing agreements. The loss-sharing agreement on single-family residential real estate assets expires February 6, 2019. The loss-sharing agreement on non-single-family residential real estate assets expired February 6, 2014 as to losses and expires February 6, 2017 as to loss recoveries.

Nonperforming Assets

	At June 30,		At December 31,
	2015	2014	2014
	(In thousands)		
Originated:			
Nonperforming nonaccrual loans	$6,269	$6,757	$ 5,296
Performing nonaccrual loans	11	203	13
Total nonaccrual loans	6,280	6,960	5,309
Accruing loans 90 or more days past due	221	183	502
Total nonperforming loans	6,501	7,143	5,811
Other real estate owned	5,906	5,308	4,809
Total nonperforming assets	$12,407	$12,451	$ 10,620
Purchased covered:			
Nonperforming nonaccrual loans	$3	$-	$ 297
Performing nonaccrual loans	-	-	-
Total nonaccrual loans	3	-	297
Accruing loans 90 or more days past due	-	-	-
Total nonperforming loans	3	-	297
Other real estate owned	486	585	-
Total nonperforming assets	$489	$585	$ 297
Purchased non-covered:			
Nonperforming nonaccrual loans	$9,937	$12,707	$ 11,901
Performing nonaccrual loans	5	895	97
Total nonaccrual loans	9,942	13,602	11,998
Accruing loans 90 or more days past due	-	351	-
Total nonperforming loans	9,942	13,953	11,998
Other real estate owned	2,868	2,650	1,565
Total nonperforming assets	$12,810	$16,603	$ 13,563
Total nonperforming assets	$25,706	$29,639	$ 24,480

At June 30, 2015, two loans secured by commercial real estate totaling $11,439 thousand were on nonaccrual status. The remaining fourteen nonaccrual loans held at June 30, 2015 had an average carrying value of $342 thousand and the largest carrying value was $1,323 thousand.

Management believes the overall credit quality of the loan portfolio is reasonably stable; however, classified and nonperforming assets could fluctuate from period to period. The performance of any individual loan can be affected by external factors such as the interest rate environment, economic conditions, and collateral values or factors particular to the borrower. No assurance can be given that additional increases in nonaccrual and delinquent loans will not occur in the future.

Allowance for Loan Losses

The Company's allowance for loan losses represents Management's estimate of loan losses inherent in the loan portfolio. In evaluating credit risk for loans, Management measures loss potential of the carrying value of loans. As described above, payments received on nonaccrual loans may be applied against the principal balance of the loans until such time as full collection of the remaining recorded balance is expected. Further, the carrying value of purchased loans includes fair value discounts assigned at the time of purchase under the provisions of FASB ASC 805, Business Combinations, and FASB ASC 310-30, Loans or Debt Securities with Deteriorated Credit Quality. The allowance for loan losses represents Management's estimate of loan losses in excess of these reductions to the carrying value of loans within the loan portfolio. The following table summarizes the allowance for loan losses, chargeoffs and recoveries of the Company for the periods indicated:

	For the Three Months Ended June 30,		For the Six Months	
	2015	2014	2015	2014
	(In thousands)			
Analysis of the Allowance for Loan Losses				
Balance, beginning of period	$31,187	$32,109	$31,485	$31,693
Provision for loan losses	-	1,000	-	2,000
Loans charged off				
Commercial	(401)	(150)	(461)	(210)
Real estate residential	-	(30)	-	(30)
Consumer installment and other	(576)	(1,301)	(1,571)	(2,300)
Purchased non-covered loans	(396)	-	(431)	(260)
Total chargeoffs	(1,373)	(1,481)	(2,463)	(2,800)
Recoveries of loans previously charged off				
Commercial	334	119	514	287
Commercial real estate	15	15	30	178
Real estate construction	-	-	-	3
Consumer installment and other	443	618	1,033	1,018
Purchased non-covered loans	222	18	229	19
Total recoveries	1,014	770	1,806	1,505
Net loan losses	(359)	(711)	(657)	(1,295)
Balance, end of period	$30,828	$32,398	$30,828	$32,398
Components:				
Net loan (losses) recoveries:				
Originated loans	$(185)	$(729)	$(455)	$(1,054)
Purchased covered loans	-	-	-	-
Purchased non-covered loans	(174)	18	(202)	(241)
Net loan losses as a percentage of average total loans (annualized)	0.09 %	0.16 %	0.08 %	0.14 %

