# Edgar Filing: TRICO BANCSHARES / - Form 10-Q 

## TRICO BANCSHARES /

Form 10-Q
November 08, 2007

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

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


Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule $12 b-2$ of the Act (check one).

Large accelerated filer
Accelerated filer X Non-accelerated filer
----- $\qquad$


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

$$
\text { Yes } \quad \text { No X }
$$

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Title of Class: Common stock, no par value

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FORWARD-LOOKING STATEMENTS

This report on Form 10-Q contains forward-looking statements about TriCo Bancshares (the "Company") for which it claims the protection of the safe harbor provisions contained in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on Management's current knowledge and belief and include information concerning the Company's possible or assumed future financial condition and results of operations. When you see any of the words "believes", "expects", "anticipates", "estimates", or similar expressions, it may mean making forward-looking statements. A number of factors, some of which are beyond the Company's ability to predict or control, could cause future results to differ materially from those contemplated. The reader is directed to the Company's annual report on Form $10-\mathrm{K}$ for the year ended December 31 , 2006 , and Part II, Item 1A of this report for further discussion of factors which could affect the Company's business and cause actual results to differ materially from those expressed in any forward-looking statement made in this report.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements
TRICO BANCSHARES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data; unaudited)

Assets:
Cash and due from banks
Federal funds sold

Cash and cash equivalents
Securities available-for-sale
Federal Home Loan Bank stock, at cost
Loans, net of allowance for loan losses
of $\$ 17,139, \$ 16,993$ and $\$ 16,914$
Foreclosed assets, net of allowance for
losses of $\$ 180$
Premises and equipment, net
Cash value of life insurance
Accrued interest receivable
Goodwill
Other intangible assets, net
Other assets

Total Assets
At September 30,
2007
2006

| $\begin{array}{r} \$ 70,791 \\ 488 \end{array}$ | $\begin{array}{r} \$ 78,281 \\ 1,387 \end{array}$ | \$102 |
| :---: | :---: | :---: |
| 71,279 | 79,668 | 103, |
| 239,242 | 209,886 | 198 |
| 8,652 | 8,206 | 8 |
| 1,517,937 | 1,490,166 | 1,492, |
| 187 | - |  |
| 20,804 | 21,556 | 21, |
| 44,751 | 42,991 | 43, |
| 8,865 | 8,637 | 8 , |
| 15,519 | 15,519 | 15, |
| 1,298 | 3,361 | 1, |
| 24,989 | 24,014 | 26, |
| \$1,953,523 | \$1,904,004 | \$1,919, |

Liabilities:
Deposits:
Noninterest-bearing demand
Interest-bearing

Total deposits
Federal funds purchased
Accrued interest payable
Reserve for unfunded commitments
Other liabilities

| \$345,467 | \$357, 754 | \$420, |
| :---: | :---: | :---: |
| 1,186,675 | 1,167,420 | 1,179, |
| 1,532,142 | 1,525,174 | 1,599, |
| 66,000 | 106,500 | 38, |
| 6,899 | 7,341 | 7, |
| 2,040 | 1,849 | 1 |
| 22,483 | 20,913 | 22, |
| 99,996 | 35,848 | 39, |
| 41,238 | 41,238 | 41 |
| 1,770,798 | 1,738,863 | 1,750, |

Commitments and contingencies
Shareholders' Equity:
Common stock, no par value: $50,000,000$ shares
authorized; issued and outstanding:
15,891,300 at September 30, 2007 78,331
15,857,107 at September 30, 2006 73,545
15,857,207 at December 31, 2006
Retained earnings
108,022
95,203
Accumulated other comprehensive loss, net
Total Shareholders' Equity
Total Liabilities and Shareholders' Equity

| $(3,628)$ | $(3,607)$ | ( 4 , |
| :---: | :---: | :---: |
| 182,725 | 165,141 | 169, |
| \$1,953,523 | \$1,904,004 | \$1,919, |

See accompanying notes to unaudited condensed consolidated financial statements.
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TRICO BANCSHARES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data; unaudited)

Three months ended September 30, Nine months ended Sep 200720062007

Interest and dividend income:
(

| Interest and dividend income: |
| :--- |
| Loans, including fees |$\$ 30,099 \quad \$ 28,901 \quad \$ 88,404$


| Taxable | 1,874 | 1,938 | 5,216 |
| :---: | :---: | :---: | :---: |
| Tax exempt | 354 | 431 | 1,123 |
| Dividends | 109 | 144 | 332 |
| Federal funds sold | 6 | 7 | 14 |
| Total interest income | 32,442 | 31,421 | 95,089 |



Noninterest expense:


3

TRICO BANCSHARES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (In thousands, except share data; unaudited)

|  | Shares of Common Stock | Common Stock | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Balance at December 31, 2005 | 15,707,835 | \$71,412 | \$81,906 | $(\$ 3,825)$ | \$149,493 |
| Comprehensive income: |  |  |  |  |  |
| Net income |  |  | 19,912 |  | 19,912 |
| Change in net unrealized gain on Securities available for sale, |  |  |  | 218 | 218 |
| Total comprehensive income |  |  |  |  | 20,130 |
| Stock option vesting |  | 468 |  |  | 468 |
| Stock options exercised | 190,187 | 1,646 |  |  | 1,646 |
| Tax benefit of stock options exer | cised | 205 |  |  | 205 |
| Repurchase of common stock | $(40,915)$ | (186) | (923) |  | $(1,109)$ |
| Dividends paid (\$0.24 per share) |  |  | $(5,692)$ |  | $(5,692)$ |
| Balance at September 30, 2006 | 15,857,107 | \$73,545 | \$95,203 | $(\$ 3,607)$ | \$165,141 |
| Balance at December 31, 2006 | 15,857,207 | \$73,739 | \$100,218 | $(\$ 4,521)$ | \$169,436 |
| Comprehensive income: |  |  |  |  |  |
| Net income |  |  | 19,992 |  | 19,992 |
| Change in net unrealized gain on |  |  |  |  |  |
| Securities available for sale, |  |  |  | 893 | 893 |
| Total comprehensive income |  |  |  |  | 20,885 |
| Stock option vesting |  | 579 |  |  | 579 |
| Stock options exercised | 362,100 | 3,863 |  |  | 3,863 |


| Tax benefit of stock options exe | sed | 1,707 |  |  | 1,707 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Repurchase of common stock | $(328,007)$ | $(1,557)$ | $(5,987)$ |  | $(7,544)$ |
| Dividends paid (\$0.26 per share) |  |  | $(6,201)$ |  | $(6,201)$ |
| Balance at September 30, 2007 | 15,891,300 | \$78,331 | \$108,022 | $(\$ 3,628)$ | \$182,725 |

See accompanying notes to unaudited condensed consolidated financial statements.

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TRICO BANCSHARES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands; unaudited)

For the nine months ended September 2007 2006

Operating activities:
Net income \$19,992 \$19,912
Adjustments to reconcile net income to net cash provided
by operating activities:

| Depreciation of property and equipment, and amortization | 2,829 | 2,816 |
| :---: | :---: | :---: |
| Amortization of intangible assets | 367 | 1,046 |
| Provision for loan losses | 1,682 | 1,289 |
| Amortization of investment securities premium, net | 528 | 689 |
| Originations of loans for resale | $(48,628)$ | $(51,959)$ |
| Proceeds from sale of loans originated for resale | 48,878 | 52,338 |
| Gain on sale of loans | (756) | (875) |
| Change in market value of mortgage servicing rights | 226 | 256 |
| Gain on sale of investments | - | (12) |
| Loss on disposal of fixed assets | 5 | 27 |
| Increase in cash value of life insurance | $(1,215)$ | $(1,223)$ |
| Stock option vesting expense | 579 | 468 |
| Change in: |  |  |
| Interest receivable | (138) | (996) |
| Interest payable | (649) | 2,835 |
| Other assets and liabilities, net | 1,525 | $(1,392)$ |
| Net cash provided by operating activities | 23,518 | 25,219 |

Investing activities:
Proceeds from maturities of securities available-for-sale
Proceeds from sales of securities available-for-sale
Purchases of securities available-for-sale
38,954
40,208
(332)

10,780

Purchases of Federal Home Loan Bank stock
(332)
(604)
$(26,841)$
$(122,646)$
Proceeds from sale of premises and equipment
Purchases of premises and equipment
Net cash used by investing activities
$(2,610)$
$(2,715)$
$(69,640)$
$(75,870)$
Financing activities:
Net (decrease) increase in deposits (67,007) 28,377
Net increase in Federal funds purchased 28,000 9,700
Payments of principal on long-term other borrowings
(51)

Proceeds from issuance of long-term other borrowings
50,000

| Net change in short-term other borrowings | 10,136 | 4,502 |
| :---: | :---: | :---: |
| Repurchase of common stock | $(2,685)$ | - |
| Dividends paid | $(6,201)$ | $(5,692)$ |
| Exercise of stock options | 488 | 537 |
| Net cash provided by financing activities | 14,387 | 37,380 |
| Net change in cash and cash equivalents | $(31,735)$ | $(13,271)$ |
| Cash and cash equivalents and beginning of period | 103,014 | 92,939 |
| Cash and cash equivalents at end of period | \$ 71,279 | \$79,668 |
| Supplemental disclosure of noncash activities: |  |  |
| Unrealized gain on securities available for sale | \$1,541 | \$377 |
| Income tax benefit from stock option exercises | \$1,707 | \$205 |
| Value of common stock tendered, in lieu of cash, to pay for exercise of stock options | \$4,859 | \$1,109 |
| Supplemental disclosure of cash flow activity: |  |  |
| Cash paid for interest expense | \$30,362 | \$21,789 |
| Cash paid for income taxes | \$12,300 | \$15,100 |

See accompanying notes to unaudited condensed consolidated financial statements 5

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1: General Summary of Significant Accounting Policies The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. The results of operations reflect interim adjustments, all of which are of a normal recurring nature and which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. The interim results are not necessarily indicative of the results expected for the full year. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes as well as other information included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Principles of Consolidation
The consolidated financial statements include the accounts of the company, and its wholly-owned subsidiary, Tri Counties Bank (the "Bank"). All significant intercompany accounts and transactions have been eliminated in consolidation.

