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AMERICAN RIVER BANKSHARES

Form 10-Q

November 07, 2006

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2006

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or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-31525

AMERICAN RIVER BANKSHARES

-----
(Exact name of registrant as specified in its charter)

California

68-0352144

-----
(State or other jurisdiction of
incorporation or organization)

-----
(IRS Employer ID Number)

3100 Zinfandel Drive, Rancho Cordova, California

95670

-----
(Address of principal executive offices)

-----
(Zip code)

(916) 231-6700

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

Not Applicable

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

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

Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ]

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

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Yes [ ] No [X]

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

No par value Common Stock - 5,399,500 shares outstanding at November 6, 2006.

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The Index to the Exhibits is located at Page 38

## PART I-FINANCIAL INFORMATION

### Item 1. Financial Statements.

#### AMERICAN RIVER BANKSHARES CONSOLIDATED BALANCE SHEETS (Unaudited) (Dollars in thousands)

	September 30, 2006	December 31, 2005
	-----	-----
<b>ASSETS</b>		
Cash and due from banks	\$ 29,076	\$
Federal funds sold	--	
	-----	-----
Total cash and cash equivalents	29,076	
Interest-bearing deposits in banks	4,951	
Investment securities:		
Available-for-sale, (amortized cost: 2006--\$110,492; 2005--\$125,468)	109,579	
Held-to-maturity (market value: 2006--\$36,104; 2005--\$44,658)	36,502	
Loans and leases, less allowance for loan and lease losses of \$5,871 at September 30, 2006 and \$5,679 at December 31, 2005	374,396	
Premises and equipment, net	1,905	
Federal Home Loan Bank stock	3,695	
Accounts receivable servicing receivables, net	2,611	
Goodwill and other intangible assets	17,903	
Accrued interest receivable and other assets	11,481	
	-----	-----
	\$ 592,099	\$
	=====	=====
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits:		
Noninterest bearing	\$ 154,549	\$
Interest bearing	338,895	
	-----	-----
Total deposits	493,444	
Short-term borrowed funds	25,566	
Long-term debt	6,722	
Accrued interest payable and other liabilities	4,747	
	-----	-----
Total liabilities	530,479	
	-----	-----

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Commitments and contingencies (Note 3)

Shareholders' equity:

Common stock - no par value; 20,000,000 shares authorized; issued and outstanding - 5,407,500 shares at September 30, 2006 and 5,604,479 shares at December 31, 2005	41,959	
Retained earnings	20,200	
Accumulated other comprehensive loss, net of taxes (Note 5)	(539)	
	-----	-----
Total shareholders' equity	61,620	-----
	\$ 592,099	\$ -----

See Notes to Unaudited Consolidated Financial Statements

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### AMERICAN RIVER BANKSHARES UNAUDITED CONSOLIDATED STATEMENT OF INCOME

(In thousands, except per share data)  
For the periods ended September 30,

	Three months		Ni
	2006	2005	2006
Interest income:			
Interest and fees on loans	\$ 8,083	\$ 6,719	\$ 23,
Interest on Federal funds sold	4	42	
Interest on deposits in banks	66	55	
Interest and dividends on investment securities:			
Taxable	1,326	1,493	4,
Exempt from Federal income taxes	250	245	
Dividends	8	8	
	-----	-----	-----
Total interest income	9,737	8,562	28,
Interest expense:			
Interest on deposits	2,325	1,553	6,
Interest on short-term borrowings	514	171	1,
Interest on long-term debt	100	85	
	-----	-----	-----
Total interest expense	2,939	1,809	8,
Net interest income	6,798	6,753	20,
Provision for loan and lease losses	30	--	-----
Net interest income after provision for loan and lease losses	6,768	6,753	20,
Noninterest income	605	594	1,
	-----	-----	-----

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Noninterest expense:			
Salaries and employee benefits	1,927	1,789	5,
Occupancy	345	300	1,
Furniture and equipment	185	228	
Other expense	1,145	1,147	3,
	-----	-----	-----
Total noninterest expense	3,602	3,464	10,
	-----	-----	-----
Income before income taxes	3,771	3,883	10,
Income taxes	1,496	1,507	4,
	-----	-----	-----
Net income	\$ 2,275	\$ 2,376	\$ 6,
	=====	=====	=====
Basic earnings per share (Note 4)	\$ 0.41	\$ 0.42	\$ 1
	=====	=====	=====
Diluted earnings per share (Note 4)	\$ 0.41	\$ 0.41	\$ 1
	=====	=====	=====
Cash dividends per share	\$ 0.15	\$ 0.14	\$ 0
	=====	=====	=====

See notes to Unaudited Consolidated Financial Statements

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AMERICAN RIVER BANKSHARES  
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
(Dollars in thousands, except number of shares) (Unaudited)

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)
	Shares	Amount		
	-----	-----	-----	-----
Balance, January 1, 2005	5,314,732	\$ 42,557	\$ 15,878	\$
Comprehensive income (Note 5):				
Net income			9,184	
Other comprehensive loss, net of tax:				
Change in unrealized losses on available-for-sale investment securities				(1)
Total comprehensive income				
Cash dividends (\$0.54 per share)			(3,012)	
Fractional shares redeemed	(1)	(32)		
5% stock dividend	266,801	6,021	(6,021)	
Stock options exercised	113,309	945		
Retirement of common stock	(90,362)	(2,017)		
	-----	-----	-----	-----

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Balance, December 31, 2005	5,604,479	47,474	16,029
Comprehensive income (Note 5):			
Net income			6,655
Other comprehensive income, net of tax:			
Change in unrealized losses on available-for-sale investment securities			
Total comprehensive income			
Cash dividends (\$0.45 per share)			(2,484)
Stock options exercised	33,162	321	
Stock option compensation		159	
Retirement of common stock	(230,141)	(5,995)	
	-----	-----	-----
Balance, September 30, 2006	5,407,500	\$ 41,959	\$ 20,200
	=====	=====	=====

See Notes to Unaudited Consolidated Financial Statements

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AMERICAN RIVER BANKSHARES  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(Unaudited)

(Dollars in thousands)  
For the nine months ended September 30,

	2006	
	-----	-----
Cash flows from operating activities:		
Net income	\$ 6,655	\$
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan and lease losses	270	
Decrease in deferred loan origination fees, net	(25)	
Depreciation and amortization	730	
Net amortization of investment security premiums	535	
Gain on sale of securities	--	
Provision for accounts receivable servicing receivable losses	2	
Increase in cash surrender value of life insurance policies	(137)	
Stock option compensation expense	159	
Decrease (increase) in accrued interest receivable and other assets	731	
Decrease in accrued interest payable and other liabilities	(878)	
	-----	-----
Net cash provided by (used in) operating activities	8,042	

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Cash flows from investing activities:		
Proceeds from the sale of available-for-sale investment securities		2,477
Proceeds from called available-for-sale investment securities		400
Proceeds from matured available-for-sale investment securities		13,000
Purchases of available-for-sale investment securities		(3,066)
Purchases of held-to-maturity investment securities		--
Proceeds from principal repayments for available-for-sale mortgage-related securities		1,781
Proceeds from principal repayments for held-to-maturity mortgage-related securities		8,358
Net (increase) decrease in interest-bearing deposits in banks		(107)
Net increase in loans		(9,069)
Net increase in accounts receivable servicing receivables		(613)
Proceeds from the sale of equipment		--
Purchases of equipment		(297)
Net increase in FHLB stock		(1,087)
		-----
Net cash provided in (used in) investing activities		11,777
		-----

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Cash flows from financing activities:			
Net (decrease) increase in demand, interest-bearing and savings deposits		\$ (22,640)	\$
Net increase in time deposits		15,378	
Net increase (decrease) in long-term debt		2,452	
Net decrease in short-term borrowings		(13,820)	
Payment of cash dividends		(2,514)	
Cash paid to repurchase common stock		(5,995)	
Cash paid for fractional shares		--	
Exercise of stock options		321	
		-----	
Net cash (used in) provided by financing activities		(26,818)	
		-----	
(Decrease) increase in cash and cash equivalents		(6,999)	
Cash and cash equivalents at beginning of year		36,075	
		-----	
Cash and cash equivalents at end of period		\$ 29,076	\$
		=====	=====

See Notes to Unaudited Consolidated Financial Statements

AMERICAN RIVER BANKSHARES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006

1. CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of management, the unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the consolidated financial position of American River Bankshares (the "Company") at September 30, 2006 and December 31, 2005, and the results of its operations and its cash flows for the three-month and nine-month periods ended September 30, 2006 and 2005 and cash flows for the nine-month periods ended September 30, 2006 and 2005 in conformity with accounting principles generally accepted in the United States of America.

Certain disclosures normally presented in the notes to the financial statements prepared in accordance with generally accepted accounting principles have been omitted. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2005 annual report on Form 10-K. The results of operations for the three-month and nine-month periods ended September 30, 2006 may not necessarily be indicative of the operating results for the full year.

In preparing such financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan and lease losses, the provision for taxes and the estimated fair value of investment securities.

2. STOCK-BASED COMPENSATION

Stock Option Plans

In 2000 and 1995, the Board of Directors adopted stock option plans under which options may be granted to employees and directors under incentive and nonstatutory agreements. The plans require that the option price may not be less than the fair market value of the stock at the date the option is granted. The options under the plans expire on dates determined by the Board of Directors, but not later than ten years from the date of grant. The vesting period is generally five years; however the vesting period can be modified at the discretion of the Company's Board of Directors. Outstanding options under the plans are exercisable until their expiration. New shares are issued upon exercise.

Adoption of FAS 123(R)

Prior to January 1, 2006, the Company accounted for the plans under the recognition and measurement provisions of Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations, as permitted by Financial Accounting Standards Board ("FASB") Statement No. 123, Accounting for Stock-Based Compensation and FASB Statement No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure. No stock-based employee compensation cost was recognized for options granted for the three-month and nine-month periods ended September 30, 2005 in the Statement of Income, as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective January 1, 2006, the Company adopted the fair value recognition provisions of

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FASB Statement No. 123(R), Share-Based Payment, using the modified prospective transition method. Under that transition method, compensation cost recognized in fiscal year 2006 includes: (a) compensation cost for all share-based payments vesting during 2006 that were granted prior to, but not yet vested as of, January 1, 2006 based on the grant-date fair value estimated in accordance with the original provisions of Statement 123, and (b) compensation cost for all share-based payments vesting during 2006 that were granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R). Results for prior periods have not been

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restated and there was no one-time effect resulting from the adoption of FASB Statement No. 123(R). Compensation expense is recognized over the vesting period on a straight line accounting basis.

As a result of adopting Statement 123(R) on January 1, 2006, the Company's income before provision for income taxes and net income for the three-month and nine-month periods ended September 30, 2006, was \$62,000 and \$51,000 and \$159,000 and \$132,000 lower, respectively, than if it had continued to account for share-based compensation under APB Opinion No. 25. Diluted earnings per share and basic earnings per share for the three-month and nine-month periods ended September 30, 2006 would have increased \$0.01 and \$0.03, respectively, had the Company continued to account for share-based compensation under APB Opinion No. 25.