The Company's allowance for loan losses is maintained at a level considered appropriate to provide for losses that can be estimated based upon specific and general conditions. These include conditions unique to individual borrowers, as

well as overall loan loss experience, the amount of past due, nonperforming and classified loans, the amount of non-indemnified purchased loans, recommendations of regulatory authorities, prevailing economic conditions and other factors. A portion of the allowance is individually allocated to impaired loans whose full collectability of principal is uncertain. Such allocations are determined by Management based on loan-by-loan analyses. The Company evaluates all loans with outstanding principal balances in excess of $500 thousand which are classified or on nonaccrual status and all “troubled debt restructured” loans for impairment. The remainder of the loan portfolio is collectively evaluated for impairment based in part on quantitative analyses of historical loan loss experience of loan portfolio segments to determine standard loss rates for each segment. The loss rate for each loan portfolio segment reflects both the historical loss experience during a look-back period and the loss emergence period. During 2014, the Company refined its processes used to measure look-back periods and loss emergence periods. The loss rates are applied to segmented loan balances to allocate the allowance to the segments of the loan portfolio.

Purchased loans were recorded on the date of purchase at estimated fair value; fair value discounts include a component for estimated loan losses. The Company evaluates all nonaccrual purchased loans with outstanding principal balances in excess of $500 thousand for impairment; the impaired loan value is compared to the recorded investment in the loan, which has been reduced by the loan default discount estimated on the date of purchase. If Management’s impairment analysis determines the impaired loan value is less than the recorded investment in the purchased loan, an allocation of the allowance for loan losses is established for the deficiency. For all other purchased loan portfolio segments, Management applies the standard loss rates to the purchased loan portfolio segments to determine initial allocations of the allowance. Further, liquidating purchased consumer installment loans are evaluated separately by applying historical loss rates to forecasted liquidating principal balances to initially measure losses inherent in this portfolio segment. The initial allocations of the allowance to purchased loan portfolio segments are compared to loan default discounts ascribed to each segment. Management establishes allocations of the allowance for loan losses for any estimated deficiency.

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The remainder of the allowance is considered to be unallocated. The unallocated allowance is established to provide for probable losses that have been incurred as of the reporting date but not reflected in the allocated allowance. The unallocated allowance addresses additional qualitative factors consistent with Management's analysis of the level of risks inherent in the loan portfolio, which are related to the risks of the Company's general lending activity. Included in the unallocated allowance is the risk of losses that are attributable to national or local economic or industry trends which have occurred but have not yet been recognized in loan chargeoff history (external factors). The primary external factor evaluated by the Company and the judgmental amount of unallocated reserve assigned by Management as of June 30, 2015 are economic and business conditions $1.1 million. Also included in the unallocated allowance is the risk of losses attributable to general attributes of the Company's loan portfolio and credit administration (internal factors). The internal factors evaluated by the Company and the judgmental amount of unallocated reserve assigned by Management are: loan review system $1.7 million, adequacy of lending Management and staff $2.1 million, concentrations of credit $2.5 million, and other factors.

Allowance for Loan Losses
For the Three Months Ended June 30, 2015

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Purchased Non-covered Loans	Purchased Covered Loans	Unallocated	Total
	(In thousands)								
Allowance for loan losses:									
Balance at beginning of period	$5,470	$ 4,123	$ 730	$ 2,140	$ 7,031	$ 2,339	$ -	$ 9,354	$31,187
Additions:									
Provision	1,704	758	(327)	(82)	350	(921)	-	(1,482)	-
Deductions:									
Chargeoffs	(401)	-	-	-	(576)	(396)	-	-	(1,373)
Recoveries	334	15	-	-	443	222	-	-	1,014
Net loan (losses) recoveries	(67)	15	-	-	(133)	(174)	-	-	(359)
Total allowance for loan losses	$7,107	$ 4,896	$ 403	$ 2,058	$ 7,248	$ 1,244	$ -	$ 7,872	$30,828