Nature of Operations
The Company operates 32 branch offices and 25 in-store branch offices in the California counties of Butte, Contra Costa, Del Norte, Fresno, Glenn, Kern, Lake, Lassen, Madera, Mendocino, Merced, Napa, Nevada, Placer, Sacramento, Shasta, Siskiyou, Stanislaus, Sutter, Tehama, Tulare, Yolo and Yuba. The Company's operating policy since its inception has emphasized retail banking. Most of the Company's customers are retail customers and small to medium-sized businesses.

Use of Estimates in the Preparation of Financial Statements
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires Management to make

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estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, the Company evaluates its estimates, including those related to the adequacy of the allowance for loan losses, investments, intangible assets, income taxes and contingencies. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The allowance for loan losses, goodwill and other intangible assessments, income taxes, and the valuation of mortgage servicing rights, are the only accounting estimates that materially affect the company's consolidated financial statements.

Significant Group Concentration of Credit Risk

The Company grants agribusiness, commercial, consumer, and residential loans to customers located throughout the northern San Joaquin Valley, the Sacramento Valley and northern mountain regions of California. The Company has a diversified loan portfolio within the business segments located in this geographical area.

Cash and Cash Equivalents
For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold.

## Investment Securities

The Company classifies its debt and marketable equity securities into one of three categories: trading, available-for-sale or held-to-maturity. Trading securities are bought and held principally for the purpose of selling in the near term. Held-to-maturity securities are those securities which the Company has the ability and intent to hold until maturity. All other securities not included in trading or held-to-maturity are classified as available-for-sale. During the nine months ended September 30, 2007, and throughout 2006, the Company did not have any securities classified as either held-to-maturity or trading.

Available-for-sale securities are recorded at fair value. Unrealized gains and losses, net of the related tax effect, on available-for-sale securities are reported as a separate component of other accumulated comprehensive loss in shareholders' equity until realized.

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Premiums and discounts are amortized or accreted over the life of the related investment security as an adjustment to yieldusing the effective interest method. Dividend and interest income are recognized when earned. Realized gains and losses for securities are included in earnings and are derived using the specific identification method for determining the cost of securities sold. Unrealized losses due to fluctuations in fair value of securities held to maturity or available for sale are recognized through earnings when it is determined that an other than temporary decline in value has occurred.

Federal Home Loan Bank Stock
The Bank is a member of the Federal Home Loan Bank of San Francisco ("FHLB"), and as a condition of membership, it is required to purchase stock. The amount of FHLB stock required to be purchased is based on the borrowing capacity desired by the Bank. While technically these are considered equity securities,

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there is no market for the FHLB stock. Therefore, the shares are considered as restricted investment securities. Such investment is carried at cost.

Loans Held for Sale
Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by aggregate outstanding commitments from investors of current investor yield requirements. Net unrealized losses are recognized through a valuation allowance by charges to income. At September 30, 2007 and 2006, and December 31, 2006, the Company's balance of loans held for sale was immaterial.

Mortgage loans held for sale are generally sold with the mortgage servicing rights retained by the company. The carrying value of mortgage loans sold is reduced by the cost allocated to the associated mortgage servicing rights. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.

## Loans

Loans are reported at the principal amount outstanding, net of unearned income and the allowance for loan losses. Loan origination and commitment fees and certain direct loan origination costs are deferred, and the net amount is amortized as an adjustment of the related loan's yield over the estimated life of the loan. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Accrual of interest on loans is generally discontinued either when reasonable doubt exists as to the full, timely collection of interest or principal or when a loan becomes contractually past due by 90 days or more with respect to interest or principal. When loans are 90 days past due, but in Management's judgment are well secured and in the process of collection, they may be classified as accrual. When a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of Management, the loans are estimated to be fully collectible as to both principal and interest. All impaired loans are classified as nonaccrual loans.

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

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## Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans and deposit-related overdrafts are charged against the allowance for loan losses when Management believes that the collectibility of the principal is unlikely or, with respect to consumer installment loans,

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according to an established delinquency schedule. The allowance is an amount that Management existing loans impairment and prior oss experience of loans and leases. into consideration such factors as changes in the nature and size of the portfolio, overall portfolio quality, loan concentrations, specific problem loans, and current economic conditions that may affect the borrower's ability to pay. The Company defines a loan as impaired when it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's original effective interest rate. As a practical expedient, impairment may be measured based on the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a valuation allowance.

Credit risk is inherent in the business of lending. As a result, the Company maintains an allowance for loan losses to absorb losses inherent in the Company's loan portfolio. This is maintained through periodic charges to earnings. These charges are shown in the Consolidated Income Statements as provision for loan losses. All specifically identifiable and quantifiable losses are immediately charged off against the allowance. However, for a variety of reasons, not all losses are immediately known to the Company and, of those that are known, the full extent of the loss may not be quantifiable at that point in time. The balance of the Company's allowance for loan losses is meant to be an estimate of these unknown but probable losses inherent in the portfolio. For purposes of this discussion, "loans" shall include all loans and lease contracts that are part of the Company's portfolio.

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

The Company's method for assessing the appropriateness of the allowance for loan losses and the reserve for unfunded commitments includes specific allowances for identified problem loans and leases as determined by SFAS 114, formula allowance factors for pools of credits, and allowances for changing environmental factors (e.g., interest rates, growth, economic conditions, etc.). Allowance factors for loan pools are based on the previous 5 years historical loss experience by product type. Allowances for specific loans are based on SFAS 114 analysis of individual credits. Allowances for changing environmental factors are Management's best estimate of the probable impact these changes have had on the loan portfolio as a whole. This process is explained in detail in the notes to the Company's audited consolidated financial statements in its Annual Report on Form 10-K for the year ended December 31, 2006.

Based on the current conditions of the loan portfolio, Management believes that the allowance for loan losses and the reserve for unfunded commitments, which collectively stand at $\$ 19,179,000$ at September 30,2007 , are adequate to absorb probable losses inherent in the Company's loan portfolio. No assurance can be

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given, however, that adverse economic conditions or other circumstances will not result in increased losses in the portfolio.

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The following tables summarize the activity in the allowance for loan losses, reserve for unfunded commitments, and allowance for losses (which is comprised of the allowance for loan losses and the reserve for unfunded commitments) for the periods indicated (dollars in thousands):

Allowance for loan losses:
Balance at beginning of period
Provision for loan losses
Loans charged off
Recoveries of previously
charged-off loans

Net charge-offs

Balance at end of period

Reserve for unfunded commitments:
Balance at beginning of period
Provision for losses -
Unfunded commitments

Balance at end of period

| \$16,999 | \$16,893 | \$16,914 | \$16,226 |
| :---: | :---: | :---: | :---: |
| 700 | 235 | 1,682 | 1,289 |
| (843) | (368) | $(2,333)$ | $(1,289)$ |
| 283 | 233 | 876 | 767 |
| (560) | (135) | $(1,457)$ | ( 522 ) |
| \$17,139 | \$16,993 | \$17,139 | \$16,993 |

$\$ 2,040 \quad \$ 1,849 \quad \$ 1,813$

191
36

| \$2,040 | \$1,849 | \$2,040 | \$1,849 |
| :---: | :---: | :---: | :---: |

Balance at end of period:
Allowance for loan losses
Reserve for unfunded commitments

Allowance for losses

As a percentage of total loans:
Allowance for loan losses

| $1.12 \%$ | $1.13 \%$ |
| :---: | ---: |
| $0.13 \%$ | $0.12 \%$ |
| $---------------1.25 \%$ |  |

$======================$

Mortgage Servicing Rights
Mortgage servicing rights (MSRs) represent the Company's right to a future stream of cash flows based upon the contractual servicing fee associated with servicing mortgage loans. Our MSRs arise from residential mortgage loans that we originate and sell, but retain the right to service the loans. For sales of residential mortgage loans, a portion of the cost of originating the loan is

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allocated to the servicing right based on relative fair values of the loan and the servicing right. The net gain from the retention of the servicing right is included in gain on sale of loans in noninterest income when the loan is sold. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. MSRs are included in other assets. Servicing fees are recorded in noninterest income when earned.

Effective with the Company's early adoption of SFAS 156 , beginning as of January 1,2006 MSRs are carried at fair value, with changes in fair value reported in noninterest income in the period in which the change occurs. On or before December 31, 2005, MSRs were carried at the lower of amortized cost or market value. The cumulative effect related to the adoption of this change in accounting from lower of amortized cost or market value to fair value on January 1, 2006 was immaterial.

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

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The following tables summarize the activity in, and the main assumptions we used to determine the fair value of mortgage servicing rights for the periods indicated (dollars in thousands):

|  | Nine month | September |
| :---: | :---: | :---: |
|  | 2007 | 2006 |
| Mortgage servicing rights: |  |  |
| Balance at beginning of period | \$3,912 | \$3,638 |
| Additions | 506 | 496 |
| Change in fair value | (226) | (256) |
| Balance at end of period | \$4,192 | \$3,878 |
| Servicing fees received | \$737 | \$712 |
| Balance of loans serviced at: |  |  |
| Beginning of period | \$389,636 | \$373,163 |
| End of period | \$402,806 | \$384,862 |
| Weighted-average prepayment speed (CPR) | $11.6 \%$ | 12.1\% |
| Discount rate | 10.0\% | 10.0\% |

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

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

## Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, management periodically performs valuations and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other noninterest expense.