In accordance with FASB Statement No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, the following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based compensation for the three-month and nine-month periods ended September 30, 2005. Pro forma adjustments to the Company's consolidated net income and earnings per share are disclosed during the years in which the options become vested (dollars in thousands, except per share data).

	Three Months Ended September 30, 2005 -----	Nine Months Ended September 30, 2005 -----
(Dollars in thousands, except per share data)		
Net income, as reported	\$ 2,376	\$ 6,617
Deduct: Total stock-based compensation expense determined under the fair value based method for all awards, net of related tax effects	(21)	(58)
Pro forma net income	\$ 2,355 =====	\$ 6,559 =====
Basic earnings per share - as reported	\$ 0.42	\$ 1.18
Basic earnings per share - pro forma	\$ 0.42	\$ 1.17
Diluted earnings per share - as reported	\$ 0.41	\$ 1.15
Diluted earnings per share - pro forma	\$ 0.41	\$ 1.15

The fair value of each option award is estimated on the date of grant using a Black-Scholes-Merton based option valuation model that uses the assumptions noted in the following table. Because Black-Scholes-Merton based option valuation models incorporate ranges of assumptions for inputs, those ranges are



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disclosed. Expected volatilities are based on historical volatility of the Company's stock and other factors. The Company uses historical data to estimate option exercise and employee termination within the valuation model. The expected term of options granted is derived from guidance provided in the Securities and Exchange Commission's Staff Accounting Bulletin No. 107 and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	Nine Months Ended September 30,	
	2006	2005
Dividend yield	2.16%	2.27%-2.71%
Expected volatility	29.6%	30.3-34.1%
Risk-free interest rate	4.68%	2.71%-3.96%
Weighted average expected option life	7 years	7 years
Weighted average fair value of options granted during the period	\$8.76	\$6.20-6.48

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Options granted during the three-month period ended September 30, 2005:

Dividend yield	2.71%
Expected life	7 years
Expected volatility	30.3%
Risk-free rate	4.08%
Weighted average fair value of options granted during the period	\$6.51

There were no options granted during the third quarter of 2006.

A summary of option activity under the stock option plans as of September 30, 2006 and changes during the period then ended is presented below:

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Ag In
-----	-----	-----	-----	---
Outstanding at January 1, 2006	289,393	\$13.22	5.6 years	
Granted	64,699	\$27.80	9.4 years	
Exercised	(33,162)	\$ 6.21	--	
Cancelled	(386)	\$19.44	--	
Outstanding at September 30, 2006	320,544	\$16.88	6.3 years	
Exercisable at September 30, 2006	157,344	\$ 9.94	4.0 years	

The intrinsic value was derived from the market price of the Company's common stock of \$25.00 as of September 30, 2006. The total intrinsic value of options exercised during the three-month and nine-month periods ended September 30, 2006

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was \$22,000 and \$631,000, respectively. The total intrinsic value of options exercised during the three-month and nine-month periods ended September 30, 2005 was \$539,000 and \$2,600,000, respectively.

At September 30, 2006, the total compensation cost related to nonvested awards not yet recorded is expected to be \$889,000. This amount will be recognized over the next five years and the weighted average period of recognizing these costs is expected to be 2.5 years.

### 3. COMMITMENTS AND CONTINGENCIES

In the normal course of business there are outstanding various commitments to extend credit which are not reflected in the financial statements, including loan commitments of approximately \$126,107,000 and letters of credit of approximately \$5,331,000 at September 30, 2006. Such loans relate primarily to real estate construction loans and revolving lines of credit and other commercial loans. However, all such commitments will not necessarily culminate in actual extensions of credit by the Company during 2006 as some of these are expected to expire without being fully drawn upon.

Standby letters of credit are conditional commitments issued to guarantee the performance or financial obligation of a client to a third party. These guarantees are issued primarily relating to purchases of inventory or as security for real estate rents by commercial clients and are typically short term in nature. Credit risk is similar to that involved in extending loan commitments to clients and accordingly, evaluation and collateral requirements similar to those for loan commitments are used. The majority of all such commitments are collateralized. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees was not material at September 30, 2006 or September 30, 2005.

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### 4. EARNINGS PER SHARE COMPUTATION

Basic earnings per share is computed by dividing net income by the weighted average common shares outstanding for the period (5,507,202 and 5,569,109 shares for the three-month and nine-month periods ended September 30, 2006, and 5,634,929 and 5,619,448 shares for the three-month and nine-month periods ended September 30, 2005). Diluted earnings per share reflect the potential dilution that could occur if outstanding stock options were exercised. Diluted earnings per share is computed by dividing net income by the weighted average common shares outstanding for the period plus the dilutive effect of options (102,637 and 108,691 shares for the three-month and nine-month periods ended September 30, 2006 and 105,941 and 121,903 shares for the three-month and nine-month periods ended September 30, 2005). Earnings per share is retroactively adjusted for stock dividends and stock splits for all periods presented.

### 5. COMPREHENSIVE INCOME

Comprehensive income is reported in addition to net income for all periods presented. Comprehensive income is comprised of net income plus other comprehensive income (loss). Other comprehensive income (loss), net of taxes, was comprised of the unrealized gains (losses) on available-for-sale investment securities of \$888,000 and \$218,000, respectively, for the three-month and nine-month periods ended September 30, 2006 and \$(667,000) and \$(1,003,000), respectively, for the three-month and nine month periods ended September 30, 2005. Comprehensive income was \$3,163,000 and \$6,873,000, respectively, for the three-month and nine-month periods ended September 30, 2006 and \$1,709,000 and \$5,614,000, respectively, for the three-month and nine-month periods ended

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September 30, 2005. Reclassification adjustments resulting from gain or loss on sale of investment securities were not material for all periods presented.

### 6. BORROWING ARRANGEMENTS

The Company has a total of \$53,000,000 in unsecured short-term borrowing arrangements with four of its correspondent banks. There were no advances under the borrowing arrangements as of September 30, 2006 or December 31, 2005.

In addition, the Company has a line of credit available with the Federal Home Loan Bank (the "FHLB") which is secured by pledged mortgage loans and investment securities. Borrowings may include overnight advances as well as loans with terms of up to thirty years. Advances totaling \$32,288,000 were outstanding from the FHLB at September 30, 2006, bearing interest rates ranging from 2.66% to 6.13% and maturing between October 2, 2006 and April 7, 2008. Advances totaling \$43,656,000 were outstanding from the FHLB at December 31, 2005, bearing interest rates ranging from 2.10% to 6.13% and maturing between January 3, 2006 and December 21, 2007. Remaining amounts available under the borrowing arrangement with the FHLB at September 30, 2006 and December 31, 2005 totaled \$104,592,000 and \$3,539,000, respectively.

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### 7. INVESTMENT SECURITIES

Investment securities with unrealized losses at September 30, 2006 are summarized and classified according to the duration of the loss period as follows (dollars in thousands):

	Less than 12 Months		Greater than 12	
	Fair Value	Unrealized Loss	Fair Value	Unre L
<b>Available-for-Sale:</b>				
U.S. Treasury securities and agencies	\$ 2,438	\$ (63)	\$ 33,785	\$
Mortgage-backed securities	--	--	32,399	
Obligations of state and political subdivisions	2,603	(21)	15,106	
Corporate debt securities	--	--	1,004	
Corporate stock	--	--	240	
	\$ 5,041	\$ (84)	\$ 82,534	\$
<b>Held-to-Maturity:</b>				
Mortgage-backed securities	\$ 6,294	\$ (53)	\$ 26,602	\$

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Management periodically evaluates each investment security in a loss position for other than temporary impairment relying primarily on industry analyst reports, observation of market conditions and interest rate fluctuations. Management believes it will be able to collect all amounts due according to the contractual terms of the underlying investment securities and that the noted decline in fair value is considered temporary and is due only to interest rate fluctuations.

### 8. ACCOUNTING PRONOUNCEMENTS

On November 10, 2005, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position No. FAS 123R-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards ("FSP 123R-3"). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee share-based compensation, and to determine the subsequent impact on the APIC pool and consolidated statements of cash flows of the tax effects of employee share-based compensation awards that are outstanding upon adoption of Statement of Financial Accounting Standards No. 123 (revised 2004), Share Based Payment, ("SFAS 123R"). Management is currently evaluating the available transition alternatives of FSP 123R-3. Management does not believe the adoption of FSP 123R-3 will have a material impact on the Company's financial position, results of operations or cash flows.

On September 13, 2006, the Securities and Exchange Commission published Staff Accounting Bulletin ("SAB") No. 108 Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. The interpretations in this Staff Accounting Bulletin are being issued to address diversity in practice in quantifying financial statement misstatements and the potential under current practice to build up improper amounts on the balance sheet. This guidance will apply to the first fiscal year ending after November 15, 2006 and early application in interim periods is encouraged. Management does not believe the adoption of SAB 108 will have a material impact on the Company's financial position, results of operations or cash flows.

On February 16, 2006, the FASB issued Statement No. 155, "Accounting for Certain Hybrid Instruments." This standard amends the guidance in FASB Statements ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. SFAS No. 155 is effective for all

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financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. Management does not anticipate that this statement will have a material effect on the Company's financial position, results of operations or cash flows.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets-An Amendment of FASB Statement No. 140." This standard amends the guidance in SFAS No.140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." Among other requirements, SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract. The standard requires initial measurement of all newly purchased or issued separately recognized servicing assets and

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servicing liabilities at fair value, if practicable. Subsequent measurements may be made using either the fair value or amortization method. SFAS No. 156 is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006 with early adoption permitted in the quarter-ended March 31, 2006. Management does not anticipate that this statement will have a material effect on the Company's financial position, results of operations or cash flows.

On July 13, 2006, the FASB issued FASB Interpretation No. 48 ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes". FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. An enterprise shall disclose the cumulative effect of the change on retained earnings in the statement of financial position as of the date of adoption and such disclosure is required only in the year of adoption. Management is in the process of analyzing the implications of FIN 48. Management does not anticipate that this statement will have a material effect on the Company's financial position, results of operations or cash flows.

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

The following is management's discussion and analysis of the significant changes in American River Bankshares' (the "Company") balance sheet accounts between December 31, 2005 and September 30, 2006 and its income and expense accounts for the three-month and nine-month periods ended September 30, 2006 and 2005. The discussion is designed to provide a better understanding of significant trends related to the Company's financial condition, results of operations, liquidity, capital resources and interest rate sensitivity. This discussion and supporting tables and the consolidated financial statements and related notes appearing elsewhere in this report are unaudited.