Allowance for Loan Losses
For the Six Months Ended June 30, 2015

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Purchased Non-covered Loans	Purchased Covered Loans	Unallocated	Total
	(In thousands)								
Allowance for loan losses:									
	$5,460	$ 4,245	$ 644	$ 2,241	$ 7,717	$ 2,120	$ -	$ 9,058	$31,485

Balance at beginning of period									
Additions:									
Provision	1,594	621	(241)	(183)	69	(674)	-	(1,186)	-
Deductions:									
Chargeoffs	(461)	-	-	-	(1,571)	(431)	-	-	(2,463)
Recoveries	514	30	-	-	1,033	229	-	-	1,806
Net loan recoveries (losses)	53	30	-	-	(538)	(202)	-	-	(657)
Total allowance for loan losses	$7,107	$ 4,896	$ 403	$ 2,058	$ 7,248	$ 1,244	$ -	$ 7,872	$30,828

Allowance for Loan Losses and Recorded Investment in Loans Evaluated for Impairment
At June 30, 2015

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Purchased Non-covered Loans	Purchased Covered Loans	Unallocated	Total
	(In thousands)								
Allowance for loan losses:									
Individually evaluated for impairment	$2,533	$1,034	$ -	$ -	$ -	$ -	$ -	$ -	$3,567
Collectively evaluated for impairment	4,574	3,862	403	2,058	7,248	1,244	-	7,872	27,261
Purchased loans with evidence of credit deterioration	-	-	-	-	-	-	-	-	-
Total	$7,107	$4,896	$403	$2,058	$7,248	$1,244	$ -	$7,872	$30,828
Carrying value of loans:									
Individually evaluated for impairment	$12,417	$5,806	$ -	$ -	$ -	$11,712	$ -	$ -	$29,935
Collectively evaluated for impairment	358,580	542,804	6,762	134,421	364,257	174,980	14,892	-	1,596,696
Purchased loans with evidence of credit deterioration	-	-	-	-	-	4,423	217	-	4,640
Total	$370,997	$548,610	$6,762	$134,421	$364,257	$191,115	$15,109	$ -	$1,631,271

Management considers the $30.8 million allowance for loan losses to be adequate as a reserve against loan losses inherent in the loan portfolio as of June 30, 2015.

See Note 4 to the unaudited consolidated financial statements for additional information related to the loan portfolio, loan portfolio credit risk, and allowance for loan losses.

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Asset/Liability and Market Risk Management

Asset/liability management involves the evaluation, monitoring and management of interest rate risk, market risk, liquidity and funding. The fundamental objective of the Company's management of assets and liabilities is to maximize its economic value while maintaining adequate liquidity and a conservative level of interest rate risk.

Interest Rate Risk

Interest rate risk is a significant market risk affecting the Company. Many factors affect the Company's exposure to interest rates, such as general economic and financial conditions, customer preferences, historical pricing relationships, and re-pricing characteristics of financial instruments. Assets and liabilities may mature or re-price at different times. Assets and liabilities may re-price at the same time but by different amounts. Short-term and long-term market interest rates may change by different amounts. The timing and amount of cash flows of various assets or liabilities may shorten or lengthen as interest rates change. In addition, the changing levels of interest rates may have an impact on loan demand, demand for various deposit products, credit losses, and other elements of earnings such as account analysis fees on commercial deposit accounts and correspondent bank service charges.

The Company's earnings are affected not only by general economic conditions, but also by the monetary and fiscal policies of the U.S. and its agencies, particularly the Federal Reserve Board (the "FRB"). The monetary policies of the FRB can influence the overall growth of loans, investment securities, and deposits and the level of interest rates earned on assets and paid for liabilities. The nature and impact of future changes in monetary policies are generally not predictable.

The Federal Open Market Committee's June 17, 2015 press release stated "To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that the current 0 to 1/4 percent target range for the federal funds rate remains appropriate. In determining how long to maintain this target range, the Committee will assess progress--both realized and expected--toward its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments. The Committee anticipates that it will be appropriate to raise the target range for the federal funds rate when it has seen further improvement in the labor market and is reasonably confident that inflation will move back to its 2 percent objective over the medium term.… When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent. The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run." In this context, Management's most likely earnings forecast for the twelve months ending June 30, 2016 assumes market interest rates will either remain relatively stable or short-term rates will rise gradually.