Goodwill and Other Intangible Assets
Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill and other intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment.

The Company has identifiable intangible assets consisting of core deposit premiums and minimum pension liability. Core deposit premiums are amortized using an accelerated method over a period of ten years. Intangible assets related to minimum pension liability are adjusted annually based upon actuarial estimates.

The following table summarizes the Company's goodwill intangible as of September 30, 2007 and December 31, 2006.

| (Dollars in Thousands) | $\begin{gathered} \text { December } \\ 2006 \end{gathered}$ | Additions | Reductions | $\begin{aligned} & \text { September } 30 \text {, } \\ & 2007 \end{aligned}$ |
| :---: | :---: | :---: | :---: | :---: |
| Goodwill | \$15,519 | - | - | \$15,519 |

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The following table summarizes the Company's core deposit intangibles as of September 30, 2007 and December 31, 2006.

|  | December 31, 2006 |  | September 30, |  |
| :---: | :---: | :---: | :---: | :---: |
| (Dollars in Thousands) |  |  | Reductions | 2007 |
| Core deposit intangibles | \$13,643 | - | (\$10,278) | \$3,365 |
| Accumulated amortization | $(11,977)$ | \$10,278 | (368) | $(2,067)$ |
| Core deposit intangibles, | \$1,666 | \$10, 278 | $(\$ 10,646)$ | \$1,298 |

Core deposit intangibles are amortized over their expected useful lives. Such lives are periodically reassessed to determine if any amortization period adjustments are indicated.

The following table summarizes the Company's estimated core deposit intangible amortization for each of the five succeeding years:

| Estimated Core Deposit <br> Intangible Amortization <br> (Dollars in thousands) |  |
| :---: | :---: |
| Years Ended | $\$ 490$ |
| 2007 | $\$ 523$ |
| 2008 | $\$ 328$ |
| 2009 | $\$ 260$ |
| 2010 | $\$ 65$ |
| 2011 | - |

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

On December 31 of each year, goodwill is tested for impairment, and is tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. This determination is made at the reporting unit level and consists of two steps. First, the Company determines the fair value of a reporting unit and compares it to its carrying amount. Second, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

## Income Taxes

The Company's accounting for income taxes is based on an asset and liability approach. The Company recognizes the amount of taxes payable or refundable for the current year, and deferred tax assets and liabilities for the future tax consequences that have been recognized in its financial statements or tax returns. The measurement of tax assets and liabilities is based on the provisions of enacted tax laws.

Stock-Based Compensation
On January 1, 2006 the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R), using the modified-prospective transition method. Under this transition method, compensation cost recognized during the nine months ended September 30, 2007 and September 30, 2006 include: (a) compensation cost for all share-based awards

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granted prior to, but not yet vested as of, January 1, 2007 and January 1, 2006, respectively, based on the grant-date fair value and related service period estimates in accordance with the original provisions of SFAS 123 and (b) compensation cost for all share-based awards granted subsequent to January 1 , 2007 and January 1, 2006, respectively, based on the grant-date fair value and related service periods estimated in accordance with the provisions of SFAS 123R. Historically, stock options are the only type of share-based award granted by the Company.

Prior to the adoption of SFAS 123R, the Company used the intrinsic value method to account for its stock option plans (in accordance with the provisions of Accounting Principles Board Opinion No. 25). Intrinsic value is the difference between share fair market value and option exercise price. Under this method, compensation expense was recognized for awards of options to purchase shares of common stock to employees under compensatory plans only if the fair market value of the stock at the option grant date (or other measurement date, if later) was greater than the amount the employee was required to pay to acquire the stock. Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123), permitted companies to continue using the intrinsic value method or to adopt a fair value based method to account for stock option plans. The fair value based method would have resulted in the recognition, as expense over the vesting period, of the fair value of all stock-based awards on the date of grant.

SFAS 123R clarifies and expands the guidance in SFAS 123 in several areas, including measuring fair value and attributing compensation cost to reporting periods. SFAS 123R includes a requirement to: (a) estimate forfeitures of share-based awards at the date of grant, (b) expense share-based awards granted to retirement eligible employees and those employees with non-substantive non-compete agreements immediately, (c) attribute compensation costs of share-based award grants to the stated future vesting period, and (d) recognize compensation cost of all share-based awards based upon the grant-date fair value (including pre-2006 options).

The following table shows the number, weighted-average exercise price, intrinsic value, and weighted average remaining contractual life, of options exercisable, options not yet exercisable, and total options outstanding as of September 30, 2007:

| (dollars in thousands except exercise price) | Currently <br> Exercisable | Currently Not Exercisable | Total <br> Outstanding |
| :---: | :---: | :---: | :---: |
| Number of options | 1,044,077 | 322,354 | 1,366,431 |
| Weighted average exercise price | \$12.46 | \$21.51 | \$14.59 |
| Intrinsic value | \$10,245 | \$245 | \$10,490 |
| Weighted average remaining contractual term (yrs.) | 4.97 | 8.86 | 5.89 |

The options for 322,354 shares that are not currently exercisable as of September 30, 2007 are expected to vest, on a weighted-average basis, over the next 3.04 years, and the Company is expected to recognize $\$ 1,961,000$ of compensation costs related to these options as they vest.

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divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from assumed issuance. Potential common shares that may be issued by the Company relate solely from outstanding stock options, and are determined using the treasury stock method. In applying the treasury method, the Company uses the excess tax benefit that would result from the assumed issuance.

Earnings per share have been computed based on the following:

| (in thousands) | Three Months```Ended September 30, 2007 2006``` |  | ```Nine Months Ended September 30, 2007 2006``` |  |
| :---: | :---: | :---: | :---: | :---: |
| Net income | \$6,793 | \$6,820 | \$19,992 | \$19,912 |
| Average number of common shares outstanding | 15,889 | 15,856 | 15,895 | 15,797 |
| Effect of dilutive stock options | 422 | 510 | 502 | 582 |
| Average number of common shares outstanding used to calculate diluted earnings per share | 16,311 | 16,366 | 16,397 | 16,379 |

There were 302,050 and 42,000 options excluded from the computation of diluted earnings per share for the nine month periods ended September 30, 2007 and 2006, respectively, because the effect of these options was antidilutive.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income (loss) and related tax effects are as follows:

| (in thousands) | Three Months <br> Ended September 30, |  | $\begin{aligned} & \text { Nine } \\ & \text { Ended Sep } \\ & 2007 \end{aligned}$ | $\begin{aligned} & \text { ths } \\ & \text { ber } 30 \text {, } \\ & 6 \end{aligned}$ |
| :---: | :---: | :---: | :---: | :---: |
| Unrealized holding gains (losses) on available-for-sale securities | \$1,987 | \$3,490 | \$1,541 | \$377 |
| Tax effect | (836) | $(1,468)$ | (648) | (159) |
| Unrealized holding gains (losses) on available-for-sale securities, net of tax | \$1,151 | \$2,022 | \$893 | \$218 |

The components of accumulated other comprehensive loss, included in

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shareholders' equity, are as follows:
(in thousands)
Net unrealized losses on available-for-sale securities Tax effect

| $\begin{aligned} & \text { September } 30, \\ & 2007 \end{aligned}$ | $\begin{gathered} \text { December } \\ 2006 \end{gathered}$ |
| :---: | :---: |
| $(\$ 2,314)$ | (\$3, 855) |
| 973 | 1,621 |
| $(1,341)$ | $(2,234)$ |
| $(3,946)$ | $(3,946)$ |
| 1,659 | 1,659 |
| $(2,287)$ | $(2,287)$ |
| $(\$ 3,628)$ | $(\$ 4,521)$ |

Unrealized holding losses on
available-for-sale securities, net of tax

$$
(1,341) \quad(2,234)
$$

Minimum pension liability
Tax effect

Minimum pension liability, net of tax

Accumulated other comprehensive loss

Retirement Plans

The Company has supplemental retirement plans covering directors and key executives. These plans are non-qualified defined benefit plans and are unsecured and unfunded. The Company has purchased insurance on the lives of the participants and intends to use the cash values of these policies to pay the retirement obligations. The following table sets forth the net periodic benefit cost recognized for the plans:


During the nine months ended September 30, 2007 and 2006, the Company contributed and paid out as benefits $\$ 405,000$ and $\$ 409,000$, respectively, to participants under the plans. For the year ending December 31, 2007, the Company expects to contribute and pay out as benefits $\$ 528,000$ to participants under the

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plans.
Recent Accounting Pronouncements
In February 2006, the FASB issued FASB Statement of Financial Accounting Standards No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 (SFAS 155). SFAS 155 amends SFAS 133, Accounting for Derivative Instruments and Hedging Activities and SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS 155 (i) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (ii) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133, (iii) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (iv) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and (v) amends SFAS 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The adoption of SFAS 155 on January 1, 2007 had no impact the Company's consolidated financial statements.

In September 2006, the FASB issued FASB Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for the Company on January 1, 2008 and is not expected to have a significant impact on the Company's consolidated financial statements.

