TRICO BANCSHARES /
Form 10-Q
August 08, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

for the quarterly period ended: June 30, 2014

Transition Report Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

for the transition period from __________ to __________.

Commission File Number: 000-10661

TriCo Bancshares

(Exact Name of Registrant as Specified in Its Charter)

CALIFORNIA	**94-2792841**
(State or Other Jurisdiction	**(I.R.S. Employer**
of Incorporation or Organization)	**Identification Number)**

63 Constitution Drive

Chico, California 95973

(Address of Principal Executive Offices)(Zip Code)

(530) 898-0300

(Registrant s Telephone Number, Including Area Code)

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. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes ¨ No

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ Yes x No

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

Common stock, no par value: 16,133,414 shares outstanding as of August 1, 2014

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TriCo Bancshares

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FORWARD-LOOKING STATEMENTS

This report on Form 10-Q contains forward-looking statements about TriCo Bancshares (the Company) that are subject to the protection of the safe harbor provisions contained in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on the current knowledge and belief of the Company s management (Management) and include information concerning the Company s possible or assumed future financial condition and results of operations. When you see any of the words believes , expects , anticipates , estimates , or similar expression it may mean the Company is 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-K for the year ended December 31, 2013, 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 suggested by any forward-looking statement made in this report. Such Form 10-K and this report should be read to put any forward-looking statements in context and to gain a more complete understanding of the risks and uncertainties involved in the Company s business. Any forward-looking statement may turn out to be wrong and cannot be guaranteed. The Company does not intend to update any forward-looking statement after the date of this report.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

TRICO BANCSHARES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data; unaudited)

	At June 30, 2014	At December 31, 2013
Assets:		
Cash and due from banks	$ 76,104	$ 76,915
Cash at Federal Reserve and other banks	268,279	521,453
Cash and cash equivalents	344,383	598,368
Investment securities:		
Available for sale	91,514	104,647
Held to maturity	422,502	240,504
Restricted equity securities	11,582	9,163
Loans held for sale	1,671	2,270
Loans	1,738,586	1,672,007
Allowance for loan losses	(39,968)	(38,245)
Total loans, net	1,698,618	1,633,762
Foreclosed assets, net	5,785	6,262
Premises and equipment, net	31,880	31,612
Cash value of life insurance	53,106	52,309
Accrued interest receivable	7,008	6,516
Goodwill	15,519	15,519
Other intangible assets, net	779	883
Mortgage servicing rights	5,909	6,165
Other assets	34,225	36,086
Total assets	$ 2,724,481	$ 2,744,066
Liabilities and Shareholders Equity:		
Liabilities:		
Deposits:		
Noninterest-bearing demand	$ 720,743	$ 789,458
Interest-bearing	1,664,453	1,621,025
Total deposits	2,385,196	2,410,483
Accrued interest payable	849	938
Reserve for unfunded commitments	2,045	2,415

Other liabilities	28,135	31,711
Other borrowings	6,075	6,335
Junior subordinated debt	41,238	41,238
Total liabilities	2,463,538	2,493,120
Commitments and contingencies (Note 18)		
Shareholders equity:		
Common stock, no par value: 50,000,000 shares authorized; issued and outstanding:		
16,133,414 at June 30, 2014	92,322	
16,076,662 at December 31, 2013		89,356
Retained earnings	166,433	159,733
Accumulated other comprehensive income, net of tax	2,188	1,857
Total shareholders equity	260,943	250,946
Total liabilities and shareholders equity	$ 2,724,481	$ 2,744,066

The accompanying notes are an integral part of these 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 June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Interest and dividend income:				
Loans, including fees	$ 24,433	$ 23,883	$ 48,171	$ 47,955
Investment securities:				
Taxable	3,440	1,149	6,262	2,280
Tax exempt	117	150	253	251
Dividends	154	80	308	136
Interest bearing cash at				
Federal Reserve and other banks	274	494	583	940
Total interest and dividend income	28,418	25,756	55,577	51,562
Interest expense:				
Deposits	768	855	1,550	1,780
Other borrowings	1	1	2	2
Junior subordinated debt	306	311	610	622
Total interest expense	1,075	1,167	2,162	2,404
Net interest income	27,343	24,589	53,415	49,158
Provision for (benefit from) loan losses	1,708	614	353	(494)
Net interest income after provision for (benefit from) loan losses	25,635	23,975	53,062	49,652
Noninterest income:				
Service charges and fees	5,519	6,693	10,981	12,622
Gain on sale of loans	514	1,590	978	3,884
Commissions on sale of non-deposit investment products	843	841	1,614	1,602
Increase in cash value of life insurance	400	380	797	806
Other	601	627	1,802	1,435
Total noninterest income	7,877	10,131	16,172	20,349
Noninterest expense:				
Salaries and related benefits	13,317	12,890	26,620	25,851
Other	11,799	10,619	21,813	19,259
Total noninterest expense	25,116	23,509	48,433	45,110

Income before income taxes	8,396	10,597	20,801	24,891
Provision for income taxes	3,537	4,272	8,577	10,089
Net income	$ 4,859	$ 6,325	$ 12,224	$ 14,802
Earnings per share:				
Basic	$ 0.30	$ 0.39	$ 0.76	$ 0.92
Diluted	$ 0.30	$ 0.39	$ 0.75	$ 0.92

See accompanying notes to unaudited condensed consolidated financial statements.

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TRICO BANCSHARES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands; unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Net income	$ 4,859	$ 6,325	$ 12,224	$ 14,802
Other comprehensive income (loss), net of tax:				
Unrealized gains (losses) on available for sale securities arising during the period	381	(1,489)	321	(2,110)
Change in minimum pension liability	5		10	
Other comprehensive income (loss)	386	(1,489)	331	(2,110)
Comprehensive income	$ 5,245	$ 4,836	$ 12,555	$ 12,692

See accompanying notes to unaudited condensed consolidated financial statements.