Certain matters discussed or incorporated by reference in this Quarterly Report on Form 10-Q including, but not limited to, matters described in "Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations," are "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. Such forward-looking statements may contain words related to future projections including, but not limited to, words such as "believe," "expect," "anticipate," "intend," "may," "will," "should," "could," "would," and variations of those words and similar words that are subject to risks, uncertainties and other factors that could cause actual results to differ materially from those projected. Factors that could cause or contribute to such differences include, but are not limited to, the following: (1) variances in the actual versus projected growth in assets; (2) return on assets; (3) loan and lease losses; (4) expenses; (5) changes in the interest rate environment including interest rates charged on loans, earned on securities investments and paid on deposits; (6) competition effects; (7) fee and other noninterest income earned; (8) general economic conditions nationally, regionally, and in the operating market areas of the Company and its subsidiaries; (9) changes in the regulatory environment; (10) changes in business conditions and inflation; (11) changes in securities markets; (12) data processing problems; (13) a decline in real estate values in the Company's operating market areas; (14) the effects of terrorism, the threat of terrorism or the impact of the current military conflict in Iraq and the conduct of the

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war on terrorism by the United States and its allies, as well as other factors. These factors and other cautionary statements and information set forth in this report should be carefully considered and understood as being applicable to all related forward-looking statements contained in this report, when evaluating the business prospects of the Company and its subsidiaries.

Forward-looking statements are not guarantees of performance. By their nature, they involve risks, uncertainties and assumptions. The future results and shareholder values may differ significantly from those expressed in these forward-looking statements. You are cautioned not to put undue reliance on any forward-looking statement. Any such statement speaks only as of the date of this report, and in the case of any documents that may be incorporated by reference, as of the date of those documents. We do not undertake any obligation to update or release any revisions to any forward-looking statements, to report any new information, future event or other circumstances after the date of this report or to reflect the occurrence of unanticipated events, except as required by law. To gain a more complete understanding of the uncertainties and risks involved in the Company's business, this report should be read in conjunction with the Company's annual report on Form 10-K for the year ended December 31, 2005 and its 2006 reports filed on Form 10-Q and 8-K.

Interest income and net interest income are presented on a fully taxable equivalent basis (FTE) within management's discussion and analysis.

### Critical Accounting Policies

#### General

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The financial information contained within our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. We use historical loss data and the economic environment as factors, among others, in determining the inherent loss that may be present in our loan and lease portfolio. Actual losses could

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differ significantly from the factors that we use. Other estimates that we use are related to the expected useful lives of our depreciable assets. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

#### Allowance for Loan and Lease Losses

The allowance for loan and lease losses is an estimate of the credit loss risk in our loan and lease portfolio. The allowance is based on two basic principles of accounting: (1) Statement of Financial Accounting Standards ("SFAS") No. 5 "Accounting for Contingencies," which requires that losses be accrued when it is probable that a loss has occurred at the balance sheet date and such loss can be reasonably estimated; and (2) SFAS No. 114, "Accounting by Creditors for Impairment of a Loan," which requires that losses be accrued on impaired loans based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

The allowance for loan and lease losses is determined based upon estimates that can and do change when the actual risk, loss events, or changes in other factors, occur. The analysis of the allowance uses an historical loss

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view as an indicator of future losses and as a result could differ from the loss incurred in the future. However, since our analysis of risk and loss potential is updated regularly, the errors that might otherwise occur are mitigated. If the allowance for loan and lease losses falls below that deemed adequate (by reason of loan and lease growth, actual losses, the effect of changes in risk ratings, or some combination of these factors), the Company has a strategy for supplementing the allowance for loan and lease losses, over the short term. For further information regarding our allowance for loan and lease losses, see "Allowance for Loan and Lease Losses Activity" discussion later in this Item 2.

### Stock-Based Compensation

The Company previously accounted for its stock-based compensation under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Because the Company's 2000 Stock Option Plan provides for the issuance of options at a price of no less than the fair market value at the date of the grant, no compensation expense was recognized in the financial statements unless the options were modified after the grant date.

On January 1, 2006, the Company began to apply the provisions of SFAS 123 (R) on a modified prospective method. Under this method, the Company is required to record compensation expense (net of estimated forfeitures) for the unvested portion of previously granted awards that remain outstanding at the date of adoption and for all grants of stock options after January 1, 2006. The fair value of each option is estimated on the date of grant and amortized over the service period using an option pricing model. Critical assumptions that affect the estimated fair value of each option include expected stock price volatility, dividend yields, option life and the risk-free interest rate.

### Goodwill

Business combinations involving the Company's acquisition of the equity interests or net assets of another enterprise or the assumption of net liabilities in an acquisition of branches constituting a business may give rise to goodwill. Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed in transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisition. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed for impairment at a reporting unit level at least annually following the year of acquisition. The Company performed an evaluation of the goodwill, recorded as a result of the Bank of Amador acquisition, during the fourth quarter of 2005 and determined that there was no impairment. While the Company believes all assumptions utilized in its assessment of goodwill for impairment are reasonable and appropriate, changes in earnings, the effective tax rate, historical earnings multiples and the cost of capital could all cause different results for the calculation of the present value of future cash flows.

### General Development of Business

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was incorporated under the laws of the State of California in 1995. As a bank holding company, the Company is authorized to engage in the activities permitted under the Bank Holding Company Act of 1956, as amended, and regulations thereunder. Its principal office is located at 3100 Zinfandel Drive, Suite 450, Rancho Cordova, California 95670 and its telephone number is (916) 231-6700. The Company employed an equivalent of

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125 full-time employees as of September 30, 2006.

The Company owns 100% of the issued and outstanding common shares of its banking subsidiary, American River Bank, and American River Financial, a California corporation which has been inactive since its incorporation in 2003.

American River Bank was incorporated and commenced business in Fair Oaks, California, in 1983 and thereafter moved its headquarters to Sacramento, California in 1985. American River Bank operates: (1) five full service offices and one convenience office in Sacramento and Placer Counties including the head office located at 1545 River Park Drive, Suite 107, Sacramento, and branch offices located at 520 Capitol Mall, Suite 100, Sacramento, 9750 Business Park Drive, Sacramento, 10123 Fair Oaks Boulevard, Fair Oaks and 2240 Douglas Boulevard, Roseville, and the convenience office (limited service office) located at 3100 Zinfandel Drive, Suite 450, Rancho Cordova, and (2) three full service offices in Sonoma County located at 412 Center Street, Healdsburg, 8733 Lakewood Drive, Windsor, and 50 Santa Rosa Avenue, Suite 100, Santa Rosa, operated under the name "North Coast Bank, a division of American River Bank." North Coast Bank was incorporated and commenced business in 1990 as Windsor Oaks National Bank in Windsor, California. In 1997, the name was changed to North Coast Bank. In 2000, North Coast Bank was acquired by the Company as a separate bank subsidiary. Effective December 31, 2003, North Coast Bank was merged with and into American River Bank.

On December 3, 2004, the Company acquired Bank of Amador located in Jackson, California. Bank of Amador was merged with and into American River Bank and now operates three full service banking offices as "Bank of Amador, a division of American River Bank" within its primary service area of Amador County, in the cities of Jackson, Pioneer and Ione.

American River Bank's deposits are insured by the Federal Deposit Insurance Corporation up to applicable legal limits. American River Bank does not offer trust services or international banking services and does not plan to do so in the near future. American River Bank's primary business is serving the commercial banking needs of small to mid-sized businesses within those counties listed above. American River Bank accepts checking and savings deposits, offers money market deposit accounts and certificates of deposit, makes secured and unsecured commercial, secured real estate, and other installment and term loans and offers other customary banking services. American River Bank also conducts lease financing for most types of business equipment, from computer software to heavy earth-moving equipment.

American River Bank owns 100% of two inactive companies, ARBCO and American River Mortgage. ARBCO was formed in 1984 to conduct real estate development and has been inactive since 1995. American River Mortgage has been inactive since its formation in 1994.

During 2006, the Company conducted no significant activities other than holding the shares of its subsidiaries. However, it is authorized, with the prior approval of the Board of Governors of the Federal Reserve System (the "Board of Governors"), the Company's principal regulator, to engage in a variety of activities which are deemed closely related to the business of banking.

The common stock of the Company is registered under the Securities Exchange Act of 1934, as amended, and is listed and traded on the Nasdaq Global Select Market under the symbol "AMRB."



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The Company recorded net income of \$2,275,000 for the quarter ended September 30, 2006, which was \$101,000 (4.3%) below the \$2,376,000 reported for the same period of 2005. Diluted earnings per share for the third quarters of 2006 and 2005 remained the same at \$0.41. The return on average equity (ROAE) and the return on average assets (ROAA) for the third quarter of 2006 were 14.39% and 1.50%, respectively, as compared to 15.32% and 1.54%, respectively, for the same period in 2005.

Net income for the nine months ended September 30, 2006 and 2005 was \$6,655,000 and \$6,617,000, respectively, with diluted earnings per share of \$1.17 and \$1.15, respectively. For the first nine months of 2006, ROAE was 14.11% and ROAA was 1.47% as compared to 14.71% and 1.49% for the same period in 2005.

Total assets of the Company decreased by \$20,664,000 (3.4%) from \$612,763,000 at December 31, 2005 to \$592,099,000 at September 30, 2006. Net loans totaled \$374,396,000 at September 30, 2006, up \$8,825,000 (2.4%) from the \$365,571,000 at December 31, 2005. Deposit balances at September 30, 2006 totaled \$493,444,000, down \$7,262,000 (1.5%) from \$500,706,000 at December 31, 2005.

The Company ended the third quarter of 2006 with a Tier 1 capital ratio of 10.2% and a total risk-based capital ratio of 11.4% versus 10.6% and 11.8%, respectively, at December 31, 2005.

Table One below provides a summary of the components of net income for the periods indicated (See the "Results of Operations" section that follows for an explanation of the fluctuations in the individual components):

Table One: Components of Net Income

(In thousands, except percentages)	For the three months ended September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
Net interest income*	\$ 6,878	\$ 6,833	\$ 20,533	\$ 19,730
Provision for loan and lease losses	(30)	--	(270)	(272)
Noninterest income	605	594	1,836	1,759
Noninterest expense	(3,602)	(3,464)	(10,862)	(10,195)
Provision for income taxes	(1,496)	(1,507)	(4,338)	(4,182)
Tax equivalent adjustment	(80)	(80)	(244)	(223)
	-----	-----	-----	-----
Net income	\$ 2,275	\$ 2,376	\$ 6,655	\$ 6,617
	-----	-----	-----	-----
Average total assets	\$ 600,053	\$ 611,175	\$ 605,620	\$ 591,869
Net income (annualized) as a percentage of average total assets	1.50%	1.54%	1.47%	1.49%

\* Fully taxable equivalent basis (FTE)

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### Results of Operations

#### Net Interest Income and Net Interest Margin

Net interest income represents the excess of interest and fees earned on interest earning assets (loans and leases, securities, Federal funds sold and investments in time deposits) over the interest paid on deposits and borrowed funds. Net interest margin is net interest income expressed as a percentage of average earning assets. The Company's net interest margin was 5.01% for the three months ended September 30, 2006, 4.92% for the three months ended September 30, 2005, 5.03% for the nine months ended September 30, 2006 and 4.95% for the nine months ended September 30, 2005.