In September 2006, the FASB issued FASB Statement of Financial Accounting Standards No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88 106, and 132 (R) (SFAS 158). SFAS 158 requires an employer to recognize the overfunded or underfunded status of defined benefit postretirement plans as an asset or a liability in its statement of financial position. The funded status is measured as the difference between plan assets at fair value and the benefit obligation (the projected benefit obligation for pension plans or the accumulated benefit obligation for other postretirement benefit plans). An employer is also required to measure the funded status of a plan as of the date of its year-end statement of financial position with changes in the funded status recognized through comprehensive income. SFAS 158 also requires certain disclosures regarding the effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of gains or losses, prior service costs or credits, and the transition asset or obligation. The Company was required to recognize the funded status of its defined benefit post-retirement benefit plans in its consolidated financial statements for the year ended December 31, 2006. The Company had previously recognized the funded status of its supplemental retirement plans for directors and key executives in prior consolidated financial statements.

TheCompany has no other defined benefit post-retirement benefit plans. The requirement to measure plan assets and benefit obligations as of the date of the year-end statement of financial position is effective for the company's consolidated financial statements beginning with the fiscal year ended after December 15, 2008. The Company currently uses December 31 as the measurement date for its defined benefit post-retirement benefit plans. In February 2007, the FASB issued FASB Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment to FASB Statement No. 115 (SFAS 159). SFAS 159 permits entities to

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choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for the Company on January 1, 2008 and is not expected to have a significant impact on the Company's consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109 (FIN 48). FIN 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. FIN 48 also provides guidance on the accounting for and disclosure of unrecognized tax benefits, interest and penalties. FIN 48 was effective for the Company on January 1 , 2007 and did not have a significant impact on the Company's consolidated financial statements.

In September 2006, the Emerging Issues Task Force (EITF) of the FASB ratified EITF Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Agreements, and EITF Issue No. 06-5, Accounting for Purchases of Life Insurance - Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance. EITF 06-4 provides that an employer should recognize a liability for future benefits based on the substantive agreement with the employee. The Issue should be applied to fiscal years beginning after December 15, 2007, with earlier application permitted. EITF 06-5 provides that in determining the amount recognized as an asset, a policyholder should consider the cash surrender value as well as any additional amounts included in the contractual terms of the policy that will be paid upon surrender. The amount that could be realized should be calculated at the individual policy level and consider any probable contractual limitations, including the exclusion of any additional amounts paid for the surrender of an entire group of policies. The Issue is effective for fiscal years beginning after December 15, 2007. The Company has life insurance arrangements. The Company is currently evaluating the impact of adoption of these rules on the Company's consolidated financial statements.

Reclassifications
Certain amounts previously reported in the 2006 financial statements have been reclassified to conform to the 2007 presentation. These reclassifications did not affect previously reported net income or total shareholders' equity.

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Financial Summary<br>(dollars in thousands, except per share amounts; unaudited)

| Three months ended |  |
| :---: | :---: |
| September 30, | Nine months ende |
| September 30, |  |

Net Interest Income (FTE)
Provision for loan losses
Noninterest income
Noninterest expense
Provision for income taxes (FTE)
Net income

Earnings per share:
Basic
Diluted

| $\$ 0.43$ | $\$ 0.43$ |
| ---: | ---: |
| $\$ 0.42$ | $\$ 0.42$ |
| $\$ 0.13$ | $\$ 0.12$ |
| $\$ 11.50$ | $\$ 10.41$ |
| $\$ 10.44$ | $\$ 9.22$ |
|  |  |
| 15,889 | 15,856 |
| 16,311 | 16,366 |
| 15,891 | 15,857 |
|  |  |
| $\$ 1,517,937$ | $\$ 1,490,166$ |
| $1,953,523$ | $1,904,004$ |
| $1,532,142$ | $1,525,174$ |
| 99,996 | 35,848 |
| 41,238 | 41,238 |
| 182,725 | $\$ 165,141$ |

Financial Ratios:
During the period (annualized):

| Return on assets | $1.44 \%$ | $1.45 \%$ |
| :--- | :--- | :--- |
| $1.42 \%$ |  |  |

Return on equity 14.92\% 16.64\% 14.94\%

Net interest margin (1) 5.12\% 5.19\% 5\%
$\begin{array}{lll}\text { Net loan charge-offs to average loans } 0.15 \% & 0.04 \% & 0.13 \%\end{array}$
Efficiency ratio(1) 58.01\% 59.27\% 59.15\%
At Period End:
Equity to assets 9.35\% 8.67
Total capital to risk assets $11.66 \% 11.08 \%$
Allowance for losses to loans(2) 1.25\% 1.25\%
(1) Fully taxable equivalent (FTE)
(2) Allowance for losses includes allowance for loan losses and reserve for unfunded commitments.

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

As TriCo Bancshares (the "Company") has not commenced any business operations independent of Tri Counties Bank (the "Bank"), the following discussion pertains
primarily to the Bank. Average balances, including such balances used in calculating certain financial ratios, are generally comprised of average daily balances for the Company. Within Management's Discussion and Analysis of Financial Condition and Results of Operations, interest income and net interest income are generally presented on a fully tax-equivalent (FTE) basis. The presentation of interest income and net interest income on a FTE basis is a common practice within the banking industry. Interest income and net interest income are shown on a non-FTE basis throughout Part I - Financial Information of this Form 10-Q, and a reconciliation of the FTE and non-FTE presentations is provided below in the discussion of net interest income.

Critical Accounting Policies and Estimates
The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to the adequacy of the allowance for loan losses, intangible assets, and contingencies. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. (See "Allowance for Loan Losses" in Part I, Item 1, for a more detailed discussion).

Results of Operations
The following discussion and analysis is designed to provide a better understanding of the significant changes and trends related to the company and the Bank's financial condition, operating results, asset and liability management, liquidity and capital resources and should be read in conjunction with the unaudited condensed consolidated financial statements of the Company and the Notes thereto at Part I, Item 1, of this Form 10-Q.

Following is a summary of the components of fully taxable equivalent ("FTE") net income for the periods indicated (dollars in thousands):

Net Interest Income (FTE)
Provision for loan losses
Noninterest income

| Three months ended Spetember 30, |  | Nine months ended September 30, |  |
| :---: | :---: | :---: | :---: |
| 2007 | 2006 | 2007 | 2006 |
| \$22,031 | \$22,077 | \$66,005 | \$64,903 |
| 700 | 235 | 1,682 | 1,289 |
| 6,847 | 6,649 | 20,476 | 19,628 |
| 16,752 | 17,026 | 51,155 | 49,724 |
| 4,633 | 4,645 | 13,652 | 13,606 |
| \$6,793 | \$6,820 | \$19,992 | \$19,912 |

The Company had quarterly earnings of $\$ 6,793,000$, or $\$ 0.42$ per diluted share, for the three months ended September 30,2007 . These results represent no change from the $\$ 0.42$ earnings per diluted share reported for the three months ended September 30,2006 on earnings of $\$ 6,820,000$.

The Company reported earnings of $\$ 19,992,000$, or $\$ 1.22$ per diluted share, for the nine months ended September 30,2007 . These results represent no change from the $\$ 1.22$ earnings per diluted share reported for the nine months ended

September 30, 2006 on earnings of $\$ 19,912,000$.
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Net Interest Income
Following is a summary of the components of net interest income for the periods indicated (dollars in thousands):

|  | Three months ended September 30, |  | Nine months ended September 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2007 | 2006 | 2007 | 2006 |
| Interest income | \$32,442 | \$31,421 | \$95,089 | \$88,778 |
| Interest expense | $(10,602)$ | $(9,576)$ | $(29,713)$ | $(24,624)$ |
| FTE adjustment | 191 | 232 | 629 | 749 |
| Net interest income (FTE) | \$22,031 | \$22,077 | \$66,005 | \$64,903 |
| Average interest-earning \$1 assets | 721,547 | \$1,701,166 | \$1,704,342 | \$1,675,027 |
| Net interest margin (FTE) | 5.12\% | $5.19 \%$ | $5.16 \%$ | $5.17 \%$ |

The Company's primary source of revenue is net interest income, or the difference between interest income on interest-earning assets and interest expense in interest-bearing liabilities.

Net interest income (FTE) during the third quarter of 2007 decreased $\$ 46,000$ ( $0.2 \%$ ) from the same period in 2006 to $\$ 22,031,000$. The decrease in net interest income (FTE) was due to a $0.07 \%$ decrease in net interest margin (FTE) to 5.12\% that was substantially offset by a $\$ 20,381,000$ (1.2\%) increase in average balances of interest-earning assets to \$1,721,547,000.

Net interest income (FTE) during the first nine months of 2007 increased $\$ 1,102,000$ (1.7\%) from the same period in 2006 to $\$ 66,005,000$. The increase in net interest income (FTE) was due to a $\$ 29,315,000$ (1.8\%) increase in average balances of interest-earning assets to $\$ 1,704,342,000$ that was partially offset by a $0.01 \%$ decrease in net interest margin (FTE) to 5.16\%.

Interest and Fee Income
Interest and fee income (FTE) for the third quarter of 2007 increased $\$ 980,000$ (3.1\%) from the third quarter of 2006 . The increase was due to a $\$ 20,381,000$ (1.2\%) increase in average interest-earning assets to $\$ 1,721,547,000$ and a $0.14 \%$ increase in the yield on those average interest-earning assets to 7.58\%. The growth in interest-earning assets was due to a $\$ 39,868,000$ (2.7\%) increase in average loan balances to $\$ 1,517,419,000$ that was partially offset by a decrease of $\$ 19,358,000$ ( $8.7 \%$ ) in average balances of investments to $\$ 203,673,000$. The increase in the yield on average interest-earning assets was mainly due to a $0.11 \%$ increase in yield on loans to $7.93 \%$ and a change in the mix of earning assets from lower-earning investments towards higher-earning loans.