TRICO BANCSHARES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(In thousands, except share and per share data; unaudited)

	Shares of Common Stock	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2012	16,000,838	$ 85,561	$ 141,639	$ 2,159	$ 229,359
Net income			14,802		14,802
Other comprehensive loss				(2,110)	(2,110)
Stock option vesting		540			540
Stock options exercised	230,765	2,937			2,937
Tax benefit of stock options exercised		342			342
Repurchase of common stock	(166,134)	(892)	(2,445)		(3,337)
Dividends paid ($0.20 per share)			(3,207)		(3,207)
Balance at June 30, 2013	16,065,469	$ 88,488	$ 150,789	$ 49	$ 239,326
Balance at December 31, 2013	16,076,662	$ 89,356	$ 159,733	$ 1,857	$ 250,946

Net income			12,224		12,224
Other comprehensive loss				331	331
Stock option vesting		534			534
Stock options exercised	160,020	2,786			2,786
Tax benefit of stock options exercised		220			220
Repurchase of common stock	(103,268)	(574)	(1,977)		(2,551)
Dividends paid ($0.22 per share)			(3,547)		(3,547)
Balance at June 30, 2014	16,133,414	$ 92,322	$ 166,433	$ 2,188	$ 260,943

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 six months ended June 30, 2014	For the six months ended June 30, 2013
Operating activities:		
Net income	$ 12,224	$ 14,802
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of premises and equipment, and amortization	2,704	1,962
Amortization of intangible assets	104	105
Provision for (benefit from) loan losses	353	(494)
Amortization of investment securities premium, net	349	411
Originations of loans for resale	(31,032)	(94,623)
Proceeds from sale of loans originated for resale	32,333	103,089
Gain on sale of loans	(978)	(3,884)
Change in market value of mortgage servicing rights	532	(130)
Provision for losses on foreclosed assets	40	573
Gain on sale of foreclosed assets	(1,468)	(1,166)
(Gain) loss on disposal of fixed assets	(70)	14
Increase in cash value of life insurance	(797)	(806)
Stock option vesting expense	534	540
Stock option excess tax benefits	(220)	(342)
Change in:		
Reserve for unfunded commitments	(370)	(405)
Interest receivable	(492)	(703)
Interest payable	(89)	(92)
Other assets and liabilities, net	(2,256)	(1,277)
Net cash from operating activities	11,401	17,574
Investing activities:		
Proceeds from maturities of securities available for sale	13,464	31,471
Proceeds from maturities of securities held to maturity	9,548	218
Purchases of securities held to maturity	(191,673)	(85,877)
(Purchase) redemption of restricted equity securities	(2,419)	484
Loan origination and principal collections, net	(49,635)	(34,239)
Loans purchased	(19,690)	(62,698)
Improvement of foreclosed assets	(462)	
Proceeds from sale of other real estate owned	6,483	10,202
Proceeds from sale of premises and equipment	120	2
Purchases of premises and equipment	(2,483)	(5,700)

Life insurance proceeds		706
Net cash (used) provided by investing activities	(236,747)	(145,431)
Financing activities:		
Net decrease in deposits	(25,287)	(23,000)
Net change in other borrowings	(260)	(2,622)
Stock option excess tax benefits	220	342
Repurchase of common stock	(292)	(501)
Dividends paid	(3,547)	(3,207)
Exercise of stock options	527	101
Net cash used by financing activities	(28,639)	(28,887)
Net change in cash and cash equivalents	(253,985)	(156,744)
Cash and cash equivalents and beginning of year	598,368	748,899
Cash and cash equivalents at end of period	$ 344,383	$ 592,155
Supplemental disclosure of noncash activities:		
Unrealized gain (loss) on securities available for sale	$ 553	$ (3,642)
Loans transferred to foreclosed assets	$ 4,116	$ 7,164
Market value of shares tendered in-lieu of cash to pay for exercise of options and/or related taxes	$ 2,259	$ 2,836
Supplemental disclosure of cash flow activity:		
Cash paid for interest expense	$ 2,251	$ 2,496
Cash paid for income taxes	$ 11,500	$ 12,900

See accompanying notes to unaudited condensed consolidated financial statements.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Summary of Significant Accounting Policies

Description of Business and Basis of Presentation

TriCo Bancshares is a California corporation organized to act as a bank holding company for Tri Counties Bank (the Bank). The Bank is a state-chartered financial institution that is engaged in the general commercial banking business 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. Tri Counties Bank currently operates from 41 traditional branches and 19 in-store branches. The Company also formed two subsidiary business trusts, TriCo Capital Trust I and TriCo Capital Trust II (collectively, the Trusts), to issue trust preferred securities.

The following unaudited condensed financial statements of the Company have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading. In the opinion of Management, all adjustments, consisting solely of normal recurring adjustments, considered necessary for a fair presentation of results for the interim periods presented have been included. These interim condensed consolidated financial statements should be read in conjunction with the financial statements and related notes contained in the Company s 2013 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 7, 2014.

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned financial subsidiary, Tri Counties Bank. All significant intercompany balances and transactions have been eliminated. TriCo Capital Trust I and TriCo Capital Trust II, which were formed solely for the purpose of issuing trust preferred securities, are unconsolidated subsidiaries as the Company is not the primary beneficiary of the trusts and they are not considered variable interest entities. Operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. Certain amounts in the consolidated financial statements for the year ended December 31, 2013 and for the three and six months ended June 30, 2014 may have been reclassified to conform to the presentation of the condensed consolidated financial statements in 2014.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. 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, indemnification asset, foreclosed assets, goodwill and other intangible assets, income taxes, fair value of assets acquired and liabilities assumed in business combinations, the valuation of securities available-for-sale, and the valuation of mortgage servicing rights are the only accounting estimates that materially affect the Company s consolidated financial statements.