The fully taxable equivalent interest income component for the third quarter of 2006 increased \$1,175,000 (13.6%) to \$9,817,000 compared to \$8,642,000 for the three months ended September 30, 2005. The increase in the fully taxable equivalent interest income for the third quarter of 2006 compared to the same period in 2005 is broken down by rate (up \$957,000) and volume (up \$218,000). The rate increase can be attributed to increases implemented by the Company during 2004 and 2005 and continuing through the third quarter of 2006 in response to the Federal Reserve Board (the "FRB") increases in the Federal funds and Discount rates. Increases by the FRB have resulted in seventeen 25 basis point increases since June 2004. The overall increasing interest rate environment since June 2004 has resulted in an 93 basis point increase in the yield on average earning assets from 6.22% for the third quarter of 2005 to 7.15% for the third quarter of 2006. The volume increase was the result of a shift into higher earning loans out of lower yielding investment securities. Average loan balances were up \$30,264,000 (8.5%) in 2006 over the balances in 2005, while average investment securities balances were down \$30,986,000 (17.0%). The increase in average loans is the result of concentrated focus on business lending, the demand for commercial real estate and the effects of a favorable local market.

Total fully taxable equivalent interest income for the nine months ended September 30, 2006 increased \$4,091,000 (16.7%) to \$28,561,000 compared to \$24,470,000 for the nine months ended September 30, 2005. The breakdown of the fully taxable equivalent interest income for the nine months ended September 30, 2006 over the same period in 2005 resulted from increases in volume (up \$1,033,000) and increases in rate (up \$3,058,000). Average earning assets increased \$13,162,000 (2.5%) during the first nine months of 2006 as compared to the same period in 2005. Average loan balances increased \$23,511,000 (6.6%) during that same period and average investments securities balances decreased \$6,026,000 (3.6%).

Interest expense was \$1,130,000 (62.5%) higher in the third quarter of 2006 versus the same period in the prior year. The average balances on interest bearing liabilities were \$5,775,000 (1.5%) lower in the third quarter of 2006 versus the same quarter in 2005, however, there was a change in the mix that saw the Company's non-time deposit balances drop and saw an increase in time deposits and overnight borrowings. The higher balances in the more expensive time deposits and other borrowings accounted for a \$152,000 increase in interest expense. Increased rates accounted for an additional \$978,000 in interest expense for the three-month period. Rates paid on interest bearing liabilities increased 122 basis points on a quarter-over-quarter basis from 1.87% to 3.09%. The increase in rates is a direct result of the higher overall rate environment as well as an increase in higher cost other borrowings. The increase in other borrowings is primarily the result of a decline in deposit balance--both interest bearing and noninterest bearing. The decline in deposit balances is partially related to a decrease in bankruptcy trustee related noninterest bearing and money market accounts. As a result of a change in the California bankruptcy laws, the Company has seen very little activity from its bankruptcy

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trustees account relationships during 2006. The bankruptcy cases are being resolved and the funds are being paid out and few new cases are being opened. In addition, the Company has seen a decline in the deposit balances in a number of its business accounts as a result of these businesses paying down debt and/or investing in real estate or business assets. Although these balances are down the relationships remain with the Company. The decreasing deposit balances were replaced with funds from other borrowing sources.

Interest expense was \$3,288,000 (69.4%) higher in the nine-month period ended September 30, 2006 versus the same period in the prior year. The average balances on interest bearing liabilities were \$9,735,000 (2.6%) higher in the nine-month period ended September 30, 2006 versus the same period in 2005. The higher balances accounted for a \$557,000 increase in interest expense. Increased rates accounted for an additional \$2,731,000 in interest expense for the nine-month period. Rates paid on interest bearing liabilities increased 111 basis points on a year-over-year basis from 1.70% to 2.81%.

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Table Two, Analysis of Net Interest Margin on Earning Assets, and Table Three, Analysis of Volume and Rate Changes on Net Interest Income and Expenses, are provided to enable the reader to understand the components and trends of the Company's interest income and expenses. Table Two provides an analysis of net interest margin on earning assets setting forth average assets, liabilities and shareholders' equity; interest income earned and interest expense paid and average rates earned and paid; and the net interest margin on earning assets. Table Three sets forth a summary of the changes in interest income and interest expense from changes in average asset and liability balances (volume) and changes in average interest rates.

Table Two: Analysis of Net Interest Margin on Earning Assets

Three Months Ended September 30,	2006			2005	
(Taxable Equivalent Basis) (Dollars in thousands)	Avg Balance	Interest	Avg Yield (4)	Avg Balance	Inter est
<b>Assets</b>					
<b>Earning assets:</b>					
Loans (1)	\$ 387,992	\$ 8,083	8.27%	\$ 357,728	\$
Taxable investment securities	123,902	1,326	4.25%	154,876	
Tax-exempt investment securities (2)	27,080	328	4.81%	27,078	
Corporate stock (2)	551	10	7.20%	565	
Federal funds sold	250	4	6.35%	5,070	
Investments in time deposits	4,934	66	5.31%	6,184	
<b>Total earning assets</b>	<b>544,709</b>	<b>9,817</b>	<b>7.15%</b>	<b>551,501</b>	
Cash & due from banks	26,208			30,075	
Other assets	35,129			35,342	
Allowance for loan & lease losses	(5,993)			(5,743)	
	<b>\$ 600,053</b>			<b>\$ 611,175</b>	

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Liabilities & Shareholders' Equity

Interest bearing liabilities:

NOW & MMDA	\$ 163,333	858	2.08%	\$ 196,324
Savings	33,755	58	0.68%	39,593
Time deposits	131,899	1,409	4.25%	116,943
Other borrowings	48,500	614	5.02%	30,402
	-----	-----		-----
Total interest bearing liabilities	377,487	2,939	3.09%	383,262
		-----		-----
Noninterest demand deposits	154,398			161,172
Other liabilities	5,443			5,200
	-----			-----
Total liabilities	537,328			549,634
Shareholders' equity	62,725			61,541
	-----			-----
	\$ 600,053			\$ 611,175
	=====			=====

Net interest income & margin (3)	\$ 6,878	5.01%	\$
	=====	=====	=====

- (1) Loan interest includes loan fees of \$227,000 and \$240,000 during the three months ending September 30, 2006 and September 30, 2005, respectively.
- (2) Includes taxable-equivalent adjustments that primarily relate to income on certain securities that is exempt from federal income taxes. The effective federal statutory tax rate was 34% for 2005 and 35% for 2006.
- (3) Net interest margin is computed by dividing net interest income by total average earning assets.
- (4) Average yield is calculated based on actual days in quarter (92) and annualized to actual days in year (365).

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Nine Months Ended September 30,	2006			2005	
	Avg Balance	Interest	Avg Yield (4)	Avg Balance	Inter est
(Taxable Equivalent Basis) (Dollars in thousands)	-----	-----	-----	-----	-----
<b>Assets</b>					
<b>Earning assets:</b>					
Loans (1)	\$ 381,153	\$ 23,170	8.13%	\$ 357,642	\$ 1
Taxable investment securities	131,637	4,189	4.25%	140,336	
Tax-exempt investment securities (2)	27,283	990	4.85%	25,053	
Corporate stock (2)	1,007	32	1.25%	564	
Federal funds sold	159	6	5.05%	3,368	
Investments in time deposits	4,908	174	4.74%	6,022	
	-----	-----		-----	-----
Total earning assets	546,147	28,561	6.99%	532,985	2
		-----			-----
Cash & due from banks	29,691			29,084	
Other assets	35,634			35,487	
Allowance for loan & lease losses	(5,852)			(5,687)	

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	----- \$ 605,620 =====			----- \$ 591,869 =====	
Liabilities & Shareholders' Equity					
Interest bearing liabilities:					
NOW & MMDA	\$ 166,319	2,253	1.81%	\$ 186,116	
Savings	34,300	127	0.50%	39,491	
Time deposits	127,684	3,766	3.94%	111,943	
Other borrowings	53,535	1,882	4.70%	34,553	
	-----	-----		-----	-----
Total interest bearing liabilities	381,838	8,028	2.81%	372,103	
	-----	-----		-----	-----
Noninterest demand deposits	155,272			153,625	
Other liabilities	5,442			5,984	
	-----			-----	
Total liabilities	542,552			531,712	
Shareholders' equity	63,068			60,157	
	-----			-----	
	\$ 605,620			\$ 591,869	
	=====			=====	
Net interest income & margin (3)		\$ 20,533	5.03%		\$ 1
		=====	=====		=====

- (1) Loan interest includes loan fees of \$722,000 and \$794,000 during the nine months ending September 30, 2006 and September 30, 2005, respectively.
- (2) Includes taxable-equivalent adjustments that primarily relate to income on certain securities that is exempt from federal income taxes. The effective federal statutory tax rate was 34% for 2005 and 35% for 2006.
- (3) Net interest margin is computed by dividing net interest income by total average earning assets.
- (4) Average yield is calculated based on actual days in period (273) and annualized to actual days in year (365).

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Table Three: Analysis of Volume and Rate Changes on Net Interest Income and Expenses

Three Months Ended September 30, 2006 over 2005 (Dollars in thousands)  
Increase (decrease) due to change in:

Interest-earning assets:	Volume	Rate (4)	Net Change
	-----	-----	-----
Net loans (1) (2)	\$ 568	\$ 796	\$ 1,364
Taxable investment securities	(299)	132	(167)
Tax exempt investment securities (3)	--	5	5
Corporate stock	--	--	--
Federal funds sold	(40)	2	(38)
Investment in time deposits	(11)	22	11
	-----	-----	-----
Total	218	957	1,175
	-----	-----	-----
Interest-bearing liabilities:			
NOW & MMDA deposits	(107)	331	224
Savings deposits	(6)	26	20
Time deposits	113	415	528
Other borrowings	152	206	358

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Total	152	978	1,130
Interest differential	\$ 66	\$ (21)	\$ 45

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Aine Months Ended September 30, 2006 over 2005 (Dollars in thousands)  
Increase (decrease) due to change in:

Interest-earning assets:	Volume	Rate (4)	Net Change
Net loans (1) (2)	\$ 1,273	\$ 2,526	\$ 3,799
Taxable investment securities	(245)	478	233
Tax exempt investment securities (3)	80	15	95
Corporate stock	24	(23)	1
Federal funds sold	(73)	2	(71)
Investment in time deposits	(26)	60	34
Total	1,033	3,058	4,091
Interest-bearing liabilities:			
NOW & MMDA deposits	(168)	837	669
Savings deposits	(15)	29	14
Time deposits	320	1,168	1,488
Other borrowings	420	697	1,117
Total	557	2,731	3,288
Interest differential	\$ 476	\$ 327	\$ 803

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- (1) The average balance of non-accruing loans is immaterial as a percentage of total loans and, as such, has been included in net loans.
  - (2) Loan fees of \$227,000 and \$240,000 during the three months ending September 30, 2006 and September 30, 2005, respectively, and \$722,000 and \$794,000 during the nine months ending September 30, 2006 and September 30, 2005, respectively, have been included in the interest income computation.
  - (3) Includes taxable-equivalent adjustments that primarily relate to income on certain securities that is exempt from federal income taxes. The effective federal statutory tax rate was 34% for 2005 and 35% for 2006.
  - (4) The rate/volume variance has been included in the rate variance.