Interest and fee income (FTE) for the nine months ended September 30, 2007 increased $\$ 6,191,000$ ( $6.9 \%$ ) from the same period of 2006 . The increase was the net effect of a $\$ 29,315,000(1.8 \%)$ increase in average interest-earning assets to $\$ 1,704,342,000$ and a $0.36 \%$ increase in the yield on those average interest-earning assets to 7.49\%. The growth in interest-earning assets was due to a $\$ 74,661,000$ (5.2\%) increase in average loan balances to $\$ 1,504,865,000$ that was partially offset by a decrease of $\$ 44,491,000$ (18.3\%) in average balances of investments to $\$ 199,099,000$. The increase in the yield on average

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interest-earning assets was mainly due to a $0.32 \%$ increase in yield on loans to $7.83 \%$ and a change in the mix of earning assets from lower-earning investments towards higher-earning loans.

Interest Expense
Interest expense increased $\$ 1,026,000(10.7 \%)$ to $\$ 10,602,000$ in the third quarter of 2007 compared to the year-ago quarter. The average balance of interest-bearing liabilities decreased $\$ 3,648,000$ ( $0.3 \%$ ) to $\$ 1,333,948,000$ in the third quarter compared to the year-ago quarter. The decrease in the average balance of interest-bearing liabilities was concentrated in Federal funds purchased (down $\$ 36,600,000$ or $34.1 \%$ ) and demand deposits (down $\$ 11,337,000$ or $4.9 \%$ ) . In addition, the average balance of other borrowings and savings deposits increased $\$ 28,655,000(78.9 \%)$ and $\$ 10,969,000(2.9 \%)$, respectively, from the year-ago quarter. The average rate paid on interest-bearing liabilities in the quarter ended September 30, 2007 increased $0.32 \%$ to $3.18 \%$ compared to the year-ago quarter as a result of increases in market interest rates and changes in the mix of interest-bearing liabilities towards higher paying liabilities.

Interest expense increased $\$ 5,089,000(20.7 \%)$ to $\$ 29,713,000$ for the nine months ended September 30, 2007 compared to the year-ago nine month period. The average balance of interest-bearing liabilities decreased $\$ 1,902,000$ (0.1\%) to $\$ 1,313,548,000$ for the nine months ended September 30, 2007 compared to the year-ago period. The decrease in interest-bearing liabilities was concentrated in Federal funds purchased (down $\$ 27,477,000$ or $30.7 \%$ ), savings deposits (down $\$ 19,733,000$ or $4.9 \%$ ) and demand deposits (down $\$ 14,983,000$ or $6.2 \%$ ). In addition, for the nine months ended September 30, 2007, the average balance of time deposits and other borrowings increased $\$ 44,190,000$ ( $8.7 \%$ ) and $\$ 16,101,000$ (48.0\%), respectively, from the year-ago period. The average rate paid on interest-bearing liabilities in the nine month period ended September 30, 2007 increased $0.52 \%$ to $3.02 \%$ compared to the year-ago period as a result of increases in market interest rates and changes in the mix of interest-bearing liabilities towards higher paying liabilities.

Net Interest Margin (FTE)
The following table summarizes the components of the Company's net interest margin for the periods indicated:

Yield on interest-earning assets

| Three Sep | $\begin{aligned} & \text { nded } \\ & 30, \end{aligned}$ | Nine months ended September 30, |  |
| :---: | :---: | :---: | :---: |
| 2007 | 2006 | 2007 | 2006 |
| $7.58 \%$ | $7.44 \%$ | 7.49\% | $7.13 \%$ |
| $3.18 \%$ | $2.86 \%$ | 3.02\% | $2.50 \%$ |
| $4.40 \%$ | 4.58\% | $4.47 \%$ | $4.63 \%$ |
| $0.72 \%$ | $0.61 \%$ | $0.69 \%$ | $0.54 \%$ |
| $5.12 \%$ | 5.19\% | $5.16 \%$ | $5.17 \%$ |

Net interest margin for the three months ended September 30, 2007 decreased $0.07 \%$ compared to the three months ended September 30, 2006. This decrease in net interest margin was mainly due to an $0.11 \%$ increase in the impact of net noninterest-bearing funds to $0.72 \%$ from $0.61 \%$ in the year-ago three month period that was more than offset by a $0.18 \%$ decrease in net interest spread as the

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average yield on interest-earning assets increased 0.14\% while the average rate paid on interest-bearing liabilities increased $0.32 \%$ from the year-ago three month period.

Net interest margin for the nine months ended September 30, 2007 decreased $0.01 \%$ compared to the nine months ended September 30, 2006. This decrease in net interest margin was mainly due to a $0.15 \%$ increase in the impact of net noninterest-bearing funds to $0.69 \%$ from $0.54 \%$ in the year-ago nine month period that was more than offset by a $0.16 \%$ decrease in net interest spread as the average yield on interest-earning assets increased $0.36 \%$ while the average rate paid on interest-bearing liabilities increased $0.52 \%$ from the year-ago three month period.

Summary of Average Balances, Yields/Rates and Interest Differential
The following tables present, for the periods indicated, information regarding the Company's consolidated average assets, liabilities and shareholders' equity, the amounts of interest income from average interest-earning assets and resulting yields, and the amount of interest expense paid on interest-bearing liabilities. Average loan balances include nonperforming loans. Interest income includes proceeds from loans on nonaccrual loans only to the extent cash payments have been received and applied to interest income. Yields on securities and certain loans have been adjusted upward to reflect the effect of income thereon exempt from federal income taxation at the current statutory tax rate (dollars in thousands).
Loans
Investment securities - taxable
Investment securities - nontaxable
Federal funds sold
Total interest-earning assets
Other assets
Total assets
Liabilities and shareholders' equity:
Interest-bearing demand deposits
Savings deposits
Time deposits
Federal funds purchased
Other borrowings
Junior subordinated debt
Total interest-bearing liabilities

| \$1,517,419 | \$30,099 | $7.93 \%$ | \$1,477,551 | \$28,901 |
| :---: | :---: | :---: | :---: | :---: |
| 174,472 | 1,983 | 4.55\% | 188,021 | 2,082 |
| 29,201 | 545 | $7.47 \%$ | 35,010 | 663 |
| 455 | 6 | 5.27\% | 584 | 7 |
| 1,721,547 | 32,633 | $7.58 \%$ | 1,701,166 | 31,653 |
| 170,445 |  |  | 178,863 |  |
| \$1,891,992 |  |  | \$1,880,029 |  |
| \$220,582 | 114 | $0.21 \%$ | \$231,919 | 118 |
| 388,315 | 1,761 | 1.81\% | 377,346 | 906 |
| 548,229 | 6,203 | 4.53\% | 543,564 | 5,820 |
| 70,602 | 922 | 5.22\% | 107,202 | 1,448 |
| 64,982 | 768 | 4.73\% | 36,327 | 442 |
| 41,238 | 834 | 8.09\% | 41,238 | 842 |
| 1,333,948 | 10,602 | $3.18 \%$ | 1,337,596 | 9,576 |


(1) Net interest spread represents the average yield earned on interest-earning assets minus the average rate paid on interest-bearing liabilities.
(2) Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets.

For the nine months ended



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 (FTE) and interest expense from changes in average asset and liability balances (volume) and changes in average interest rates for the periods indicated. Changes not solely attributable to volume or rates have been allocated in proportion to the respective volume and rate components (dollars in thousands).

|  | ```Three months ended September 30, 2007 compared with three months ended September 30, 2006``` |  |  |
| :---: | :---: | :---: | :---: |
|  | Volume | Rate | Total |
| Increase (decrease) in interest income: |  |  |  |
| Loans | \$779 | \$419 | \$1,198 |
| Investment securities | (260) | 43 | (217) |
| Federal funds sold | (2) | 1 | (1) |
| Total interest-earning assets | 517 | 463 | 980 |
| Increase (decrease) in interest expense: |  |  |  |
| Interest-bearing demand deposits | (6) | 2 | ( 4 ) |
| Savings deposits | 26 | 829 | 855 |
| Time deposits | 50 | 333 | 383 |
| Federal funds purchased | (494) | (32) | (526) |
| Other borrowings | 349 | (23) | 326 |
| Junior subordinated debt | - | (8) | (8) |
| Total interest-bearing liabilities | (75) | 1,101 | 1,026 |
| Increase in Net Interest Income | \$592 | (\$638) | (\$46) |

Nine months ended September 30, 2007
compared with nine months ended
September 30, 2006

| Volume | Rate | Total |
| :---: | :---: | :---: |
| \$4,205 | \$3,674 | \$7,879 |


| Investment securities | $(1,577)$ | (80) | $(1,657)$ |
| :---: | :---: | :---: | :---: |
| Federal funds sold | (31) | - | (31) |
| Total interest-earning assets | 2,597 | 3,594 | 6,191 |
| Increase (decrease) in interest expense: |  |  |  |
| Interest-bearing demand deposits | (22) | 3 | (19) |
| Savings deposits | (126) | 1,982 | 1,856 |
| Time deposits | 1,289 | 2,183 | 3,472 |
| Federal funds purchased | (1, 032 ) | 123 | (909) |
| Other borrowings | 569 | 9 | 578 |
| Junior subordinated debt | - | 111 | 111 |
| Total interest-bearing liabilities | 678 | 4,411 | 5,089 |
| Increase in Net Interest Income | \$1,919 | (\$817) | \$1,102 |

Provision for Loan Losses
The Company provided $\$ 700,000$ for loan losses in the third quarter of 2007 versus $\$ 235,000$ in the third quarter of 2006 . During the third quarter of 2007 , the Company recorded $\$ 560,000$ of net loan charge-offs versus $\$ 135,000$ of net loan charge-offs in the year earlier quarter.