During each of 2011 and 2010, the Bank assumed the banking operations of a failed financial institution from the FDIC under whole bank purchase agreement. The acquired assets and assumed liabilities were measured at estimated fair value values under the acquisition method of accounting. The Company made significant estimates and exercised significant judgment in accounting for the acquisitions. The Company determined loan fair values based on loan file reviews, loan risk ratings, appraised collateral values, expected cash flows and historical loss factors. Foreclosed assets were primarily valued based on appraised values of the repossessed loan collateral. An identifiable intangible was also recorded representing the fair value of the core deposit customer base based on an evaluation of the cost of such deposits relative to alternative funding sources. The fair value of time deposits and borrowings were determined based on the present value of estimated future cash flows using current rates as of the acquisition date.

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. The Company currently classifies all its operations into one business segment that it denotes as community banking.

Cash and Cash Equivalents

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

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. These securities are carried at cost adjusted for amortization of premium and accretion of discount, computed by the effective interest method over their contractual lives. All other securities not included in trading or held to maturity are classified as available for sale. Available for sale securities are recorded at fair value. Unrealized gains and losses, net of the related tax effect, on available for sale securities are reported as a separate component of other accumulated comprehensive income in shareholders equity until realized. Premiums and discounts are amortized or accreted over the life of the related investment security as an adjustment to yield using the effective interest method. Dividend and interest income are recognized when earned. Realized gains and losses are derived from the amortized cost of the security sold. During the six months ended June 30, 2014 and the year ended December 31, 2013, the Company did not have any securities classified as trading. During the three months ended March 31, 2013, the Company did not have any securities classified as held to maturity.

The Company assesses other-than-temporary impairment (OTTI) based on whether it intends to sell a security or if it is likely that the Company would be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity. For debt securities, if the Company intends to sell the security or it is likely that it will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If the Company does not intend to sell the security and it is not likely that it will be required to sell the security but it does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (OCI). Impairment losses related to all other factors are presented as separate categories within OCI. The accretion of the amount recorded in OCI increases the carrying value of the investment and does not affect earnings. If there is an indication of additional credit losses the security is re-evaluated according to the procedures described above. No OTTI losses were recognized during the six months ended June 30, 2014 or the year ended December 31, 2013.

Restricted Equity Securities

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

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

Loans Held for Sale

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

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

Loans and Allowance for Loan Losses

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

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

An allowance for loan losses for originated loans is established through a provision for loan losses charged to expense. The allowance is maintained at a level which, in Management s judgment, is adequate to absorb probable incurred credit losses inherent in the loan portfolio as of the balance sheet date. Originated loans and deposit related overdrafts are charged against the allowance for loan losses when Management believes that the collectability of the principal is unlikely or, with respect to consumer installment loans, according to an established delinquency schedule. The allowance is an amount that Management believes will be adequate to absorb probable incurred losses inherent in existing loans and leases, based on evaluations of the collectability, impairment and prior loss experience of loans and leases. The evaluations take into consideration such factors as changes in the nature and size of the portfolio, overall portfolio quality, loan concentrations, specific problem loans, and current economic conditions that may affect the borrower s ability to pay. The Company defines an originated loan as impaired when it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement.

Impaired originated loans are measured based on the present value of expected future cash flows discounted at the loan s original effective interest rate. As a practical expedient, impairment may be measured based on the loan s observable market price or the fair value of the collateral if the loan is collateral dependent. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a valuation allowance.

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

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

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

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

During the three months ended March 31, 2013, the Company changed the method it uses to estimate net sale proceeds from real estate collateral sales when calculating the allowance for loan losses associated with impaired real estate collateral dependent loans. Previously, the Company used the greater of fifteen percent or actual estimated selling costs. Currently, the Company uses the actual estimated selling costs, and an adjustment to appraised value based on the age of the appraisal. These changes are intended to more accurately reflect the estimated net sale proceeds from the sale of impaired collateral dependent real estate loans. This change in methodology resulted in the allowance for loan losses as of March 31, 2013 being $494,000 more than it would have been without this change in methodology.

During the three months ended June 30, 2013, the Company modified its loss migration analysis methodology used to determine the formula allowance factors. When the Company originally established its loss migration analysis methodology during the quarter ended March 31, 2012, it reviewed the loss experience of each rolling twelve month period over the previous three years in order to calculate an annualized loss rate by loan category and risk rating. The use of three years of loss experience data was originally used because that was the extent of the detailed loss data by loan category and risk rating that was available at the time. This three year historical look-back period was used through the quarter ended March 31, 2013. Starting with the quarter ended June 30, 2013, the Company reviews all available detailed loss experience data, going back to, and including, the twelve month period ended June 30, 2009, and does not limit the look-back period to the most recent three years of historical loss data. Using this data, the Company calculates loss factors for each quarter from the quarter ended June 30, 2009 to the most recent quarter. The Company then calculates a weighted average formula allowance factor for each loan category and risk rating with the most recent quarterly loss factor being weighted 125%, the quarter ended June 30, 2009 loss factor being weighted 75%, and the loss factors for all the quarters between the most recent quarter and the quarter ended June 30, 2009, being weighted on a linear scale from 75% to 125%. This change is intended to more accurately reflect the risk inherent in the loan portfolio by considering historical loss data for all years as the data for new periods becomes available. This change in methodology resulted in the allowance for loan losses as of June 30, 2013 being $1,314,000 more than it would have been without this change in methodology.

During the three months ended September 30, 2013, the Company modified its methodology used to determine the allowance for changing environmental factors. Previously, the Company compared the current value of each environmental factor to a fixed baseline value. The deviation of the current value from the baseline value was then multiplied by a conversion factor to determine the required allowance related to each environmental factor. As of September 30, 2013, the Company replaced the fixed baseline values with average baseline values derived from historical averages, and adjusted the conversion factors. This change is intended to more accurately reflect the risk inherent in the portfolio by recognizing that baseline, or normal, levels for environmental factors may change over time. This change in methodology resulted in the allowance for loan losses as of September 30, 2013 being $1,665,000 more than it would have been without this change in methodology.