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Provision for Loan and Lease Losses

The Company provided \$30,000 for loan and lease losses for the third quarter of 2006 as compared to no provision during the third quarter of 2005. Net loan and lease charge-offs for the three months ended September 30, 2006 were \$83,000 or .08% (on an annualized basis) of average loans and leases as compared to charge-offs of \$46,000 or .05% (on an annualized basis) of average loans and leases for the three months ended September 30, 2005. For the first nine months of 2006, the Company made provisions for loan and lease losses of \$270,000 and net loan and lease charge-offs were \$78,000 or .03% (on an annualized basis) of average loans and leases outstanding. This compares to provisions for loan and lease losses of \$272,000 and net loan and lease charge-offs of \$77,000 for the first nine months of 2005 or .03% (on an annualized basis) of average loans and leases outstanding. For additional

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information see the Allowance for Loan and Lease Losses Activity later in this section.

### Noninterest Income

Table Four below provides a summary of the components of noninterest income for the periods indicated (Dollars in thousands):

Table Four: Components of Noninterest Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Service charges on deposit accounts	\$ 185	\$ 168	\$ 592	\$ 509
Accounts receivable servicing fees	92	82	285	262
Gain on sale of securities	--	5	--	48
Merchant fee income	149	140	404	377
Income from residential lending	60	86	190	214
Bank owned life insurance	47	45	137	134
Other	72	68	228	215
<b>Total noninterest income</b>	<b>\$ 605</b>	<b>\$ 594</b>	<b>\$ 1,836</b>	<b>\$ 1,759</b>

Noninterest income was up \$11,000 (1.9%) to \$605,000 for the three months ended September 30, 2006 as compared to \$594,000 for the three months ended September 30, 2005. For the nine months ended September 30, 2006, noninterest income was up \$77,000 (4.4%) to \$1,836,000. The increase is primarily related to increased service charges on deposit accounts (up \$83,000 or 16.3%).

### Noninterest Expense

Noninterest expenses increased \$138,000 (4.0%) to a total of \$3,602,000 in the third quarter of 2006 versus \$3,403,000 in the third quarter of 2005. Salary and employee benefits increased \$138,000 (7.7%) from \$1,789,000 during the third quarter of 2005 to \$1,927,000 during the third quarter of 2006 primarily as a result of market-condition salary adjustments, additional administrative staff to address the burden of more stringent compliance and regulatory issues, and the addition of service personnel to help achieve strategic growth in business banking. In addition, the adoption of FAS 123(R) in January of 2006 resulted in an increase in salaries and benefits of \$38,000 during the quarter. See Note 2 to the financial statements for additional information on FAS 123(R). At September 30, 2006, the Company employed 125 persons on a full-time equivalent basis as compared to 115 at September 30, 2005. The employee benefits and taxes component also increased as a result of the increase in employees. On a quarter-over-quarter basis, occupancy increased \$45,000 (15.0%) and furniture and equipment decreased \$43,000 (18.9%). The increase in occupancy is related to normal rent increases in the Company's leased facilities and costs associated with the Company's new administration office lease, which was occupied in October 2005. The new location contributed \$45,000 to the increased occupancy expense. Other expense decreased \$2,000 (0.2%) to a total of \$1,145,000 in the third quarter of 2006 versus the third quarter of 2005. The efficiency ratios (fully taxable equivalent), excluding the amortization of intangible assets, for the 2006 and 2005 third quarters were

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47.0% and 45.4%, respectively.

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Noninterest expense for the nine-month period ended September 30, 2006 was \$10,862,000 versus \$10,195,000 for the same period in 2005 for an increase of \$667,000 (6.5%). Salaries and benefits increased \$602,000 (11.4%) in 2006 as compared to 2005. The increase relates to market-condition salary adjustments, additional administrative staff to address the burden of more stringent compliance and regulatory issues, the addition of service personnel to help achieve strategic growth in business banking, and stock option expenses under FAS 123(R). In addition to the stock option expense included in salaries and benefits (\$96,000 through the first nine months of 2006) there is also \$63,000 in stock option expense related to the Company's directors--this expense is recorded in other expense. Occupancy increased \$148,000 (16.6%) and furniture and equipment decreased \$59,000 (8.6%). The increase in occupancy is related to normal rent increases in the Company's leased facilities and costs associated with the Company's new administration office lease, which was occupied in October 2005. The new location contributed \$135,000 to the increased occupancy expense. Other expense increased \$66,000 (2.0%). The overhead efficiency ratio (fully taxable equivalent), excluding the amortization of intangible assets, for the first nine months of 2006 was 47.5% as compared to 46.2% in the same period of 2005.

### Provision for Income Taxes

The effective tax rate for the third quarter and first nine months of 2006 was 39.7% and 39.5%, respectively, versus 38.8% and 38.7%, respectively, for the same two periods of 2005. The increase in 2006 is related to the Company's higher taxable income resulting from a move up from the 34% tax tier to the 35% tax tier, for federal income tax purposes and a portion of the stock option expense in 2006 is not tax deductible for income tax purposes.

### Balance Sheet Analysis

The Company's total assets were \$592,099,000 at September 30, 2006 as compared to \$612,763,000 at December 31, 2005, representing a decrease of \$20,664,000 or 3.4%. The average balance of total assets for the nine months ended September 30, 2006 was \$605,620,000, which represents an increase of \$13,751,000 or 2.3% over the balance of \$591,869,000 during the nine-month period ended September 30, 2005. Total average assets for the third quarter of 2006 were \$600,053,000 compared to \$611,175,000 during the third quarter of 2005 for a decrease of 1.8%.

### Investment Securities

The Company classifies its investment securities as held to maturity or available for sale. The Company's intent is to hold all securities classified as held to maturity until maturity and management believes that it has the ability to do so. Securities available for sale may be sold to implement asset/liability management strategies and in response to changes in interest rates, prepayment rates and similar factors. Table Five below summarizes the values of the Company's investment securities held on September 30, 2006 and December 31, 2005.

Table Five: Investment Securities Composition  
(Dollars in thousands)

Available-for-sale (at fair value)

September 30, 2006

December 31, 2005



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-----			
Debt securities:			
U.S. Government agencies	\$	36,222	\$ 49,119
Mortgage-backed securities		34,474	36,326
Obligations of states and political subdivisions		37,256	37,106
Corporate debt securities		1,004	1,014
Corporate stock		623	624
-----			
Total available-for-sale investment securities	\$	109,579	\$ 124,189
=====			
Held-to-maturity (at amortized cost)			
-----			
Debt securities:			
Mortgage-backed securities	\$	36,502	\$ 45,012
-----			
Total held-to-maturity investment securities	\$	36,502	\$ 45,012
=====			

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Loans and Leases

The Company concentrates its lending activities in the following principal areas: (1) commercial; (2) commercial real estate; (3) multi-family real estate; (4) real estate construction (both commercial and residential); (5) residential real estate; (6) lease financing receivable; (7) agriculture; and (8) consumer loans. At September 30, 2006, these categories accounted for approximately 22%, 41%, 1%, 28%, 1%, 2%, 2% and 3%, respectively, of the Company's loan portfolio. This mix was relatively unchanged compared to 21%, 42%, 1%, 28%, 1%, 2%, 2% and 3% at December 31, 2005. Continuing economic activity in the Company's market area, new borrowers developed through the Company's marketing efforts, and credit extensions expanded to existing borrowers resulted in the Company originating over \$183 million in new loans during the first three quarters of 2006; however, loan and lease paydowns and payoffs resulted in net increases in balances for commercial (\$5,157,000 or 6.6%), commercial real estate (\$1,544,000 or 1.0%), multi-family real estate (\$68,000 or 1.8%), real estate construction (\$3,263,000 or 3.2%), residential real estate (\$480,000 or 10.3%), and consumer loans (\$100,000 or 0.8%). The Company experienced a decrease in lease financing receivable (\$1,281,000 or 16.1%) and agriculture (\$339,000 or 4.2%) as a result of net paydowns. Table Six below summarizes the composition of the loan portfolio as of September 30, 2006 and December 31, 2005.

Table Six: Loan and Lease Portfolio Composition

(Dollars in thousands)	September 30, 2006	December 31, 2005
Commercial	\$ 83,128	\$ 77,971
Real estate		
Commercial	156,044	154,500
Multi-family	3,835	3,767
Construction	106,311	103,048
Residential	5,160	4,680
Lease financing receivable	6,686	7,967
Agriculture	7,790	8,129
Consumer	12,000	11,900

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Total loans and leases	380,954	371,962
Deferred loan and lease fees, net	(687)	(712)
Allowance for loan and lease losses	(5,871)	(5,679)
Total net loans and leases	\$ 374,396	\$ 365,571

A significant portion of the Company's loans and leases are direct loans and leases made to individuals and local businesses. The Company relies substantially on local promotional activity and personal contacts by American River Bank officers, directors and employees to compete with other financial institutions. The Company makes loans and leases to borrowers whose applications include a sound purpose and a viable primary repayment source, generally supported by a secondary source of repayment.

Commercial loans consist of credit lines for operating needs, loans for equipment purchases, working capital, and various other business loan products. Consumer loans include a range of traditional consumer loan products such as personal lines of credit and loans to finance purchases of autos, boats, recreational vehicles, mobile homes and various other consumer items. Construction loans are generally comprised of commitments to customers within the Company's service area for construction of commercial properties, multi-family properties and custom and semi-custom single-family residences. Other real estate loans consist primarily of loans secured by first trust deeds on commercial and residential properties typically with maturities from 3 to 10 years and original loan to value ratios generally from 65% to 75%. Agriculture loans consist primarily of vineyard loans and development loans to plant vineyards. In general, except in the case of loans under SBA programs or Farm Services Agency guarantees, the Company does not make long-term mortgage loans; however, American River Bank has a residential lending division to assist customers in securing most forms of longer term single-family mortgage financing. American River Bank acts as a broker between American River Bank's clients and the loan wholesalers. American River Bank receives an origination fee for loans closed.

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### Risk Elements

The Company assesses and manages credit risk on an ongoing basis through a total credit culture that emphasizes excellent credit quality, extensive internal monitoring and established formal lending policies. Additionally, the Company contracts with an outside loan review consultant to periodically review the existing loan and lease portfolio. Management believes its ability to identify and assess risk and return characteristics of the Company's loan and lease portfolio is critical for profitability and growth. Management strives to continue its emphasis on credit quality in the loan and lease approval process, active credit administration and regular monitoring. With this in mind, management has designed and implemented a comprehensive loan and lease review and grading system that functions to continually assess the credit risk inherent in the loan and lease portfolio.