In adjusting the Company's asset/liability position, Management attempts to manage interest rate risk while enhancing the net interest margin and net interest income. At times, depending on expected increases or decreases in general interest rates, the relationship between long and short term interest rates, market conditions and competitive factors, Management may adjust the Company's interest rate risk position in order to manage its net interest margin and net interest income. The Company's results of operations and net portfolio values remain subject to changes in interest rates and to fluctuations in the difference between long and short term interest rates.

The Company’s asset and liability position was slightly “asset sensitive” at June 30, 2015, depending on the interest rate assumptions applied to the simulation model employed by Management to measure interest rate risk. An “asset sensitive” position results in a slightly larger change in interest income than in interest expense resulting from application of assumed interest rate changes. Simulation estimates depend on, and will change with, the size and mix of the actual and projected balance sheet at the time of each simulation. Management’s interest rate risk management is currently biased toward stable or gradually increasing interest rates in the near-term, and ultimately, rising interest rates. Management continues to monitor the interest rate environment as well as economic conditions and other factors it deems relevant in managing the Company's exposure to interest rate risk.

The Company does not currently engage in trading activities or use derivative instruments to control interest rate risk, even though such activities may be permitted with the approval of the Company's Board of Directors.

Market Risk - Equity Markets

Equity price risk can affect the Company. As an example, any preferred or common stock holdings, as permitted by banking regulations, can fluctuate in value. Management regularly assesses the extent and duration of any declines in market value, the causes of such declines, the likelihood of a recovery in market value, and its intent to hold securities until a recovery in value occurs. Declines in value of preferred or common stock holdings that are deemed “other than temporary” could result in loss recognition in the Company's income statement.

Fluctuations in the Company's common stock price can impact the Company's financial results in several ways. First, the Company has regularly repurchased and retired its common stock; the market price paid to retire the Company's common stock can affect the level of the Company's shareholders' equity, cash flows and shares outstanding. Second, the Company's common stock price impacts the number of dilutive equivalent shares used to compute diluted earnings per share. Third, fluctuations in the Company's common stock price can motivate holders of options to purchase Company common stock through the exercise of such options thereby increasing the number of shares outstanding. Finally, the amount of compensation expense associated with share based compensation fluctuates with changes in and the volatility of the Company's common stock price.

Market Risk - Other

Market values of loan collateral can directly impact the level of loan chargeoffs and the provision for loan losses. The financial condition and liquidity of debtors issuing bonds and debtors whose mortgages or other obligations are securitized can directly impact the credit quality of the Company’s investment portfolio requiring the Company to recognize other than temporary impairment charges. Other types of market risk, such as foreign currency exchange risk and commodity price risk, are not significant in the normal course of the Company's business activities.

Liquidity and Funding

The objective of liquidity management is to manage cash flow and liquidity reserves so that they are adequate to fund the Company's operations and meet obligations and other commitments on a timely basis and at a reasonable cost. The Company achieves this objective through the selection of asset and liability maturity mixes that it believes best meet its needs. The Company's liquidity position is enhanced by its ability to raise additional funds as needed in the wholesale markets.

In recent years, the Company's deposit base has provided the majority of the Company's funding requirements. This relatively stable and low-cost source of funds, along with shareholders' equity, provided 97 percent of funding for

average total assets in the first six months of 2015 and 2014. The stability of the Company’s funding from customer deposits is in part reliant on the confidence clients have in the Company. The Company places a very high priority in maintaining this confidence through conservative credit and capital management practices and by maintaining an appropriate level of liquidity reserves.

In the first quarter 2015 and 2014, non-deposit funding has continued to be provided by short-term borrowings and Federal Home Loan Bank advances until repayment in January 2015, and additionally, a term repurchase agreement until repayment in August 2014. These non-deposit sources of funds comprise a modest portion of total funding.

Liquidity is further provided by assets such as balances held at the Federal Reserve Bank, investment securities, and amortizing loans. The Company's investment securities portfolio provides a substantial secondary liquidity reserve. The Company held $2.8 billion in total investment securities at June 30, 2015. Under certain deposit, borrowing and other arrangements, the Company must hold and pledge investment securities as collateral. At June 30, 2015, such collateral requirements totaled approximately $759 million.