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During the three months ended March 31, 2014, the Company modified its methodology used to determine the allowance for changing environmental factors by adding a new environmental factor based on the California Home Affordability Index (CHAI). The CHAI measures the percentage of households in California that can afford to purchase the median priced home in California based on current home prices and mortgage interest rates. The use of the CHAI environmental factor consists of comparing the current CHAI to its historical baseline, and allows management to consider the adverse impact that a lower than historical CHAI may have on general economic activity and the performance of our borrowers. Based on an analysis of historical data, management believes this environmental factor gives a better estimate of current economic activity compared to other environmental factors that may lag current economic activity to some extent. This change in methodology resulted in no change to the allowance for loan losses as of March 31, 2014 compared to what it would have been without this change in methodology.

During the three months ended June 30, 2014, the Company refined the method it uses to evaluate historical losses for the purpose of estimating the pool allowance for unimpaired loans. In the third quarter of 2010, the Company moved from a six point grading system (Grades A-F) to a nine point risk rating system (Risk Ratings 1-9), primarily to allow for more distinction within the Pass risk rating. Initially, there was not sufficient loss experience within the nine point scale to complete a migration analysis for all nine risk ratings, all loans risk rated Pass or 2-5 were grouped together, a loss rate was calculated for that group, and that loss rate was established as the loss rate for risk rating 4. The reserve ratios for risk ratings 2, 3 and 5 were then interpolated from that figure. As of June 30, 2014, the Company was able to compile twelve quarters of historical loss information for all risk ratings and use that information to calculate the loss rates for each of the nine risk ratings without interpolation. This refinement led to an increase of $1,438,000 in the reserve requirement for unimpaired loans, driven primarily by home equity lines of credit with a risk rating of 5 or Pass-Watch.

Loans purchased or acquired in a business combination are referred to as acquired loans. Acquired loans are valued as of the acquisition date in accordance with Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 805, *Business Combinations*. Loans acquired with evidence of credit deterioration since origination for which it is probable that all contractually required payments will not be collected are referred to as purchased credit impaired (PCI) loans. PCI loans are accounted for under FASB ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. Under FASB ASC Topic 805 and FASB ASC Topic 310-30, PCI loans are recorded at fair value at acquisition date, factoring in credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for loan losses is not carried over or recorded as of the acquisition date. Fair value is defined as the present value of the future estimated principal and interest payments of the loan, with the discount rate used in the present value calculation representing the estimated effective yield of the loan. Default rates, loss severity, and prepayment speed assumptions are periodically reassessed and our estimate of future payments is adjusted accordingly. The difference between contractual future payments and estimated future payments is referred to as the nonaccretable difference. The difference between estimated future payments and the present value of the estimated future payments is referred to as the accretable yield. The accretable yield represents the amount that is expected to be recorded as interest income over the remaining life of the loan. If after acquisition, the Company determines that the estimated future cash flows of a PCI loan are expected to be more than originally estimated, an increase in the discount rate (effective yield) would be made such that the newly increased accretable yield would be recognized, on a level yield basis, over the remaining estimated life of the loan. If, after acquisition, the Company determines that the estimated future cash flows of a PCI loan are expected to be less than previously estimated, the discount rate would first be reduced until the present value of the reduced cash flow estimate equals the previous present value however, the discount rate may not be lowered below its original level at acquisition. If the discount rate has been lowered to its original level and the present value has not been sufficiently lowered, an allowance for loan loss would be established through a provision for loan losses charged to expense to decrease the present value to the required level. If the estimated cash flows improve after an allowance has been established for a loan, the allowance may be partially or fully reversed depending on the improvement in the estimated cash flows. Only after the allowance has been fully reversed may the discount rate be increased. PCI loans are put on nonaccrual status when cash flows cannot be reasonably estimated. PCI loans on nonaccrual status are accounted for using the cost recovery method or cash basis method of income recognition. PCI loans are charged off when evidence suggests cash flows are not recoverable. Foreclosed assets from PCI loans are recorded in foreclosed assets at fair value with the fair value at time of foreclosure representing cash flow from the loan. ASC 310-30 allows PCI loans with similar risk characteristics and acquisition time frame to be pooled and have their cash flows aggregated as if they were one loan. The Company elected to use the pooled method of ASC 310-30 for PCI other loans in the acquisition of certain assets and liabilities of Granite Community Bank, N.A. (Granite) during 2010 and Citizens Bank of Northern California (Citizens) during 2011.

Acquired loans that are not PCI loans are referred to as purchased not credit impaired (PNCI) loans. PNCI loans are accounted for under FASB ASC Topic 310-20, *Receivables Nonrefundable Fees and Other Costs,* in which interest income is accrued on a level-yield basis for performing loans. For income recognition purposes, this method assumes that all contractual cash flows will be collected, and no allowance for loan losses is established at the time of acquisition. Post-acquisition date, an allowance for loan losses may need to be established for acquired loans through a provision charged to earnings for credit losses incurred subsequent to acquisition. Under ASC 310-20, the loss would be measured based on the probable shortfall in relation to the contractual note requirements, consistent with our allowance for loan loss policy for similar loans.

Throughout these financial statements, and in particular in Note 4 and Note 5, when we refer to Loans or Allowance for loan losses we mean all categories of loans, including Originated, PNCI, PCI cash basis, and PCI other. When we are not referring to all categories of loans, we will indicate which we are referring to Originated, PNCI, PCI cash basis, or PCI other.

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

Loans are also categorized as covered or noncovered . Covered loans refer to loans covered by a Federal Deposit Insurance Corporation (FDIC) loss sharing agreement. Noncovered loans refer to loans not covered by a FDIC loss sharing agreement.

Foreclosed Assets

Foreclosed assets include assets acquired through, or in lieu of, loan foreclosure. Foreclosed assets are held for sale and are initially recorded at fair value less estimated costs to sell at the date of foreclosure, establishing a new cost basis. 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. Gain or loss on sale of foreclosed assets is included in noninterest income. Foreclosed assets that are not subject to a FDIC loss-share agreement are referred to as noncovered foreclosed assets.

Foreclosed assets acquired through FDIC-assisted acquisitions that are subject to a FDIC loss-share agreement, and all assets acquired via foreclosure of covered loans are referred to as covered foreclosed assets. Covered foreclosed assets are reported exclusive of expected reimbursement cash flows from the FDIC. Foreclosed covered loan collateral is transferred into covered foreclosed assets at the loan s carrying value, inclusive of the acquisition date fair value discount.