Ultimately, underlying trends in economic and business cycles may influence credit quality. American River Bank's business is concentrated: (1) in the Sacramento Metropolitan Statistical Area, (2) in Sonoma County, through North Coast Bank, a division of American River Bank, whose business is focused on businesses within the three communities in which it has offices (Santa Rosa, Windsor, and Healdsburg), and (3) in Amador County, through Bank of Amador, a division of American River Bank, whose business is focused on businesses and consumers within the three communities in which it has offices (Jackson, Pioneer, and Ione). American River Bank also has a diversified residential

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construction loan business in numerous Northern California counties. The Sacramento Metropolitan Statistical Area is a diversified economy, but with a large State of California government presence and employment base, the economy of Sonoma County is diversified with professional services, manufacturing, agriculture and real estate investment and construction, while the economy of Amador County is reliant upon government, services, retail trade, manufacturing industries and Indian gaming.

The Company has significant extensions of credit and commitments to extend credit that are secured by real estate. The ultimate repayment of these loans is generally dependent on personal or business cash flows or the sale or refinancing of the real estate. The Company monitors the effects of current and expected market conditions and other factors on the collectability of real estate loans. The more significant factors management considers involve the following: lease rate and terms, capitalization rates, absorption and sale rates; real estate values and rates of return; operating expenses; inflation; and sufficiency of repayment sources independent of the real estate including, in some instances, personal guarantees.

In extending credit and commitments to borrowers, the Company generally requires collateral and/or guarantees as security. The repayment of such loans is expected to come from cash flow or from proceeds from the sale of selected assets of the borrowers. The Company's requirement for collateral and/or guarantees is determined on a case-by-case basis in connection with management's evaluation of the creditworthiness of the borrower. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, income-producing properties, residences and other real property. The Company secures its collateral by perfecting its security interest in business assets, obtaining deeds of trust, or outright possession among other means.

In management's judgment, a concentration exists in real estate loans which represented approximately 71.2% of the Company's loan and lease portfolio at September 30, 2006, down from 71.5% at December 31, 2005. Although management believes this concentration to have no more than the normal risk of collectability, a substantial decline in the economy in general, or a decline in real estate values in the Company's primary market areas in particular, could have an adverse impact on the collectability of these loans and require an increase in the provision for loan and lease losses which could adversely affect the Company's future prospects, results of operations, profitability and stock price. Management believes that its lending policies and underwriting standards will tend to minimize losses in an economic downturn; however, there is no assurance that losses will not occur under such circumstances. The Company's loan policies and underwriting standards include, but are not limited to, the following: (1) maintaining a thorough understanding of the Company's service area and originating a significant majority of its loans within that area, (2) maintaining a thorough understanding of borrowers' knowledge, capacity, and market position in their field of expertise, (3) basing real estate loan approvals not only on market demand for the project, but also on the borrowers' capacity to support the project financially in the event it does not perform to expectations (whether sale or income performance), and (4) maintaining conforming and prudent loan to value and loan to cost ratios based on independent outside appraisals and ongoing inspection and analysis by the Company's lending officers.

### Nonaccrual, Past Due and Restructured Loans and Leases

Management generally places loans and leases on nonaccrual status when they become 90 days past due, unless the loan or lease is well secured and in the process of collection. Loans and leases are charged off when, in the opinion

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of management, collection appears unlikely.

At September 30, 2006, non-performing loans and leases (those loans on non-accrual status and those loans still accruing and past due 90 days or more) were \$299,000 or 0.08% of total loans and leases. Non-performing loans and leases were \$91,000 or 0.02% of total loans and leases at December 31, 2005. There were no loan concentrations in excess of 10% of total loans not otherwise disclosed as a category of loans as of September 30, 2006 or December 31, 2005. Management is not aware of any potential problem loans, which were accruing and current at September 30, 2006, where serious doubt exists as to the ability of the borrower to comply with the present repayment terms or that would result in a material loss to the Company. Table Seven below sets forth nonaccrual loans and loans past due 90 days or more as of September 30, 2006 and December 31, 2005.

Table Seven: Non-Performing Loans

(Dollars in thousands)	September 30, 2006	December 31, 2005
-----		
Past Due 90 days or more and still accruing		
Commercial	\$       --	\$       24
Real estate	--	--
Lease financing receivable	18	--
Consumer and other	--	--
-----		
Nonaccrual		
Commercial	251	--
Real estate	12	15
Lease financing receivable	18	52
Consumer and other	--	--
-----		
Total non-performing loans	\$       299	\$       91
=====		

### Allowance for Loan and Lease Losses Activity

The Company maintains an allowance for loan and lease losses ("ALLL") to cover probable losses inherent in the loan and lease portfolio, which is based upon management's estimates of those losses. The ALLL is established through a provision for loan and lease losses and is increased by provisions charged against current earnings and recoveries and reduced by charge-offs and reversals of previous provisions charged to earnings. Actual losses for loans and leases can vary significantly from this estimate. The methodology and assumptions used to calculate the allowance are continually reviewed as to their appropriateness given the most recent losses realized and other factors that influence the estimation process. The model assumptions and resulting allowance level are adjusted accordingly as these factors change.

The adequacy of the ALLL and the level of the related provision for loan and lease losses is determined based on management's judgment after consideration of numerous factors including but not limited to: (1) historical loss rates, (2) local and regional economic conditions, (3) credit policy and underwriting, (4) management and staff effectiveness, (5) trends in delinquencies and charge-offs, (5) credit concentrations, (6) impaired loans, (7) risk factors assigned to criticized or classified (problem) credits not considered impaired, and (8) assessments by banking regulators and other third parties. The Board of Directors reviews management's analysis of the adequacy of the ALLL quarterly.

The Company establishes general reserves in accordance with Statement of Accounting Standards ("SFAS") No. 5., Accounting for Contingencies, and

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specific reserves in accordance with SFAS No. 114, Accounting by Creditors for Impairment of a Loan. The ALLL is internally allocated based on loan category, loan grades, estimated risk factors, and loan impairment as discussed in the prior paragraph; however, the entire allowance is available to cover actual loan and lease losses. While management uses available information to recognize possible losses on loans and leases, future additions to the allowance may be necessary, based on changes in economic

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conditions and other matters. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's ALLL. Such agencies may require the Company to provide additions to the allowance based on their judgment of information available to them at the time of their examination. Table Eight below summarizes, for the periods indicated, the activity in the allowance for loan and lease losses.

Table Eight: Allowance for Loan and Lease Losses

(Dollars in thousands)	Three Months Ended September 30,	
	2006	2005
Average loans and leases outstanding	\$ 387,992	\$ 357,728
Allowance for possible loan and lease losses at beginning of period	\$ 5,924	\$ 5,737
Loans and leases charged off:		
Commercial	(21)	(3)
Real estate	--	--
Lease financing receivable	(63)	(48)
Consumer	(1)	--
Total	(85)	(51)
Recoveries of loans and leases previously charged off:		
Commercial	--	--
Real estate	--	--
Lease financing receivable	2	5
Consumer	--	--
Total	2	5
Net loans recovered (charged off)	(83)	(46)
Additions to allowance charged to operating expenses	30	--
Allowance for possible loan and lease losses at end of period	\$ 5,871	\$ 5,691
Ratio of net (recoveries) charge-offs to average loans and leases outstanding (annualized)	.08%	.05%
Provision of allowance for possible		

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loan and lease losses to average loans and leases outstanding (annualized)	.03%	.00%
Allowance for possible loan and lease losses to loans and leases net of deferred fees at end of period	1.54%	1.56%

The adequacy of the ALLL is determined based on three components. First, the dollar weighted risk factor of the loan portfolio (excepting criticized and classified credits and impaired loans) is determined. Second, risk factors are assigned to criticized and classified loans and leases not considered impaired. Third, the Company determines whether a loan is impaired and if so measures the degree of impairment in the context of SFAS No. 114 "Accounting by Creditors for Impairment of a Loan". These are estimated potential losses associated with specific borrowers based upon estimated cash flows or collateral value and events affecting the risk rating. These three calculations are designed to encompass the entire balance of the loan and lease portfolio. When these three dollar numbers are aggregated, it is then compared to the actual ALLL balance at the measurement date. Management is responsible to maintain the actual ALLL within a reasonable range of the total estimated loss risk inherent in the loan and lease portfolio. However, no prediction of the ultimate level of loans and leases charged off in future periods can be made with any certainty. The allowance for loan and lease losses totaled \$5,871,000 or 1.54% of total loans and leases at September 30, 2006 and \$5,679,000 or 1.53% of total loans and leases at December 31, 2005.

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### Other Real Estate

At September 30, 2006 and December 31, 2005, the Company did not have any other real estate ("ORE") properties.

### Deposits

At September 30, 2006, total deposits were \$493,444,000 representing a decrease of \$7,262,000 (1.5%) from the December 31, 2005 balance of \$500,706,000. Noninterest-bearing deposits decreased \$9,848,000 (6.0%) while interest-bearing deposits increased \$2,586,000 (0.8%).

### Other Borrowed Funds

Other borrowings outstanding as of September 30, 2006 and December 31, 2005, consist of advances (both long-term and short-term) from the FHLB. Table Nine below summarizes these borrowings:

Table Nine: Other Borrowed Funds

(Dollars in thousands)

	September 30, 2006		December 31, 2005	
	Amount	Rate	Amount	Rate
Short-Term borrowings:				
FHLB advances	\$ 25,566	4.76%	\$ 39,386	3.73%
Advances from correspondent				

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banks	--	--	--	--
Total Short-Term borrowings	\$ 25,566	4.76%	\$ 39,386	3.73%
Long-Term Borrowings:				
FHLB advances	\$ 6,722	5.23%	\$ 4,270	4.10%

The maximum amount of short-term borrowings at any month-end during the first three quarters of 2006 and 2005 was \$64,489,000 and \$32,857,000, respectively. The FHLB advances are collateralized by loans and securities pledged to the FHLB. The following is a breakdown of rates and maturities on FHLB advances (dollars in thousands):

	Short Term	Long Term
Amount	\$ 25,566	\$ 6,722
Maturity	2006 to 2007	2007 to 2008
Average rates	4.76%	5.23%

The Company has also been issued a total of \$3,500,000 in letters of credit by the FHLB which have been pledged to secure Local Agency Deposits. The letters of credit act as a guarantee of payment to certain third parties in accordance with specified terms and conditions. The letters of credit were not drawn upon in 2006 or 2005 and management does not expect to draw upon these lines in the future. See Liquidity section that follows for additional information on FHLB borrowings.

### Capital Resources

The current and projected capital position of the Company and the impact of capital plans and long-term strategies is reviewed regularly by management. The Company's capital position represents the level of capital available to support continuing operations and expansion.