Liquidity risk can result from the mismatching of asset and liability cash flows, or from disruptions in the financial markets. The Company performs liquidity stress tests on a periodic basis to evaluate the sustainability of its liquidity. Under the stress testing, the Company assumes outflows of funds increase beyond expected levels. Measurement of such heightened outflows considers the composition of the Company’s deposit base, including any concentration of deposits, non-deposit funding such as short-term borrowings and Federal Home Loan Bank advances, and unfunded lending commitments. The Company evaluates its stock of highly liquid assets to meet the assumed higher levels of outflows. Highly liquid assets include cash and amounts due from other banks from daily transaction settlements, reduced by branch cash needs and Federal Reserve Bank reserve requirements, and investment securities based on regulatory risk-weighting guidelines. Based on the results of the most recent liquidity stress test, Management is satisfied with the liquidity condition of the Bank and the Company. However, no assurance can be given the Bank or Company will not experience a period of reduced liquidity.

Management will monitor the Company’s cash levels throughout 2015. Loan demand from credit-worthy borrowers will be dictated by economic and competitive conditions. The Company aggressively solicits non-interest bearing demand deposits and money market checking deposits, which are the least sensitive to changes in interest rates. The growth of these deposit balances is subject to heightened competition, the success of the Company's sales efforts, delivery of superior customer service, new regulations and market conditions. The Company does not aggressively solicit higher-costing time deposits; as a result, Management anticipates such deposits will decline. Changes in interest rates, most notably rising interest rates, could impact deposit volumes. Depending on economic conditions, interest rate levels, and a variety of other conditions, deposit growth may be used to fund loans, reduce borrowings or purchase investment securities. However, due to possible volatility in economic conditions, competition and political uncertainty, loan demand and levels of customer deposits are not certain. Shareholder dividends are expected to continue subject to the Board's discretion and continuing evaluation of capital levels, earnings, asset quality and other factors.

Westamerica Bancorporation ("Parent Company") is a separate entity apart from Westamerica Bank (“Bank”) and must provide for its own liquidity. In addition to its operating expenses, the Parent Company is responsible for the payment of dividends declared for its shareholders, and interest and principal on any outstanding debt. Substantially all of the Parent Company's revenues are obtained from subsidiary dividends and service fees.

In the first half of 2015, the Bank’s dividends paid to the Parent Company and proceeds from the exercise of stock options provided adequate cash flow for the Parent Company to pay shareholder dividends of $19 million and retire common stock in the amount of $14 million. In the first half of 2014, the Bank’s dividends paid to the Parent Company and proceeds from the exercise of stock options provided adequate cash flow for the Parent Company to pay shareholder dividends of $20 million and retire common stock in the amount of $36 million. Payment of dividends to the Parent Company by the Bank is limited under California and Federal laws. The Company believes these regulatory dividend restrictions will not have an impact on the Parent Company's ability to meet its ongoing cash obligations.

Capital Resources

The Company has historically generated high levels of earnings, which provides a means of accumulating capital. The Company's net income as an annualized percentage of average shareholders' equity (“return on equity” or “ROE”) has been 11.5% in the first half of 2015, 11.6% in 2014 and 12.5% in 2013. The Company also raises capital as employees exercise stock options. Capital raised through the exercise of stock options was $4 million in the first half of 2015 compared with $12 million in 2014 and $21 million in 2013.

The Company paid common dividends totaling $19 million in the first half of 2015, $40 million in 2014 and $40 million in 2013, which represent dividends per common share of $0.76, $1.52 and $1.49, respectively. The Company's earnings have historically exceeded dividends paid to shareholders. The amount of earnings in excess of dividends provides the Company resources to finance growth and maintain appropriate levels of shareholders' equity. In the absence of profitable growth opportunities, the Company has repurchased and retired its common stock as another

means to return earnings to shareholders. The Company repurchased and retired 316 thousand shares valued at $14 million in the first half of 2015, 1.0 million shares valued at $53 million in 2014 and 1.2 million shares valued at $57 million in 2013.