Covered foreclosed assets are initially recorded at estimated fair value less estimated costs to sell on the acquisition date based on similar market comparable valuations less estimated selling costs. Any subsequent valuation adjustments due to declines in fair value will be charged to noninterest expense, and will be mostly offset by noninterest income representing the corresponding increase to the FDIC indemnification asset for the offsetting loss reimbursement amount. Any recoveries of previous valuation adjustments will be credited to noninterest expense with a corresponding charge to noninterest income for the portion of the recovery that is due to the FDIC.

Premises and Equipment

Land is carried at cost. Land improvements, buildings and equipment, including those acquired under capital lease, are stated at cost less accumulated depreciation and amortization. Depreciation and amortization expenses are computed using the straight-line method over the 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.

Goodwill and Other Intangible Assets

Goodwill represents the excess of costs over fair value of net 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 an identifiable intangible asset consisting of core deposit intangibles (CDI). CDI are amortized over their respective estimated useful lives, and reviewed for impairment.

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 consolidated balance sheet.

As of 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. The Company may choose to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, the Company determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then goodwill is deemed not to be impaired. However, if the Company concludes otherwise, or if the Company elected not to first assess qualitative factors, then the Company performs the first step of a two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. Second, if the carrying amount of the 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. Currently, and historically, the Company is comprised of only one reporting unit that operates within the business segment it has identified as community banking . Goodwill was not impaired as of December 31, 2013 because the fair value of the reporting unit exceeded its carrying value.

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Mortgage Servicing Rights

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

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

Indemnification Asset

The Company accounts for amounts receivable or payable under its loss-share agreements entered into with the FDIC in connection with its purchase and assumption of certain assets and liabilities of Granite as indemnification assets in accordance with FASB ASC Topic 805, *Business Combinations*. FDIC indemnification assets are initially recorded at fair value, based on the discounted value of expected future cash flows under the loss-share agreements. The difference between the fair value and the undiscounted cash flows the Company expects to collect from the FDIC will be accreted into noninterest income over the life of the FDIC indemnification asset. FDIC indemnification assets are reviewed quarterly and adjusted for any changes in expected cash flows based on recent performance and expectations for future performance of the covered portfolios. These adjustments are measured on the same basis as the related covered loans and covered other real estate owned. Any increases in cash flow of the covered assets over those expected will reduce the FDIC indemnification asset and any decreases in cash flow of the covered assets under those expected will increase the FDIC indemnification asset. Increases and decreases to the FDIC indemnification asset are recorded as adjustments to noninterest income.

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 collectability, and prior loss experience of unfunded commitments. The evaluations take into consideration such factors as changes in the nature and size of the loan portfolio, overall loan portfolio quality, loan concentrations, specific problem loans and related unfunded commitments, and current economic conditions that may affect the borrower s or depositor s ability to pay.

During the three months ended June 30, 2013, the Company modified the methodology employed to estimate potential losses on unfunded commitments. Similar to the Allowance for Loan Losses, the Company performs a migration analysis of historical loss experience. Prior to this quarter, the loss experience of each quarter over the previous three years was reviewed in order to calculate an annualized loss rate by loan category. Going forward, the Company has chosen to review all loss experience available since the conversion to a loss migration analysis. This change is intended to more accurately reflect the risk inherent in the unfunded commitments and appropriately consider all losses incurred in prior years. This change in methodology resulted in the reserve for unfunded commitments as of June 30, 2013 being $335,000 more than it would have been without this change in methodology.

Income Taxes

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

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.

Geographical Descriptions

For the purpose of describing the geographical location of the Company s loans, the Company has defined northern California as that area of California north of, and including, Stockton; central California as that area of the state south of Stockton, to and including, Bakersfield; and southern California as that area of the state south of Bakersfield.

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Reclassifications

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

Recent Accounting Pronouncements

FASB issued ASU No. 2014-04, *Receivables (Topic 310): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* ASU 2014-04 clarifies when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. ASU 2014-04 is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. ASU 2014-04 is not expected to have a significant impact on the Company s consolidated financial statements.

FASB issued ASU No. 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.* ASU 2014-08 improves the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity s operations and financial results. ASU 2014-08 requires expanded disclosures for discontinued operations that provide users of financial statements with more information about the assets, liabilities, revenues, and expenses of discontinued operations. ASU 2014-08 also requires an entity to disclose the pretax profit or loss of an individually significant component of an entity that does not qualify for discontinued operations reporting, and provide users with information about the financial effects of significant disposals that do not qualify for discontinued operations reporting. The amendments in ASU 2014-08 include several changes to the Accounting Standards Codification to improve the organization and readability of Subtopic 205-20 and Subtopic 360-10, Property, Plant, and Equipment Overall. ASU 2014-08 is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. ASU 2014-08 is not expected to have a significant impact on the Company s consolidated financial statements.

FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606).* The core principle of the guidance under ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for a public entity for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. ASU 2014-09 is not expected to have a significant impact on the Company s consolidated financial statements.

FASB issued ASU No. 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures.* ASU 2014-11 requires that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, ASU 2014-11 requires separate accounting for repurchase financings, which entails the transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty. ASU 2014-11 requires entities to disclose certain information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements. In addition, ASU 2014-11 requires disclosures related to collateral, remaining contractual tenor and of the potential risks associated with repurchase agreements, securities lending transactions and repurchase-to-maturity transactions. ASU 2014-11 is effective for public business entities for the first interim or annual period beginning after December 15, 2014. An entity is required to present changes in accounting for transactions outstanding on the effective date as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Earlier application for a public business entity is prohibited. ASU 2014-11 is not expected to have a significant impact on the Company s consolidated financial statements.