The Company provided $\$ 1,682,000$ for loan losses during the nine months ended September 30,2007 versus $\$ 1,289,000$ during the nine months ended September 30 , 2006. During the nine months ended September 30, 2007, the Company recorded $\$ 1,457,000$ of net loan charge-offs versus $\$ 522,000$ of net loan charge-offs in the year earlier nine-month period.

Noninterest Income

The following table summarizes the components of noninterest income for the periods indicated (dollars in thousands).
Service charges on deposit accounts
ATM fees and interchange
Other service fees
Change in value of mortgage servicing rights
Gain on sale of loans
Commissions on sale of
nondeposit investment products
Increase in cash value of life insurance
Gain on sale of investments
Other noninterest income
Total noninterest income


Noninterest income for the third quarter of 2007 increased $\$ 198,000$ ( $3.0 \%$ from the year-ago quarter. The increase in noninterest income from the year-ago quarter was mainly due to a $\$ 136,000$ ( $30.4 \%$ ) increase in commissions on sale of nondeposit investment products to $\$ 583,000$, a $\$ 116,000$ (3.1\%) increase in service charges on deposit accounts to $\$ 3,819,000$, and an $\$ 89,000$ (9.6\%) increase in ATM fees and interchange to $\$ 1,016,000$, that were partially offset by a $\$ 53,000$ (20.1\%) decrease in gain on sale of loans to $\$ 211,000$. The increase in commissions on sale of nondeposit investment products was primarily due to improved market conditions and increased resources focused in this area. The increase in service charges on deposit accounts was primarily due to growth in customer count. The increase in ATM fees and interchange was due to growth in customer count and expansion of ATM network as part of new branch openings. The decrease in gain on sale of loans is due to a slowdown in residential mortgage refinance activity.

Noninterest income for the nine months ended September 30, 2007 increased $\$ 848,000(4.3 \%)$ to $\$ 20,476,000$ from the same period in 2006 . The increase in noninterest income from the year-ago nine months ended September 30, 2006 was mainly due mainly due to a $\$ 104,000$ ( $6.8 \%$ ) increase in commissions on sale of nondeposit investment products to $\$ 1,633,000$, a $\$ 353,000$ (3.2\%) increase in service charges on deposit accounts to $\$ 11,236,000$, and a $\$ 370,000$ (14.0\%) increase in ATM fees and interchange to $\$ 3,011,000$, that were partially offset by a $\$ 119,000$ (13.6\%) decrease in gain on sale of loans to $\$ 756,000$. The increase in commissions on sale of nondeposit investment products was primarily due to improved market conditions and increased resources focused in this area. The increase in service charges on deposit accounts was primarily due to growth in customer count. The increase in ATM fees and interchange was due to growth in customer count and expansion of ATM network as part of new branch openings. The decrease in gain on sale of loans is due to a slowdown in residential mortgage refinance activity.

Noninterest Expense
The following table summarizes the components of noninterest expense for the periods indicated (dollars in thousands).

| Three Se | $\begin{aligned} & \text { ended } \\ & 30, \end{aligned}$ | Nine months ende September 30, |  |
| :---: | :---: | :---: | :---: |
| 2007 | 2006 | 2007 | 200 |


| Salaries \& benefits | $\$ 8,975$ | $\$ 9,276$ | $\$ 28,336$ | $\$ 27,050$ |
| :--- | ---: | ---: | ---: | ---: |
| Occupancy | 1,178 | 1,170 | 3,526 | 3,298 |
| Equipment | 1,052 | 1,018 | 3,222 | 3,187 |
| Advertising and marketing | 620 | 655 | 1,624 | 1,628 |
| Data processing and software | 564 | 453 | 1,482 | 1,259 |
| ATM network charges | 463 | 475 | 1,389 | 1,375 |
| Telecommunications | 412 | 380 | 1,240 | 1,165 |
| Professional fees | 408 | 375 | 1,217 | 1,265 |
| Courier service | 285 | 312 | 867 | 925 |
| Postage | 178 | 261 | 602 | 753 |
| Operational losses | 128 | 89 | 313 | 218 |
| Intangible amortization | 122 | 350 | 367 | 1,046 |
| Assessments | 82 | 83 | 247 | 243 |

Other

Total
Average full time equivalent staff Noninterest expense to revenue (FTE)

| 2,285 | 2,129 | 6,723 | 6,312 |
| :---: | :---: | :---: | :---: |
| $-=-16,752$ | $\$ 17,026$ | $\$ 51,155$ | $\$ 49,724$ |
| $=================================================-1$ |  |  |  |
| 646 | 630 | 636 | 619 |
| $58.01 \%$ | $59.27 \%$ | $59.12 \%$ | $59.82 \%$ |

Noninterest expense for the third quarter of 2007 decreased $\$ 274,000$ (1.6\%) compared to the third quarter of 2006. Salaries and benefits expense decreased $\$ 301,000(3.2 \%)$ to $\$ 8,975,000$. The decrease in salaries and benefits expense was mainly due to reduced commission and incentive expense that was partially offset by annual salary increases, and new employees at the Company's recently opened branches. The reduced commission and incentive expense was due to the company's employees not earning certain bonus and incentive compensation which is tied to the Company satisfying internal targeted performance goals. The Company did not meet such goals for the third quarter of 2007 and thus did not incur the related compensation expense. Intangible amortization decreased $\$ 228,000$ (65\%) to $\$ 122,000$ during the third quarter of 2007 as the core deposit intangible related to the purchase of several branches in 1997 became fully amortized in the fourth quarter of 2006.

Noninterest expense for the nine months ended September 30, 2007 increased $\$ 1,431,000$ (2.9\%) compared to the nine months ended September 30, 2006. Salaries and benefits expense increased $\$ 1,286,000(4.8 \%)$ to $\$ 28,336,000$. The increase in salaries and benefits expense was mainly due to annual salary increases and new employees at the Company's recently opened branches that were partially offset by reduced commission and incentive expense. Intangible amortization decreased $\$ 679,000$ (65\%) to $\$ 367,000$ during the nine months ended September 30,2007 as the core deposit intangible related to the purchase of several branches in 1997 became fully amortized in the fourth quarter of 2006.

Provision for Income Tax
The effective tax rate for the three months ended September 30, 2007 was 39.5\% compared to $39.3 \%$ for the three months ended September 30, 2006. The effective tax rate for the nine months ended September 30, 2007 was $39.2 \%$ and reflects no change from 39.2\% for the nine months ended September 30, 2006. The provision for income taxes for all periods presented is primarily attributable to the respective level of earnings and the incidence of allowable deductions, particularly from increase in cash value of life insurance, tax-exempt loans and state and municipal securities.

## Classified Assets

The Company closely monitors the markets in which it conducts its lending operations and continues its strategy to control exposure to loans with high credit risk. Asset reviews are performed using grading standards and criteria similar to those employed by bank regulatory agencies. Assets receiving lesser grades fall under the "classified assets" category, which includes all nonperforming assets and potential problem loans, and receive an elevated level of attention to ensure collection.

The following is a summary of classified assets on the dates indicated (dollars in thousands):

Classified loans
Other classified assets
Total classified assets

| $\$ 18,982$ | $\$ 6,114$ | $\begin{array}{r} \$ 12,868 \\ 187 \end{array}$ | \$13,116 | $\$ 6,514$ | $\$ 6,602$ |
| :---: | :---: | :---: | :---: | :---: | :---: |
| \$19,169 | \$6,114 | \$13,055 | \$13,116 | \$6,514 | \$6,602 |
| /classified loans |  | 133.2\% |  |  | 256.2\% |

Classified assets, net of guarantees of the U.S. Government, including its agencies and its government-sponsored agencies at September 30, 2007, increased $\$ 6,453,000(97.7 \%)$ to $\$ 13,055,000$ from $\$ 6,602,000$ at December 31, 2006.

## Nonperforming Loans

Loans are reviewed on an individual basis for reclassification to nonaccrual status when any one of the following occurs: the loan becomes 90 days past due as to interest or principal, the full and timely collection of additional interest or principal becomes uncertain, the loan is classified as doubtful by internal credit review or bank regulatory agencies, a portion of the principal balance has been charged off, or the Company takes possession of the collateral. Loans that are placed on nonaccrual even though the borrowers continue to repay the loans as scheduled are classified as "performing nonaccrual" and are included in total nonperforming loans. The reclassification of loans as nonaccrual does not necessarily reflect Management's judgment as to whether they are collectible.

Interest income is not accrued on loans where Management has determined that the borrowers will be unable to meet contractual principal and/or interest obligations, unless the loan is well secured and in the process of collection. When a loan is placed on nonaccrual, any previously accrued but unpaid interest is reversed. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of Management, the loans are estimated to be fully collectible as to both principal and interest.

Interest income on nonaccrual loans, which would have been recognized during the nine months, ended September 30, 2007, if all such loans had been current in accordance with their original terms, totaled $\$ 1,112,000$. Interest income actually recognized on these loans during the nine months ended September 30, 2007 was $\$ 650,000$.

The Company's policy is to place loans 90 days or more past due on nonaccrual status. In some instances when a loan is 90 days past due Management does not place it on nonaccrual status because the loan is well secured and in the process of collection. A loan is considered to be in the process of collection if, based on a probable specific event, it is expected that the loan will be repaid or brought current. Generally, this collection period would not exceed 30 days. Loans where the collateral has been repossessed are classified as OREO or, if the collateral is personal property, the loan is classified as other assets on the Company's consolidated financial statements.