The Company's primary capital resource is shareholders' equity, which was $525.3 million at June 30, 2015 compared with $526.6 million at December 31, 2014. The Company's ratio of equity to total assets was 10.44% at June 30, 2015 and 10.46% at December 31, 2014.

The Company performs capital stress tests on a periodic basis to evaluate the sustainability of its capital. Under the stress testing, the Company assumes various scenarios such as deteriorating economic and operating conditions, unanticipated asset devaluations, and significant operational lapses. The Company measures the impact of these scenarios on its earnings and capital. Based on the results of the most recent stress tests, Management is satisfied with the capital condition of the Bank and the Company. However, no assurance can be given the Bank or Company will not experience a period of reduced earnings or a reduction in capital from unanticipated events and circumstances.

Capital to Risk-Adjusted Assets

On July 2, 2013, the Federal Reserve Board approved a final rule that implements changes to the regulatory capital framework for all banking organizations. The rule's provisions which most affected the regulatory capital requirements of the Company and the Bank:

- Introduced a new "Common Equity Tier 1" capital measurement,
- Established higher minimum levels of capital,
- Introduced a "capital conservation buffer,"
- Increased the risk-weighting of certain assets, and
- Established limits on the amount of deferred tax assets with any excess treated as a deduction from Tier 1 capital.

Under the final rule, a banking organization that is not subject to the "advanced approaches rule" may make a one-time election not to include most elements of Accumulated Other Comprehensive Income, including net-of-tax unrealized gains and losses on available for sale investment securities, in regulatory capital. Neither the Company nor the Bank are subject to the "advanced approaches rule" and made the election not to include most elements of Accumulated Other Comprehensive Income in regulatory capital.

Banking organizations that are not subject to the "advanced approaches rule" began complying with the final rule on January 1, 2015; on such date, the Company and the Bank became subject to the revised definitions of regulatory capital, the new minimum regulatory capital ratios, and various regulatory capital adjustments and deductions according to transition provisions and timelines. All banking organizations began calculating standardized total risk-weighted assets on January 1, 2015. The transition period for the capital conservation buffer for all banking organizations will begin on January 1, 2016 and end January 1, 2019. Any bank subject to the rule which is unable to maintain its "capital conservation buffer" will be restricted in the payment of discretionary executive compensation and shareholder distributions, such as dividends and share repurchases.

The final rule did not supersede provisions of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) requiring federal banking agencies to take prompt corrective action (PCA) to resolve problems of insured depository institutions. The final rule revised the PCA thresholds to incorporate the higher minimum levels of capital, including the newly proposed "common equity tier 1" ratio.

The capital ratios for the Company and the Bank under the new capital framework are presented in the table below.

	Transitional Minimum Regulatory	Minimum Regulatory	Well-capitalized by Regulatory Definition

	At June 30, 2015		Requirement Effective January 1, 2015	Requirement [1] Effective January 1, 2019	Under FDICIA Effective January 1, 2015
	Company	Bank			
Common Equity Tier I Capital	12.56%	11.17%	4.50%	7.00%	6.50%
Tier I Capital	12.56%	11.17%	6.00%	8.50%	8.00%
Total Capital	13.08%	11.82%	8.00%	10.50%	10.00%
Leverage Ratio	7.98%	7.06%	4.00%	4.00%	5.00%

[1] Includes 2.5% capital conservation buffer.

The Company and the Bank intend to maintain regulatory capital in excess of the highest regulatory standard. The Company and the Bank routinely project capital levels by analyzing forecasted earnings, credit quality, securities valuations, shareholder dividends, asset volumes, share repurchase activity, stock option exercise proceeds, and other factors. Based on current capital projections, the Company and the Bank expect to maintain regulatory capital levels exceeding the highest effective regulatory standard and pay quarterly dividends to shareholders. No assurance can be given that changes in capital management plans will not occur.