FASB issued ASU No. 2014-12, *Compensation Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be achieved after the Requisite Service Period.* ASU 2014-12 requires that a performance target that affects the vesting of a share-based payment award and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718 as it relates to awards with performance conditions that affect vesting to account for such awards. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. The stated vesting period (which includes the period in which the performance target could be achieved) may differ from the requisite service period. Current U.S. GAAP does not contain explicit guidance on whether to treat a performance target that could be achieved after the requisite service period as a performance condition that affects vesting or as a nonvesting condition that affects the grant-date fair value of an award. ASU 2014-12 provides explicit guidance for those awards. For all entities, ASU 2014-12 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted.

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Note 2 Business Combinations

On January 21, 2014, TriCo announced that it had entered into an Agreement and Plan of Merger and Reorganization under which it would acquire North Valley Bancorp. North Valley Bancorp shareholders will receive a fixed exchange ratio of 0.9433 shares of TriCo common stock for each share of North Valley Bancorp common stock, which would provide North Valley Bancorp shareholders with aggregate ownership, on a pro forma basis, of approximately 28.6% of the common stock of the combined company. Based on TriCo s closing stock price of $27.66 on January 17, 2014, North Valley Bancorp shareholders would have received consideration valued at approximately $26.09 per share.

The merger will not be completed unless a number of customary closing conditions are met, including, among others, approval of the merger by shareholders of both companies, the registration of the offering of the TriCo common stock to the North Valley Bancorp shareholders under the Securities Act of 1933, receipt of required regulatory and other approvals and the expiration of applicable statutory waiting periods, the accuracy of specified representations and warranties of each party, the receipt of tax opinions confirming certain tax aspects of the merger, North Valley Bancorp s satisfaction of certain financial measures shortly prior to closing, and the absence of any injunctions or other legal restraints. If the Merger Agreement is terminated, under certain circumstances, TriCo could be required to pay a termination fee to North Valley Bancorp equal to $3,800,000.

TriCo has agreed to appoint three North Valley Bancorp directors to TriCo s board upon closing of the merger. The merger is expected to be completed in the third quarter of 2014, subject to approval of the merger by shareholders of both companies, receipt of required regulatory and other approvals and satisfaction of customary closing conditions.

North Valley Bancorp, headquartered in Redding, California, is the parent of North Valley Bank and had approximately $935 million in assets and 22 commercial banking offices in Shasta, Humboldt, Del Norte, Mendocino, Yolo, Sonoma, Placer and Trinity Counties in Northern California at June 30, 2014. In connection with the acquisition, North Valley Bank will merge into Tri Counties Bank.

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Note 3 Investment Securities

The amortized cost and estimated fair values of investments in debt and equity securities are summarized in the following tables:

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Securities Available for Sale				
Obligations of U.S. government corporations and agencies	$ 81,392	$ 4,711	$ (63)	$ 86,040
Obligations of states and political subdivisions	3,484	76		3,560
Corporate debt securities	1,883	31		1,914
Total securities available for sale	$ 86,759	$ 4,818	$ (63)	$ 91,514
Securities Held to Maturity				
Obligations of U.S. government corporations and agencies	$ 409,881	$ 6,983	$ (1,175)	$ 415,689
Obligations of states and political subdivisions	12,621		(355)	12,266
Total securities held to maturity	$ 422,502	$ 6,983	$ (1,530)	$ 427,955

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Securities Available for Sale				
Obligations of U.S. government corporations and agencies	$ 93,055	$ 4,445	$ (357)	$ 97,143
Obligations of states and political subdivisions	5,513	77	(1)	5,589
Corporate debt securities	1,877	38		1,915
Total securities available for sale	$ 100,445	$ 4,560	$ (358)	$ 104,647
Securities Held to Maturity				
Obligations of U.S. government corporations and agencies	$ 227,864	$ 298	$ (5,540)	$ 222,622
Obligations of states and political subdivisions	12,640		(1,455)	11,185
Total securities held to maturity	$ 240,504	$ 298	$ (6,995)	$ 233,807

No investment securities were sold during the six months ended June 30, 2014 or the year ended December 31, 2013. Investment securities with an aggregate carrying value of $56,583,000 and $62,064,000 at June 30, 2014 and December 31, 2013, respectively, were pledged as collateral for specific borrowings, lines of credit and local agency deposits.

The amortized cost and estimated fair value of debt securities at June 30, 2014 by contractual maturity are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. At June 30, 2014, obligations of U.S. government corporations and agencies with a cost basis totaling $491,273,000 consist almost entirely of mortgage-backed securities whose contractual maturity, or principal repayment, will follow the repayment of the underlying mortgages.

For purposes of the following table, the entire outstanding balance of these mortgage-backed securities issued by U.S. government corporations and agencies is categorized based on final maturity date. At June 30, 2014, the Company estimates the average remaining life of these mortgage-backed securities issued by U.S. government corporations and agencies to be approximately 5.7 years. Average remaining life is defined as the time span after which the principal balance has been reduced by half.

Investment Securities	Available for Sale		Held to Maturity	
(In thousands)	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year	$ 286	$ 304		
Due after one year through five years	3,187	3,280		
Due after five years through ten years	27,371	28,467		
Due after ten years	55,915	59,463	$ 422,502	$ 427,955
Totals	$ 86,759	$ 91,514	$ 422,502	$ 427,955

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Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows:

June 30, 2014	Less than 12 months Fair Value	Less than 12 months Unrealized Loss	12 months or more Fair Value	12 months or more Unrealized Loss	Total Fair Value	Total Unrealized Loss
			(in thousands)			
Securities available for sale:						
Obligations of U.S. government corporations and agencies			$ 10,068	$ (63)	$ 10,068	$ (63)
Obligations of states and political subdivisions						
Corporate debt securities						
Total securities available for sale			$ 10,068	$ (63)	$ 10,068	$ (63)
Securities held to maturity:						
Obligations of U.S. government corporations and agencies	$ 3,384	$ (14)	$ 57,938	$ (1,161)	$ 61,322	$ (1,175)
Obligations of states and political subdivisions	477	(31)	11,789	(324)	12,266	(355)
Total securities held to maturity	$ 3,861	$ (45)	$ 69,727	$ (1,485)	$ 73,588	$ (1,530)