Management considers both the adequacy of the collateral and the other resources of the borrower in determining the steps to be taken to collect nonaccrual loans. Alternatives that are considered are foreclosure, collecting on guarantees, restructuring the loan or collection lawsuits.

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the U.S. Government, including its agencies and its government-sponsored agencies, increased $\$ 3,182,000$ ( $70.5 \%$ ) to $\$ 7,694,000$ during the first nine months of 2007. Nonperforming assets net of guarantees represent $0.39 \%$ of total assets. All nonaccrual loans are considered to be impaired when determining the need for a specific valuation allowance. The Company continues to make a concerted effort to work problem and potential problem loans to reduce risk of loss.
(dollars in thousands):

| Performing nonaccrual loans | \$9,521 | \$5,980 | \$3,541 | \$10,255 | \$6,372 | \$3,8 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Nonperforming, nonaccrual loans | 3,952 | - | 3,952 | 561 | - |  |
| Total nonaccrual loans | 13,473 | 5,980 | 7,493 | 10,816 | 6,372 | 4, 4 |
| Loans 90 days past due and still accruing | 14 | - | 14 | 68 | - |  |
| Total nonperforming loans | 13,487 | 5,980 | 7,507 | 10,884 | 6,372 | 4,5 |
| Other real estate owned | 187 | - | 187 | - | - |  |
| Total nonperforming assets | \$13,674 | \$5,980 | \$7,694 | \$10,884 | \$6,372 | \$4,5 |
| Nonperforming loans to total loans |  |  | $0.49 \%$ |  |  | 0. |
| Nonperforming assets to total assets |  |  | $0.39 \%$ |  |  | 0.2 |
| Allowance for loan losses to nonperforming |  |  | 228\% |  |  | 375 |

Capital Resources
The current and projected capital position of the Company and the impact of capital plans and long-term strategies are reviewed regularly by Management.

On August 21, 2007, the Company announced the completion of its stock repurchase plan originally adopted on July 31, 2003 and amended on April 9, 2004 . Under this plan, the Company repurchased a total of 500,000 shares of its common stock with the final 105,629 shares being repurchased during August 2007 at an average price of $\$ 20.97$ per share.

Also on August 21, 2007, the Board of Directors adopted a new plan to repurchase, as conditions warrant, up to 500,000 shares of the Company's common stock on the open market. The timing of purchases and the exact number of shares to be purchased will depend on market conditions. The 500,000 shares authorized for repurchase under this new stock repurchase plan represented approximately $3.2 \%$ of the Company's $15,814,662$ outstanding common shares as of August 21 , 2007. This new stock repurchase plan has no expiration date.

The Company's primary capital resource is shareholders' equity, which was $\$ 182,725,000$ at September 30,2007 . This amount represents an increase of $\$ 13,289,000$ from December 31, 2006, the net result of comprehensive income for the period of $\$ 20,885,000$, the issuance of common shares via the exercise of stock options for proceeds of $\$ 3,863,000$, the tax effects of stock option exercises of $\$ 1,707,000$, and the effect of stock option vesting of $\$ 579,000$, partially offset by the repurchase of common stock with an aggregate value of $\$ 2,685,000$, the retirement of common stock with an aggregate value of $\$ 4,859,000$ tendered by employees, in lieu of cash, to exercise stock options, and dividends paid of $\$ 6,201,000$. The Company's ratio of equity to total assets was $9.35 \%$, 8. $67 \%$, and $8.82 \%$ as of September 30, 2007, September 30, 2006, and December 31, 2006, respectively.

The following summarizes the ratios of capital to risk-adjusted assets for the periods indicated:


Off-Balance Sheet Items
The Bank has certain ongoing commitments under operating and capital leases. These commitments do not significantly impact operating results. As of September 30, 2007 commitments to extend credit and commitments related to the Bank's deposit overdraft privilege product were the Bank's only financial instruments with off-balance sheet risk. The Bank has not entered into any contracts for financial derivative instruments such as futures, swaps, options, etc. Commitments to extend credit were $\$ 695,913,000$ and $\$ 623,133,000$ at September 30, 2007 and December 31, 2006, respectively, and represent $45.3 \%$ of the total loans outstanding at September 30, 2007 versus 41.3\% at December 31, 2006. Commitments related to the Bank's deposit overdraft privilege product totaled $\$ 33,596,000$ and $\$ 33,290,000$ at September 30, 2007 and December 31, 2006, respectively.

Item 3. Quantitative and Qualitative Disclosures about Market Risk
Asset and Liability Management
The goal for managing the assets and liabilities of the Company is to maximize shareholder value and earnings while maintaining a high quality balance sheet without exposing the Company to undue interest rate risk. The Board of Directors has overall responsibility for the Company's interest rate risk management policies. The Company has an Asset and Liability Management Committee (ALCO) which establishes and monitors guidelines to control the sensitivity of earnings to changes in interest rates.

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

Company uses simulation models to forecast net interest margin, net income and market value of equity.

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

In the simulation of net interest margin and net income under various interest rate scenarios, the forecast balance sheet is processed against seven interest rate scenarios. These seven interest rate scenarios include a flat rate scenario, which assumes interest rates are unchanged in the future, and six additional rate ramp scenarios ranging from +300 to -300 basis points around the flat scenario in 100 basis point increments. These ramp scenarios assume that interest rates increase or decrease evenly (in a "ramp" fashion) over a twelve-month period and remain at the new levels beyond twelve months.

In the simulation of market value of equity under various interest rate scenarios, the forecast balance sheet is processed against seven interest rate scenarios. These seven interest rate scenarios include the flat rate scenario described above, and six additional rate shock scenarios ranging from +300 to -300 basis points around the flat scenario in 100 basis point increments. These rate shock scenarios assume that interest rates increase or decrease immediately (in a "shock" fashion) and remain at the new level in the future.

At September 30, 2007, the results of the simulations noted above indicate that given a "flat" balance sheet scenario, and if deposit rates track general interest rate changes by approximately $50 \%$, the Company's balance sheet is slightly liability sensitive. "Liability sensitive" implies that earnings decrease when interest rates rise, and increase when interest rates decrease. The magnitude of all the simulation results noted above is within the Bank's policy guidelines. The asset liability management policy limits aggregate market risk, as measured in this fashion, to an acceptable level within the context of risk-return trade-offs.

The simulation results noted above do not incorporate any management actions, which might moderate the negative consequences of interest rate deviations. Therefore, they do not reflect likely actual results, but serve as conservative estimates of interest rate risk.

At September 30, 2007 and 2006, the Company had no material derivative financial instruments.

There have been no material changes from the information regarding market risk disclosed under Market Risk Management" at Item 7 of the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Liquidity
The Company's principal source of asset liquidity is federal funds sold and marketable investment securities available for sale. At September 30, 2007, federal funds sold and investment securities available for sale totaled $\$ 239,730,000$, representing an increase of $\$ 40,575,000$ (20.4\%) from December 31, 2006, and an increase of $\$ 28,457,000$ (13.5\%) from September 30, 2006. In addition, the Company generates additional liquidity from its operating activities. The Company's profitability during the first nine months of 2007

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generated cash flows from operations of $\$ 23,518,000$ compared to $\$ 25,219,000$ during the first nine months of 2006 . Additional cash flows may be provided by financing activities, primarily the acceptance of deposits and borrowings from banks. Maturities and sales of investment securities produced cash inflows of $\$ 38,954,000$ and $\$ 0$ respectively, during the nine months ended September 30,2007 compared to $\$ 40,208,000$ and $\$ 10,780$, respectively, for the nine months ended September 30, 2006. During the nine months ended September 30, 2007, the Company invested $\$ 78,822,000$ in securities and $\$ 26,841,000$ in net loan growth, compared to investing $\$ 896,000$ and $\$ 122,648,000$ in securities and net loan growth, respectively, during the first nine months of 2006 . These changes in investment and loan balances contributed to net cash used by investing activities of $\$ 69,640,000$ and $\$ 75,870,000$ during the nine months ended September 30, 2007 and 2006, respectively. Financing activities provided net cash of $\$ 14,387,000$ and $\$ 37,380$ during the nine months ended September 30, 2007 and 2006, respectively. A decrease in deposit balances accounted for a $\$ 67,007,000$ use of financing funds during the nine months ended September 30, 2007 compared to a $\$ 28,377,000$ source of financing funds during the nine months ended September 30, 2006 from an increase in deposit balances. Federal funds borrowed increased $\$ 28,000,000$ and $\$ 9,700,000$ in the first nine months of 2007 and 2006 , respectively. The issuance of long-term other borrowings provided $\$ 50,000,000$ and $\$ 0$ of cash during the nine months ended September 30, 2007 and 2006, respectively. Increases in short-term other borrowings provided $\$ 10,136,000$ and $\$ 4,502,000$ of cash during the nine months ended September 30, 2007 and 2006, respectively. Dividends paid used $\$ 6,201,000$ and $\$ 5,692,000$ of cash during the nine months ended September 30, 2007 and 2006 , respectively. Repurchase of common stock used $\$ 2,685,000$ and $\$ 0$ of cash during the nine months ended September 30, 2007 and 2006, respectively. Also, the Company's liquidity is dependent on dividends received from the Bank. Dividends from the Bank are subject to certain regulatory restrictions.