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The Company and American River Bank are subject to certain regulations issued by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation, which require maintenance of certain levels of capital. Failure to meet these minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, American River Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and American River Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. At September 30, 2006, shareholders' equity was \$61,620,000, representing a decrease of \$1,126,000 (1.8%) from \$62,746,000 at December 31, 2005. The ratio of total risk-based capital to risk adjusted assets was 11.4% at September 30, 2006 compared to 11.9% at December 31, 2005. Tier 1 risk-based capital to risk-adjusted assets was 10.2% at September 30, 2006 and 10.6% at December 31, 2005.

Table Ten below lists the Company's actual capital ratios at September

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30, 2006 and December 31, 2005 as well as the minimum capital ratios for capital adequacy.

Table Ten: Capital Ratios

Capital to Risk-Adjusted Assets	At September 30, 2006	At December 31, 2005	Minimum Capital
Leverage ratio	7.6%	7.7%	
Tier 1 Risk-Based Capital	10.2%	10.6%	
Total Risk-Based Capital	11.4%	11.9%	

Capital ratios are reviewed on a regular basis to ensure that capital exceeds the prescribed regulatory minimums and is adequate to meet future needs. Management believes that both the Company and American River Bank met all of their capital adequacy requirements as of September 30, 2006 and December 31, 2005.

The Company, through a Board of Director's authorized plan, may repurchase, as conditions warrant, up to 5% annually of the Company's common stock. Repurchases are generally made in the open market at market prices. (See Part II, Item 2, for additional disclosure).

### Inflation

The impact of inflation on a financial institution differs significantly from that exerted on manufacturing, or other commercial concerns, primarily because its assets and liabilities are largely monetary. In general, inflation primarily affects the Company and its subsidiaries through its effect on market rates of interest, which affects the Company's ability to attract loan customers. Inflation affects the growth of total assets by increasing the level of loan demand, and potentially adversely affects capital adequacy because loan growth in inflationary periods can increase at rates higher than the rate that capital grows through retention of earnings which may be generated in the future. In addition to its effects on interest rates, inflation increases overall operating expenses. Inflation has not had a material effect upon the results of operations of the Company and its subsidiaries during the periods ended September 30, 2006 and 2005.

### Liquidity

Liquidity management refers to the Company's ability to provide funds on an ongoing basis to meet fluctuations in deposit levels as well as the credit needs and requirements of its clients. Both assets and liabilities contribute to the Company's liquidity position. Federal funds lines, short-term investments and securities, and loan repayments contribute to liquidity, along with deposit increases, while loan funding and deposit withdrawals decrease liquidity. The Company assesses the likelihood of projected funding requirements by reviewing historical funding patterns, current and forecasted economic conditions and individual client funding needs. Commitments to fund loans

and outstanding letters of credit at September 30, 2006 and December 31, 2005 were approximately \$126,107,000 and \$5,331,000 and \$137,802,000 and \$3,393,000,



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respectively. Such loan commitments relate primarily to revolving lines of credit and other commercial loans and to real estate construction loans. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The Company's sources of liquidity consist of cash and due from correspondent banks, overnight funds sold to correspondent banks, unpledged marketable investments and loans held for sale and/or pledged for secured borrowings. At September 30, 2006, consolidated liquid assets totaled \$74.3 million or 12.6% of total assets compared to \$99.2 million or 16.2% of total assets on December 31, 2005. In addition to liquid assets, the Company maintains short-term lines of credit in the amount of \$53,000,000 with correspondent banks. At September 30, 2006, the Company had \$53,000,000 available under these credit lines. Additionally, American River Bank is a member of the FHLB. At September 30, 2006, American River Bank could have arranged for up to \$140,380,000 in secured borrowings from the FHLB. These borrowings are secured by pledged mortgage loans and investment securities. At September 30, 2006, the Company had advances, borrowings and commitments (including letters of credit) outstanding of \$35,788,000, leaving \$104,592,000 available under these FHLB secured borrowing arrangements. American River Bank also has informal agreements with various other banks to sell participations in loans, if necessary. The Company serves primarily a business and professional customer base and, as such, its deposit base is susceptible to economic fluctuations. Accordingly, management strives to maintain a balanced position of liquid assets and borrowing capacity to volatile and cyclical deposits.

Liquidity is also affected by portfolio maturities and the effect of interest rate fluctuations on the marketability of both assets and liabilities. The Company can sell any of its unpledged securities held in the available-for-sale category to meet liquidity needs. These securities are also available to pledge as collateral for borrowings if the need should arise. American River Bank has established a master repurchase agreement with a correspondent bank to enable such transactions. American River Bank can also pledge securities to borrow from the FRB and the FHLB. The principal cash requirements of the Company are for expenses incurred in the support of administration and operations. For nonbanking functions, the Company is dependent upon the payment of cash dividends from American River Bank to service its commitments. The Company expects that the cash dividends paid by American River Bank to the Company will be sufficient to meet this payment schedule.

### Off-Balance Sheet Items

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet.

The Company's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Company applies the same credit policies to commitments and letters of credit as it does for loans included on the consolidated balance sheet. As of September 30, 2006 and December 31, 2005, commitments to extend credit and standby letters of credit were the only financial instruments with off-balance sheet risk. The Company has not entered into any contracts for financial derivative instruments such as futures, swaps, options or similar instruments. Loan commitments and standby letters of credit were \$131,438,000 and \$141,195,000 at September 30, 2006 and December 31, 2005, respectively. As a percentage of net loans and leases these off-balance sheet items represent 35.1% and 38.6%, respectively.

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The Company has certain ongoing commitments under operating leases. These commitments do not significantly impact operating results.

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Certain financial institutions have elected to use special purpose vehicles ("SPV") to dispose of problem assets. The SPV is typically a subsidiary company with an asset and liability structure and legal status that makes its obligations secure even if the parent corporation goes bankrupt. Under certain circumstances, these financial institutions may exclude the problem assets from their reported impaired and non-performing assets. The Company does not use these vehicles or any other structures to dispose of problem assets.

### Other Matters

Effects of Terrorism. The terrorist actions on September 11, 2001 and thereafter, as well as, the current military conflict in Iraq have had significant adverse effects upon the United States economy. Whether the terrorist activities in the future and the actions of the United States and its allies in combating terrorism on a worldwide basis will adversely impact the Company and the extent of such impact is uncertain. Such economic deterioration could adversely affect the Company's future results of operations by, among other matters, reducing the demand for loans and other products and services offered by the Company, increasing nonperforming loans and the amounts reserved for loan and lease losses, and causing a decline in the Company's stock price.

Website Access. American River Bankshares maintains a website where certain information about the Company is posted. Through the website, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments thereto, as well as Section 16 Reports and amendments thereto, are available as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (the "SEC"). These reports are free of charge and can be accessed through the address [www.amrb.com](http://www.amrb.com) by clicking on the SEC Filings link located at that address. Once you have selected the SEC Filings link you will have the option to access the Section 16 Reports or the other above-referenced reports filed by the Company by selecting the appropriate link.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

#### Market Risk Management

Overview. Market risk is the risk of loss from adverse changes in market prices and rates. The Company's market risk arises primarily from interest rate risk inherent in its loan, investment and deposit functions. 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 interest rate risk management policies. The Company has a Risk Management Committee, made up of Company management that establishes and monitors guidelines to control the sensitivity of earnings to changes in interest rates.

Asset/Liability Management. Activities involved in asset/liability management include but are not limited to lending, accepting and placing deposits and investing in securities. 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

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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 and market value of equity under changing interest environments. The Company uses simulation models to forecast earnings, net interest margin and market value of equity.

Simulation of earnings is the primary tool used to measure the sensitivity of earnings to interest rate changes. Using computer-modeling techniques, the Company is able to estimate the potential impact of changing interest rates on earnings. A balance sheet forecast is prepared quarterly using inputs of actual loans, securities and interest bearing liabilities (i.e. deposits/borrowings) positions as the beginning base. The forecast balance sheet is processed against three interest rate scenarios. The scenarios include a 200 basis point rising rate forecast, a flat rate forecast and a 200 basis point falling rate forecast which take place within a one year time frame. The net

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interest income is measured during the year assuming a gradual change in rates over the twelve-month horizon. The simulation modeling indicated below attempts to estimate changes in the Company's net interest income utilizing a forecast balance sheet projected from the end of period balances.

Table Eleven below summarizes the effect on net interest income (NII) of a +/-200 basis point change in interest rates as measured against a constant rate (no change) scenario.

Table Eleven: Interest Rate Risk Simulation of Net Interest as of September 30, 2006 and Decem

(In thousands)	\$ Change in NII from Current 12 Month Horizon September 30, 2006	\$ Ch fro 12 Mo Decem
Variation from a constant rate scenario		
+ 200bp	\$ 540	\$
- 200bp	\$ (878)	\$

The simulations of earnings 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 reasonable estimates of interest rate risk.

#### Item 4. Controls and Procedures.

The Company, under the supervision and with the participation of its management, including the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures" (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of September 30, 2006. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely making known to them material information relating to the Company and the Company's consolidated subsidiaries required to be disclosed in the Company's reports filed or submitted under the Exchange Act.

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During the quarter ended September 30, 2006, there have been no changes in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, these controls.

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### PART II - OTHER INFORMATION

#### Item 1. Legal Proceedings.

From time to time, the Company and/or its subsidiaries is a party to claims and legal proceedings arising in the ordinary course of business. The Company's management is not aware of any material pending legal proceedings to which either it or its subsidiaries may be a party or has recently been a party, which will have a material adverse effect on the financial condition or results of operations of the Company or its subsidiaries, taken as a whole.

#### Item 1A. Risk Factors.

There have been no material changes in the risk factors previously disclosed in the Company's Form 10-K for the period ended December 31, 2005, filed with the Securities and Exchange Commission on March 9, 2006.

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

On September 20, 2001, the Board of Directors of the Company authorized a stock repurchase program which calls for the repurchase of up to five percent (5%) annually of the Company's outstanding shares of common stock. Each year the Company may repurchase up to 5% of the shares outstanding (adjusted for stock splits or stock dividends). The number of shares reported in column (d) of the table as shares that may be repurchased under the plan represent shares eligible for the calendar year 2006. The repurchases can be made from time to time in the open market as conditions allow and will be structured to comply with Commission Rule 10b-18. Management reports monthly to the Board of Directors on the status of the repurchase program. The Board of Directors has reserved the right to suspend, terminate, modify or cancel this repurchase program at any time for any reason. The following table lists shares repurchased during the quarter and the maximum amount available to repurchase under the repurchase plan.