December 31, 2013	Less than 12 months Fair Value	Less than 12 months Unrealized Loss	12 months or more Fair Value	12 months or more Unrealized Loss	Total Fair Value	Total Unrealized Loss
			(in thousands)			
Securities available for sale:						
Obligations of U.S. government corporations and agencies	$ 10,287	$ (357)			$ 10,287	$ (357)
Obligations of states and political subdivisions	199	(1)			199	(1)
Corporate debt securities						
Total securities available for sale	$ 10,486	$ (358)			$ 10,486	$ (358)
Securities held to maturity:						
Obligations of U.S. government corporations and agencies	$ 188,218	$ (5,540)			$ 188,218	$ (5,540)
Obligations of states and political subdivisions	11,185	(1,455)			11,185	(1,455)
Total securities held to maturity	$ 199,403	$ (6,995)			$ 199,403	$ (6,995)

Obligations of U.S. government corporations and agencies: Unrealized losses on investments in obligations of U.S. government corporations and agencies are caused by interest rate increases. The contractual cash flows of these securities are guaranteed by U.S. Government Sponsored Entities (principally Fannie Mae and Freddie Mac). It is expected that the securities would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell and more likely than not will not be required to sell, these investments are not considered other-than-temporarily impaired. At June 30, 2014, 9 debt securities representing obligations of U.S. government corporations and agencies had unrealized losses with aggregate depreciation of 1.71% from the Company s amortized cost basis.

Obligations of states and political subdivisions: The unrealized losses on investments in obligations of states and political subdivisions were caused by increases in required yields by investors in these types of securities. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell and more likely than not will not be required to sell, these investments are not considered other-than-temporarily impaired. At June 30, 2014, 14 debt securities representing obligations of states and political subdivisions had unrealized losses with aggregate depreciation of 2.81% from the Company s amortized cost basis.

Corporate debt securities: At June 30, 2014, no corporate debt securities had unrealized losses.

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Note 4 Loans

A summary of loan balances follows (in thousands):

	June 30, 2014				
	Originated	PNCI	PCI - Cash basis	PCI - Other	Total
Mortgage loans on real estate:					
Residential 1-4 family	$ 136,690	$ 72,387		$ 3,843	$ 212,920
Commercial	872,125	52,844		29,967	954,936
Total mortgage loan on real estate	1,008,815	125,231		33,810	1,167,856
Consumer:					
Home equity lines of credit	307,964	12,866	$ 5,712	3,645	330,187
Home equity loans	17,129	154	126	486	17,895
Auto Indirect	385				385
Other	26,745	1,861		70	28,676
Total consumer loans	352,223	14,881	5,838	4,201	377,143
Commercial	130,848	518	11	5,964	137,341
Construction:					
Residential	40,595			1,502	42,097
Commercial	14,084			65	14,149
Total construction	54,679			1,567	56,246
Total loans, net of deferred loan fees and discounts	$ 1,546,565	$ 140,630	$ 5,849	$ 45,542	$ 1,738,586
Total principal balance of loans owed, net of charge-offs	$ 1,550,887	$ 147,076	$ 15,456	$ 53,192	$ 1,766,611
Unamortized net deferred loan fees	(4,322)				(4,322)
Discounts to principal balance of loans owed, net of charge-offs		(6,446)	(9,607)	(7,650)	(23,703)
Total loans, net of unamortized deferred loan fees and discounts	$ 1,546,565	$ 140,630	$ 5,849	$ 45,542	$ 1,738,586
Noncovered loans	$ 1,546,565	$ 140,630	$ 5,849	$ 20,137	$ 1,713,181
Covered loans				25,405	25,405
Total loans, net of unamortized deferred loan fees and discounts	$ 1,546,565	$ 140,630	$ 5,849	$ 45,542	$ 1,738,586
Allowance for loan losses	$ 32,457	$ 3,235	$ 398	$ 3,878	$ 39,968

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Note 4 Loans (continued)

A summary of loan balances follows (in thousands):

	December 31, 2013				
	Originated	PNCI	PCI - Cash basis	PCI - Other	Total
Mortgage loans on real estate:					
Residential 1-4 family	$ 129,882	$ 60,475		$ 4,656	$ 195,013
Commercial	824,912	57,678		30,260	912,850
Total mortgage loan on real estate	954,794	118,153		34,916	1,107,863
Consumer:					
Home equity lines of credit	316,207	13,576	$ 6,200	3,883	339,866
Home equity loans	13,849	253		486	14,588
Auto Indirect	946				946
Other	25,608	2,074		81	27,763
Total consumer loans	356,610	15,903	6,200	4,450	383,163
Commercial	124,650	693	19	6,516	131,878
Construction:					
Residential	30,367			1,566	31,933
Commercial	17,125			45	17,170
Total construction	47,492			1,611	49,103
Total loans, net of deferred loan fees and discounts	$ 1,483,546	$ 134,749	$ 6,219	$ 47,493	$ 1,672,007
Total principal balance of loans owed, net of charge-offs	$ 1,487,240	$ 142,786	$ 16,475	$ 56,879	$ 1,703,380
Unamortized net deferred loan fees	(3,694)				(3,694)
Discounts to principal balance of loans owed, net of charge-offs		(8,037)	(10,256)	(9,386)	(27,679)
Total loans, net of unamortized deferred loan fees and discounts	$ 1,483,546	$ 134,749	$ 6,219	$ 47,493	$ 1,672,007
Noncovered loans	$ 1,483,546	$ 134,749	$ 6,219	$ 19,581	$ 1,644,095
Covered loans				27,912	27,912
Total loans, net of unamortized deferred loan fees and discounts	$ 1,483,546	$ 134,749	$ 6,219	$ 47,493	$ 1,672,007

Allowance for loan losses	$ (31,354)	$ (2,850)	$ (385)	$ (3,656)	$ (38,245)

The following is a summary of the change in accretable yield for PCI other loans during the periods indicated (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Change in accretable yield:				
Balance at beginning of period	$ 17,438	$ 20,691	$ 18,232	$ 22,337
Accretion to interest income	(1,382)	(1,568)	(3,013)	(3,191)
Reclassification from nonaccretable difference	242	604	1,079	581
Balance at end of period	$ 16,298	$ 19,727	$ 16,298	$ 19,727

Throughout these consolidated financial statements, and in particular in this Note 4 and Note 5, when we refer to Loans or Allowance for loan losses we mean all categories of loans, including Originated, PNCI, PCI cash basis, and PCI other. When we are not referring to all categories of loans, we will indicate which we are referring to Originated, PNCI, PCI cash basis, or PCI other.