The following summarizes the ratios of regulatory capital to risk-adjusted assets under the superseded capital framework on the dates indicated:

	At June 30, 2014	At December 31, 2014	Minimum Regulatory Requirement	Well-capitalized by Regulatory Definition
Company:				
Tier I Capital	13.57 %	13.30 %	4.00 %	6.00 %
Total Capital	15.04 %	14.54 %	8.00 %	10.00 %
Leverage ratio	8.26 %	7.95 %	4.00 %	5.00 %
Bank:				
Tier I Capital	12.32 %	12.04 %	4.00 %	6.00 %
Total Capital	14.01 %	13.49 %	8.00 %	10.00 %
Leverage ratio	7.47 %	7.16 %	4.00 %	5.00 %

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company does not currently engage in trading activities or use derivative instruments to control interest rate risk, even though such activities may be permitted with the approval of the Company's Board of Directors.

Credit risk and interest rate risk are the most significant market risks affecting the Company, and equity price risk can also affect the Company's financial results. These risks are described in the preceding sections regarding "Loan Portfolio Credit Risk," and "Asset/Liability and Market Risk Management." Other types of market risk, such as foreign currency exchange risk and commodity price risk, are not significant in the normal course of the Company's business activities.

Item 4. Controls and Procedures

The Company's principal executive officer and principal financial officer have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended, as of June 30, 2015.

Based upon their evaluation, the principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective to ensure that material information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported as and when required and that such information is communicated to the Company's management, including the principal executive officer and the principal financial officer, to allow for timely decisions regarding required disclosures. The evaluation did not identify any change in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2015 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Neither the Company nor any of its subsidiaries is a party to any material pending legal proceeding, nor is their property the subject of any material pending legal proceeding, other than ordinary routine legal proceedings arising in the ordinary course of the Company's business. None of these proceedings is expected to have a material adverse impact upon the Company's business, financial position or results of operations.

Item 1A. Risk Factors

The Company's Form 10-K as of December 31, 2014 includes detailed disclosure about the risks faced by the Company's business; such risks have not materially changed since the Form 10-K was filed.

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

(a) Previously reported on Form 8-K.

(b) None

(c) Issuer Purchases of Equity Securities

The table below sets forth the information with respect to purchases made by or on behalf of the Company or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of common stock during the quarter ended June 30, 2015.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs*	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
	(In thousands, except per share data)			
April 1 through April 30	50	$ 43.75	50	1,500
May 1 through May 31	83	43.97	83	1,417
June 1 through June 30	-	-	-	1,417
Total	133	$ 43.89	133	1,417

* Includes 3 thousand, 1 thousand and -0- thousand shares purchased in April, May and June, respectively, by the Company in private transactions with the independent administrator of the Company's Tax Deferred Savings/Retirement Plan (ESOP). The Company includes the shares purchased in such transactions within the total number of shares authorized for purchase pursuant to the currently existing publicly announced program.

The Company repurchases shares of its common stock in the open market to optimize the Company's use of equity capital and enhance shareholder value and with the intention of lessening the dilutive impact of issuing new shares under stock option plans, and other ongoing requirements.

Shares were repurchased during the second quarter of 2015 pursuant to a program approved by the Board of Directors on July 24, 2014 authorizing the purchase of up to 2 million shares of the Company's common stock from time to time prior to September 1, 2015.

Item 3. Defaults upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

The exhibit list required by this item is incorporated by reference to the Exhibit Index filed with this report.

SIGNATURES

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

WESTAMERICA BANCORPORATION

(Registrant)

/s/ JOHN "ROBERT" THORSON

John "Robert" Thorson

Senior Vice President and Chief Financial Officer

(Chief Financial and Accounting Officer)

Date: July 31, 2015

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EXHIBIT INDEX

Exhibit 31.1: Certification of Chief Executive Officer pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a)

Exhibit 31.2: Certification of Chief Financial Officer pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a)

Exhibit 32.1: Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 32.2: Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 101: Pursuant to Rule 405 of Regulation S-T, the following financial information from the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2015, is formatted in XBRL interactive data files: (i) Consolidated Statements of Income for the three and six months ended June 30, 2015 and 2014; (ii) Consolidated Balance Sheets at June 30, 2015, and December 31, 2014; (iii) Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2015 and 2014, (iv) Consolidated Statements of Changes in Shareholders' Equity for the six months ended June 30, 2015 and 2014; (v) Consolidated Statements of Cash Flows for the six months ended June 30, 2015 and 2014 and (vi) Notes to the Unaudited Consolidated Financial Statements.