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Sha (or Units) Purchased Part of Publicly Announced Plans o Programs
Month #1 July 1 through July 31, 2006	30,000	26.30	30,000
Month #2 August 1 through August 31, 2006	100,000	25.00	100,000
Month #3 September 1 through September 30, 2006	None	None	None
Total	130,000	\$ 25.30	130,000

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Item 3. Defaults Upon Senior Securities.

b None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

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Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit Number -----	Document Description -----
(2.1)	Agreement and Plan of Reorganization and Merger by and among the Registrant, ARH Interim National Bank and North Coast Bank, N.A., dated as of March 1, 2000 (included as Annex A). **
(2.2)	Agreement and Plan of Reorganization and Merger by and among the Registrant, American River Bank and Bank of Amador, dated as of July 8, 2004 (included as Annex A). ***
(3.1)	Articles of Incorporation, as amended, incorporated by reference from Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed with the Commission on August 11, 2004.
(3.2)	Bylaws, as amended, incorporated by reference from Exhibit 3.2 to the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2006, filed with the Commission on May 9, 2006.
(4.1)	Specimen of the Registrant's common stock certificate, incorporated by reference from Exhibit 4.1 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed with the Commission on August 11, 2004.
(10.1)	Lease agreement between American River Bank and Spieker Properties, L.P., a California limited partnership, dated April 1, 2000, related to 1545 River Park Drive, Suite 107, Sacramento, California. **
(10.2)	Lease agreement and addendum between American River Bank and Bradshaw Plaza Group each dated January 31, 2000, related to 9750 Business Park Drive, Sacramento, California. **

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- (10.3) Lease agreement between American River Bank and Marjorie G. Taylor dated April 5, 1984, and addendum dated July 16, 1997, related to 10123 Fair Oaks Boulevard, Fair Oaks, California. \*\*
- (10.4) Lease agreement between American River Bank and LUM YIP KEE, Limited (formerly Sandalwood Land Company) dated August 28, 1996, related to 2240 Douglas Boulevard, Suite 100, Roseville, California (\*\*). Lease Amendment No. 1 to said lease dated July 28, 2006, incorporated by reference from Exhibit 99.1 to the Registrant's Report on Form 8-K, filed with the Commission on July 31, 2006.
- \*(10.5) Registrant's 1995 Stock Option Plan. \*\*
- \*(10.6) Form of Nonqualified Stock Option Agreement under the 1995 Stock Option Plan. \*\*
- \*(10.7) Form of Incentive Stock Option Agreement under the 1995 Stock Option Plan. \*\*
- \*(10.8) Registrant's Stock Option Gross-Up Plan and Agreement, as amended, dated May 20, 1998. \*\*
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- \*(10.9) Registrant's Deferred Compensation Plan, incorporated by reference from Exhibit 99.2 to the Registrant's Report on Form 8-K, filed with the Commission on May 30, 2006.
- \*(10.10) Registrant's Deferred Fee Plan, incorporated by reference from Exhibit 99.1 to the Registrant's Report on Form 8-K, filed with the Commission on May 30, 2006.
- \*(10.11) American River Bank Employee Severance Policy dated March 18, 1998. \*\*
- (10.12) Lease agreement and addendum between North Coast Bank, N.A. and Rosario LLC, each dated September 1, 1998, related to 50 Santa Rosa Avenue, Santa Rosa, California. \*\*
- (10.13) Lease agreement between American River Bank and 520 Capitol Mall, Inc., dated August 19, 2003, related to 520 Capitol Mall, Suite 100, Sacramento, California, incorporated by reference from Exhibit 10.29 to the Registrant's Form 10-Q for the period ended September 30, 2003, filed with the Commission on November 7, 2003.
- \*(10.14) Employment Agreement between Registrant and David T. Taber dated June 2, 2006, incorporated by reference from Exhibit 99.3 to the Registrant's Report on Form 8-K, filed with the Commission on May 30, 2006.

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- (10.15) Lease agreement between R & R Partners, a California General Partnership and North Coast Bank, N.A., dated July 1, 2003, related to 8733 Lakewood Drive, Suite A, Windsor, California, incorporated by reference from Exhibit 10.32 to the Company's Form 10-Q for the period ended September 30, 2003, filed with the Commission on November 7, 2003.
- \*(10.16) Salary Continuation Agreement, as amended on June 2, 2006, between American River Bank and Mitchell A. Derenzo, incorporated by reference from Exhibit 99.9 to the Registrant's Report on Form 8-K, filed with the Commission on May 30, 2006.
- \*(10.17) Salary Continuation Agreement, as amended on June 2, 2006, between the Registrant and David T. Taber, incorporated by reference from Exhibit 99.7 to the Registrant's Report on Form 8-K, filed with the Commission on May 30, 2006.
- \*(10.18) Salary Continuation Agreement, as amended on June 2, 2006, between American River Bank and Douglas E. Tow, incorporated by reference from Exhibit 99.8 to the Registrant's Report on Form 8-K, filed with the Commission on May 30, 2006.
- \*(10.19) Registrant's 2000 Stock Option Plan with forms of Nonqualified Stock Option Agreement and Incentive Stock Option Agreement. \*\*
- (10.20) First Amendment dated April 21, 2004, to the lease agreement between American River Bank and 520 Capitol Mall, Inc. dated August 19, 2003, related to 520 Capitol Mall, Suite 100 Sacramento, California, incorporated by reference from Exhibit 10.37 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed with the Commission on August 11, 2004.
- \*(10.21) Registrant's 401(k) Plan dated September 20, 2004, incorporated by reference from Exhibit 10.38 to the Registrant's Quarterly Report on Form 10-Q for the period ended September 30, 2004, filed with the Commission on November 12, 2004.
- (10.22) Agreement between Bank of Amador and the United States Postal Service, dated April 24, 2001, related to 424 Sutter Street, Jackson, California. \*\*\*
- (10.23) Ground lease agreement between Bank of Amador and the James B. Newman and Helen M. Newman, dated June 1, 1992, related to 26675 Tiger Creek Road, Pioneer, California. \*\*\*
- \*(10.24) Salary Continuation Agreement, as amended on June 2, 2006, between Bank of Amador, a division of American River Bank, and Larry D. Standing and

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- related Endorsement Split Dollar Agreement, incorporated by reference from Exhibit 99.5 to the Registrant's Report on Form 8-K, filed with the Commission on May 30, 2006.
- \* (10.25) Director Retirement Agreement, as amended on June 2, 2006, between Bank of Amador, a division of American River Bank, and Larry D. Standing, incorporated by reference from Exhibit 99.6 to the Registrant's Report on Form 8-K, filed with the Commission on May 30, 2006.
- \* (10.26) Employment Agreement dated June 2, 2006 between Bank of Amador, a division of American River Bank, and Larry D. Standing, incorporated by reference from Exhibit 99.4 to the Registrant's Report on Form 8-K, filed with the Commission on May 30, 2006.
- (10.27) Item Processing Agreement between American River Bank and Fidelity Information Services, Inc., dated April 22, 2005, incorporated by reference from Exhibit 99.1 to the Registrant's Report on Form 8-K, filed with the Commission on April 27, 2005.
- (10.28) Lease agreement between Registrant and One Capital Center, a California limited partnership, dated May 17, 2005, related to 3100 Zinfandel Drive, Rancho Cordova, California, incorporated by reference from Exhibit 99.1 to the Registrant's Report on Form 8-K, filed with the Commission on May 18, 2005.
- (10.29) Managed Services Agreement between American River Bankshares and ProNet Solutions, Inc., dated September 8, 2005, incorporated by reference from Exhibit 99.1 to the Registrant's Report on Form 8-K, filed with the Commission on September 9, 2005.
- \* (10.30) American River Bankshares 2005 Executive Incentive Plan, incorporated by reference from Exhibit 99.1 to the Registrant's Report on Form 8-K, filed with the Commission on October 27, 2005 and First Amendment thereto, incorporated by reference from Exhibit 99.1 to the Registrant's Report on Form 8-K, filed with the Commission on March 17, 2006.
- (10.31) First Amendment to Commercial Lease Agreement between R. & R. Partners, and North Coast Bank, a division of American River Bank, dated January 2, 2006, related to 8733 Lakewood Drive, Suite A, Windsor, California, incorporated by reference from Exhibit 99.1 to the Registrant's Report on Form 8-K, filed with the Commission on January 3, 2006.
- (10.32) First Amendment to Commercial Lease Agreement between the United States Postal Service and Bank of Amador, a division of American River Bank, dated June 5, 2006, related to 424 Sutter Street,



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Jackson, California, incorporated by reference from Exhibit 99.1 to the Registrant's Report on Form 8-K, filed with the Commission on June 6, 2006.

- \* (10.33) American River Bankshares Director Emeritus Program, incorporated by reference from Exhibit 10.33 to the Registrant's Report on Form 10-Q, filed with the Commission on August 8, 2006.
  - \* (10.34) Employment Agreement dated September 20, 2006 between American River Bankshares and Mitchell A. Derenzo, incorporated by reference from Exhibit 99.1 to the Registrant's Report on Form 8-K, filed with the Commission on September 20, 2006.
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- \* (10.35) Employment Agreement dated September 20, 2006 between American River Bankshares and Douglas E. Tow, incorporated by reference from Exhibit 99.2 to the Registrant's Report on Form 8-K, filed with the Commission on September 20, 2006.
  - \* (10.36) Employment Agreement dated September 20, 2006 between American River Bankshares and Kevin B. Bender, incorporated by reference from Exhibit 99.3 to the Registrant's Report on Form 8-K, filed with the Commission on September 20, 2006.
  - \* (10.37) Employment Agreement dated September 20, 2006 between American River Bank and Gregory N. Patton, incorporated by reference from Exhibit 99.4 to the Registrant's Report on Form 8-K, filed with the Commission on September 20, 2006.
  - \* (10.38) Employment Agreement dated September 20, 2006 between American River Bank and Raymond F. Byrne, incorporated by reference from Exhibit 99.5 to the Registrant's Report on Form 8-K, filed with the Commission on September 20, 2006.
  - (14.1) Registrant's Code of Ethics, incorporated by reference from Exhibit 14.1 to the Registrant's Annual Report on Form 10-K for the period ended December 31, 2003, filed with the Commission on March 19, 2004.
  - (21.1) The Registrant's only subsidiaries are American River Bank and American River Financial.
  - (31.1) Certifications of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - (31.2) Certifications of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - (32.1) Certification of Registrant by its Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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\*Denotes management contracts, compensatory plans or arrangements.

\*\*Incorporated by reference to Registrant's Registration Statement on Form S-4 (No. 333-36326) filed with the Commission on May 5, 2000.

\*\*\*Incorporated by reference to Registrant's Registration Statement on Form S-4 (No. 333-119085) filed with the Commission on September 17, 2004.

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### 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, thereunto duly authorized.

#### AMERICAN RIVER BANKSHARES

November 6, 2006  
-----

By: /s/ DAVID T. TABER  
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David T. Taber  
President  
Chief Executive Officer

#### AMERICAN RIVER BANKSHARES

November 6, 2006  
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By: /s/ MITCHELL A. DERENZO  
-----

Mitchell A. Derenzo  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

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### EXHIBIT INDEX

Exhibit Number	Description	Page
31.1	Certifications of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	39
31.2	Certifications of Chief Financial Officer pursuant	

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	to Section 302 of the Sarbanes-Oxley Act of 2002.	40
32.1	Certification of American River Bankshares by its Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	41