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Note 5 Allowance for Loan Losses

The following tables summarize the activity in the allowance for loan losses, and ending balance of loans, net of unearned fees for the periods indicated.

Allowance for Loan Losses Three Months Ended June 30, 2014

	RE Mortgage		Home Equity		Auto	Other		Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Indirect	Consum.	C&I	Resid.	Comm.	Total
Beginning balance	$ 2,980	$ 9,875	$ 16,366	$ 1,291	$ 45	$ 590	$ 4,136	$ 1,501	$ 1,538	$ 38,322
Charge-offs	(1)	(45)	(677)	(11)		(144)	(151)			(1,029)
Recoveries		299	180	25	39	119	188	97	20	967
(Benefit) provision	(147)	(298)	2,186	106	(56)	(9)	234	(87)	(221)	1,708
Ending balance	$ 2,832	$ 9,831	$ 18,055	$ 1,411	$ 28	$ 556	$ 4,407	$ 1,511	$ 1,337	$ 39,968

Allowance for Loan Losses Six Months Ended June 30, 2014

	RE Mortgage		Home Equity		Auto	Other		Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Indirect	Consum.	C&I	Resid.	Comm.	Total
Beginning balance	$ 3,154	$ 9,700	$ 16,375	$ 1,208	$ 66	$ 589	$ 4,331	$ 1,559	$ 1,263	$ 38,245
Charge-offs	(136)	(58)	(855)	(11)		(271)	(390)	(4)	(69)	(1,794)
Recoveries		471	509	27	51	302	1,061	608	135	3,164
(Benefit) provision	(186)	(282)	2,026	187	(89)	(64)	(595)	(652)	8	353
Ending balance	$ 2,832	$ 9,831	$ 18,055	$ 1,411	$ 28	$ 556	$ 4,407	$ 1,511	$ 1,337	$ 39,968
Ending balance:										
Individ. evaluated for impairment	$ 780	$ 392	$ 2,088	$ 211		$ 3	$ 405	$ 61		$ 3,940
Loans pooled for evaluation	$ 1,869	$ 8,605	$ 15,466	$ 1,199	$ 27	$ 553	$ 2,534	$ 720	$ 779	$ 31,752
	$ 185	$ 835	$ 499				$ 1,469	$ 730	$ 558	$ 4,276

Loans acquired with deteriorated credit quality										

	Loans, net of unearned fees	As of June 30, 2014								
	RE Mortgage		Home Equity		Auto	Other		Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Indirect	Consum.	C&I	Resid.	Comm.	Total
Ending balance:										
Total loans	$ 212,920	$ 954,936	$ 330,187	$ 17,895	$ 385	$ 28,676	$ 137,341	$ 42,097	$ 14,149	$ 1,738,586
Individ. evaluated for impairment	$ 7,397	$ 52,570	$ 6,987	$ 871	$ 40	$ 77	$ 2,159	$ 2,751	$ 16	$ 72,868
Loans pooled for evaluation	$ 201,680	$ 872,399	$ 313,843	$ 16,412	$ 345	$ 28,529	$ 129,207	$ 37,844	$ 14,068	$ 1,614,327
Loans acquired with deteriorated credit quality	$ 3,843	$ 29,967	$ 9,357	$ 612		$ 70	$ 5,975	$ 1,502	$ 65	$ 51,391

	Allowance for Loan Losses	Year Ended December 31, 2013								
	RE Mortgage		Home Equity		Auto	Other		Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Indirect	Consum.	C&I	Resid.	Comm.	Total
Beginning balance	$ 3,523	$ 8,782	$ 21,367	$ 1,155	$ 243	$ 696	$ 4,703	$ 1,400	$ 779	$ 42,648
Charge-offs	(46)	(2,038)	(2,651)	(94)	(68)	(887)	(1,599)	(20)	(140)	(7,543)
Recoveries	345	994	1,053	41	195	759	340	63	65	3,855
(Benefit) provision	(668)	1,962	(3,394)	106	(304)	21	887	116	559	(715)
Ending balance	$ 3,154	$ 9,700	$ 16,375	$ 1,208	$ 66	$ 589	$ 4,331	$ 1,559	$ 1,263	$ 38,245
Ending balance:										
Individ. evaluated	$ 775	$ 1,198	$ 1,140	$ 169	$ 1	$ 8	$ 585	$ 91	$ 8	$ 3,975

for impairment										
Loans pooled for evaluation	$ 2,039	$ 7,815	$ 14,749	$ 1,039	$ 65	$ 581	$ 2,402	$ 751	$ 789	$ 30,230
Loans acquired with deteriorated credit quality	$ 340	$ 687	$ 486				$ 1,344	$ 717	$ 466	$ 4,040

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Note 5 Allowance for Loan Losses (continued)

	Loans, net of unearned fees As of December 31, 2013									
	RE Mortgage		Home Equity		Auto	Other		Construction		
(in thousands)	Resid.	Comm.	Lines	Loans	Indirect	Consum.	C&I	Resid.	Comm.	Total
Ending balance:										
Total loans	$ 195,013	$ 912,850	$ 339,866	$ 14,588	$ 946	$ 27,763	$ 131,878	$ 31,933	$ 17,170	$ 1,672,007
Individ. evaluated for impairment	$ 7,342	$ 59,936	$ 6,918	$ 778	$ 60	$ 90	$ 3,177	$ 2,756	$ 178	$ 81,235
Loans pooled for evaluation										