## Item 4. Controls and Procedures

The Chief Executive Officer, Richard Smith, and the Chief Financial Officer, Thomas Reddish, evaluated the effectiveness of the Company's disclosure controls and procedures as of September 30, 2007 ("Evaluation Date"). Based on that evaluation, they concluded that as of the Evaluation Date the Company's disclosure controls and procedures are effective to allow timely communication to them of information relating to the Company and the Bank required to be disclosed in its filings with the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934, as amended ("Exchange Act"). Disclosure controls and procedures are Company controls and other procedures that are designed to ensure that information required to be disclosed by the Company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

No changes in the Company's internal control over financial reporting occurred during the first nine months of 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II - OTHER INFORMATION

Item 1 - Legal Proceedings

Due to the nature of the banking business, the Bank is at times party to various legal actions; all such actions are of a routine nature and arise in the normal course of business of the Bank.

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Item 1A - Risk Factors

There have been no material changes to the risk factors previously disclosed in Item 1A to Part I of our Annual Report on Form $10-\mathrm{K}$ for the year ended December 31, 2006.

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

The following table shows information concerning the common stock repurchased by the Company during the third quarter of 2007 pursuant to (i) the Company's stock repurchase plan originally announced on July 31, 2003, as amended on March 11, 2004, to conform with the Company's two-for-one stock split effective on April 9, 2004, and (ii) the Company's stock repurchase plan originally announced on August 21, 2007 which are discussed in more detail under "Capital Resources" at Part I, Item 2, of this report:

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 ma be purchased unde plans or programs

| Jul. 1-31, 2007 | - | - | - | 105,629 |
| :---: | :---: | :---: | :---: | :---: |
| Aug. 1-31, 2007 | 105,629 | \$20.97 | 105,629 | 500,000 |
| Sep. 1-30, 2007 | - | - | - | 500,000 |
| Total | 105,629 | \$20.97 | 105,629 | 500,000 |

During the quarter ended September 30, 2007, employees tendered 202,378 shares of the Company's common stock with an aggregate value of $\$ 4,859,000$, in lieu of cash, to exercise stock options.

Item 6 - Exhibits
3.1* Restated Articles of Incorporation dated May 9, 2003, filed as Exhibit 3.1 to TriCo's Quarterly Report on Form 10-Q for the quarter ended March 31, 2003.
3.2* Bylaws of TriCo Bancshares, as amended, filed as Exhibit 3.2 to TriCo's Form S-4 Registration Statement dated January 16, 2003 (No. 333-102546).

4* Certificate of Determination of Preferences of Series AA Junior Participating Preferred Stock filed as Exhibit 3.3 to TriCo's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001.
10.1* Rights Agreement dated June 25, 2001, between TriCo and Mellon Investor Services LLC filed as Exhibit 1 to TriCo's Form 8-A dated July 25, 2001.
10.2* Form of Change of Control Agreement dated as of August 23, 2005, between TriCo, Tri Counties Bank and each of Dan Bailey, Bruce Belton,

|  | Craig Carney, Gary Coelho, W.R. Hagstrom, Rick Miller, Richard O'Sullivan, Thomas Reddish, and Ray Rios filed as Exhibit 10.2 to TriCo's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005. |
| :---: | :---: |
| 10.3* | TriCo's 1995 Incentive Stock Option Plan filed as Exhibit 4.1 to TriCo's Form S-8 Registration Statement dated August 23, 1995 (No. 33-62063). |
| 10.4* | TriCo's 2001 Stock Option Plan as amended filed as Exhibit 10.7 to TriCo's Annual Report on Form 10-K for the year ended December 31, 2004 . |
| 10.5* | Amended Employment Agreement between TriCo and Richard Smith dated March 20, 2007 filed as Exhibit 10.1 to TriCo's Report on Form 8-K dated March 20, 2007. |
| 10.6* | Tri Counties Bank Executive Deferred Compensation Plan dated September 1, 1987, as restated April 1, 1992, and amended and restated effective as of January 1, 2004 filed as Exhibit 10.9 to TriCo's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005. |
| 10.7* | Tri Counties Bank Deferred Compensation Plan for Directors effective January 1, 2005 filed as Exhibit 10.10 to TriCo's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005. |
| 10.8* | 2005 Tri Counties Bank Deferred Compensation Plan for Executives and Directors effective January 1, 2005 filed as Exhibit 10.11 to TriCo's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005. |
| 10.9* | Tri Counties Bank Supplemental Retirement Plan for Directors dated September 1, 1987, as restated January 1, 2001, and amended and restated January 1, 2004 filed as Exhibit 10.12 to TriCo's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004. |
| 10.10* | ```2004 TriCo Bancshares Supplemental Retirement Plan for Directors effective January 1, 2004 filed as Exhibit 10.13 to TriCo's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004.``` |
| 10.11* | Tri Counties Bank Supplemental Executive Retirement Plan effective September 1, 1987, as amended and restated January 1, 2004 filed as Exhibit 10.14 to TriCo's Quarterly Report on Form $10-Q$ for the quarter ended June 30, 2004. |

10.12* 2004 TriCo Bancshares Supplemental Executive Retirement Plan effective January 1, 2004 filed as Exhibit 10.15 to TriCo's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004.
10.13* Form of Joint Beneficiary Agreement effective March 31, 2003 between Tri Counties Bank and each of Craig Carney, Richard Miller, Richard O'Sullivan, Thomas Reddish, and Richard Smith, filed as Exhibit 10.14 to TriCo's Quarterly Report on Form $10-Q$ for the quarter ended September 30, 2003.
10.14* Form of Joint Beneficiary Agreement effective March 31, 2003 between Tri Counties Bank and each of Don Amaral, William Casey, Craig Compton, John Hasbrook, Michael Koehnen, Donald Murphy, Carroll Taresh, and Alex

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|  | Vereshagin, filed as Exhibit 10.15 to TriCo's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003. |
| :---: | :---: |
| 10.15* | Form of Tri-Counties Bank Executive Long Term Care Agreement effective June 10, 2003 between Tri Counties Bank and each of Craig Carney, Richard Miller, Richard O'Sullivan and Thomas Reddish, filed as Exhibit 10.16 to TriCo's Quarterly Report on Form $10-Q$ for the quarter ended September 30, 2003. |
| 10.16* | Form of Tri-Counties Bank Director Long Term Care Agreement effective June 10, 2003 between Tri Counties Bank and each of Don Amaral, William Casey, Craig Compton, John Hasbrook, Michael Koehnen, Donald Murphy, Carroll Taresh, and Alex Verischagin, filed as Exhibit 10.17 to TriCo's Quarterly Report on Form $10-Q$ for the quarter ended September 30, 2003. |
| 10.17* | Form of Indemnification Agreement between TriCo Bancshares/Tri Counties Bank and each of the directors of TriCo Bancshares/Tri Counties Bank effective on the date that each director is first elected, filed as Exhibit 10.18 to TriCo's Annual Report on Form 10-K for the year ended December 31, 2003. |
| 10.18* | Form of Indemnification Agreement between TriCo Bancshares/Tri Counties Bank and each of Dan Bailey, W.R. Hagstrom, Craig Carney, Richard Miller, Raymond Rios, Richard O'Sullivan, Thomas Reddish, and Richard Smith filed as Exhibit 10.21 to TriCo's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004. |
| 21.1 | Tri Counties Bank, a California banking corporation, TriCo Capital Trust I, a Delaware business trust, and TriCo Capital Trust II, a Delaware business trust, are the only subsidiaries of Registrant |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of CEO |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of CFO |
| 32.1 | Section 1350 Certification of CEO |
| 32.2 | Section 1350 Certification of CFO |

## 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.

TRICO BANCSHARES (Registrant)

Date: November 6, 2007
/s/ Thomas J. Reddish
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Thomas J. Reddish
Executive Vice President and
Chief Financial Officer

Exhibit 31.1

Rule 13a-14(a)/15d-14(a) Certification of CEO

I, Richard P. Smith, certify that;

1. I have reviewed this quarterly report on Form 10-Q of TriCo Bancshares;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Richard P. Smith<br>Richard P. Smith<br>President and Chief Executive Officer

Exhibit 31.2

Rule 13a-14(a)/15d-14(a) Certification of CFO

I, Thomas J. Reddish, certify that;

1. I have reviewed this quarterly report on Form 10-Q of TriCo Bancshares;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules $13 a-15(e)$ and $15 d-15(e))$ and internal control over financial reporting (as defined in Exchange Act Rules $13 a-15(f)$ and $15 d-15(f))$ for the registrant and we have:
a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting

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which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2007
/s/ Thomas J. Reddish

Thomas J. Reddish Executive Vice President and Chief Financial Officer

Exhibit 32.1

Section 1350 Certification of CEO

In connection with the Quarterly Report of TriCo Bancshares (the "Company") on Form 10-Q for the period ended September 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Richard P. Smith, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:
(1) The Report fully complies with the requirements of section $13(a)$ or 15 (d) of the Securities Exchange Act of 1934; and
(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

## /s/ Richard P. Smith

Richard P. Smith
President and Chief Executive Officer

A signed original of this written statement required by Section 906 has been provided to TriCo Bancshares and will be retained by TriCo Bancshares and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 32.2

Section 1350 Certification of CFO

In connection with the Quarterly Report of TriCo Bancshares (the "Company") on Form 10-Q for the period ended September 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Thomas J. Reddish, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350 , as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 , that:
(1) The Report fully complies with the requirements of section $13(a)$ or $15(d)$ of the Securities Exchange Act of 1934; and
( 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

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    /s/ Thomas J. Reddish
    Thomas J. Reddish
    Executive Vice President and Chief Financial Officer
A signed original of this written statement required by Section 906 has been
provided to TriCo Bancshares and will be retained by TriCo Bancshares and
furnished to the Securities and Exchange Commission or its staff upon request.
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