Oak Valley Bancorp
Form 10-Q
November 15, 2010
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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, 2010

OR

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

Commission file number 001-34142

OAK VALLEY BANCORP

(Exact name of registrant as specified in its charter)

California	**26-2326676**

State or other jurisdiction of incorporation or organization	I.R.S. Employer Identification No.

125 N. Third Ave., Oakdale, CA 95361

(Address of principal executive offices)

(209) 848-2265

Issuer s telephone number

Not applicable

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

Indicate by check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 **o**

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

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

Large accelerated filer **o**	Accelerated filer **o**
Non-accelerated filer **o** (Do not check if a smaller reporting company)	Smaller reporting company **x**

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 7,702,127 shares of common stock outstanding as of October 31, 2010.

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September 30, 2010

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PART I FINANCIAL STATEMENTS

Item 1. Financial Statements

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

AT SEPTEMBER 30, 2010 AND DECEMBER 31, 2009

	September 30, 2010	December 31, 2009
ASSETS		
Cash and due from banks	$ 36,321,885	$ 20,003,548
Federal funds sold	10,170,000	1,645,000
Cash and cash equivalents	46,491,885	21,648,548
Securities available for sale	55,023,463	50,765,314
Loans, net of allowance for loan loss of $7,700,206 in 2010 and $7,020,222 in 2009	400,459,919	417,795,686
Bank premises and equipment, net	10,334,633	10,167,297
Other real estate owned (OREO)	1,142,887	2,149,514
Accrued interest and other assets	21,426,083	22,195,354
	$ 534,878,870	$ 524,721,713
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits	$ 448,904,177	$ 429,210,284
Accrued interest and other liabilities	3,369,731	2,619,178
FHLB advances	18,500,000	32,200,000
Total liabilities	470,773,908	464,029,462
Commitments and contingencies		
Shareholders equity		
Preferred stock, no par value; $1,000 per share liquidation preference, 10,000,000 shares authorized and 13,500 issued and outstanding at September 30, 2010 and December 31, 2009	12,972,283	12,847,297
Common stock, no par value; 50,000,000 shares authorized, 7,702,127 and 7,681,877 shares issued and outstanding at September 30, 2010 and December 31, 2009, respectively	24,003,550	23,933,440
Additional paid-in capital	2,067,431	1,997,747
Retained earnings	22,726,795	20,230,683
Accumulated other comprehensive income, net of tax	2,334,903	1,683,084
Total shareholders equity	64,104,962	60,692,251
	$ 534,878,870	$ 524,721,713

The accompanying notes are an integral part of these consolidated financial statements.

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

FOR THE THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2010 AND SEPTEMBER 30, 2009

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2010	2009	2010	2009
INTEREST INCOME				
Interest and fees on loans	$ 6,405,225	$ 6,736,602	$ 19,232,421	$ 20,048,818
Interest on securities available for sale	592,553	678,379	1,769,197	1,967,059
Interest on federal funds sold	3,346	1,334	7,220	2,929
Interest on deposits with banks	13,370	1,942	21,158	3,574
Total interest income	7,014,494	7,418,257	21,029,996	22,022,380
INTEREST EXPENSE				
Deposits	570,347	1,245,576	2,097,640	3,918,842
FHLB advances	85,370	152,841	268,625	539,979
Federal funds purchased	0	38	110	381
Total interest expense	655,717	1,398,455	2,366,375	4,459,202
Net interest income	6,358,777	6,019,802	18,663,621	17,563,178
PROVISION FOR LOAN LOSSES	1,005,000	925,000	3,015,000	4,962,012
Net interest income after provision for loan losses	5,353,777	5,094,802	15,648,621	12,601,166
NON-INTEREST INCOME				
Service charges on deposits	272,136	300,282	787,142	875,229
Earnings on cash surrender value of life insurance	103,986	101,057	308,671	303,170
Mortgage commissions	30,849	38,143	74,984	127,160
Other	269,078	338,154	884,047	717,763
Total non-interest income	676,049	777,636	2,054,844	2,023,322
NON-INTEREST EXPENSE				
Salaries and employee benefits	2,143,094	1,974,022	6,483,605	5,889,247
Occupancy expenses	690,209	658,928	2,031,127	2,031,844
Data processing fees	233,694	220,181	706,889	672,597
OREO expenses	35,051	915,623	598,894	1,974,375
Assessments (FDIC & DFI)	258,000	230,269	774,000	667,355
Other operating expenses	828,155	745,563	2,355,381	2,234,073
Total non-interest expense	4,188,203	4,744,586	12,949,896	13,469,491
Net income before provision for income taxes	1,841,623	1,127,852	4,753,569	1,154,997
PROVISION (BENEFIT) FOR INCOME TAXES	700,700	248,701	1,626,221	(109,401)
NET INCOME	$ 1,140,923	$ 879,151	$ 3,127,348	$ 1,264,398
Preferred stock dividends and accretion	210,412	210,411	631,236	631,233
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$ 930,511	$ 668,740	$ 2,496,112	$ 633,165

NET EARNINGS PER COMMON SHARE	$ 0.12	$ 0.09	$ 0.32	$ 0.08
NET EARNINGS PER DILUTED COMMON SHARE	$ 0.12	$ 0.09	$ 0.32	$ 0.08

The accompanying notes are an integral part of these consolidated financial statements.

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)

FOR THE YEAR ENDED DECEMBER 31, 2009 AND THE NINE-MONTH PERIOD ENDED SEPTEMBER 30, 2010

	NINE MONTHS ENDED SEPTEMBER 30, 2010 AND YEAR ENDED DECEMBER 31, 2009								
	Common Stock		Preferred Stock		Additional Paid-in	Retained	Comprehensive	Accumulated Other Comprehensive	Total Shareholders
	Shares	Amount	Shares	Amount	Capital	Earnings	Income	Income	Equity
Balances, January 1, 2009	7,661,627	$ 23,863,331	13,500	$ 12,680,649	$ 1,925,224	$ 19,226,645		$ 290,230	$ 57,986,079
Stock options exercised	20,250	$ 70,109							70,109
Preferred stock accretion				$ 166,648		$ (166,648)			0
Preferred stock dividend payments						(637,500)			(637,500)
Cash dividends ($0.025 per share)						(191,542)			(191,542)
Stock based compensation					72,523				72,523
Comprehensive income:									
Net changes in unrealized gain on available-for-sale securities (net of income tax of $988,188)							1,392,854	1,392,854	1,392,854
Net income						1,999,728	1,999,728		1,999,728
Comprehensive income							$ 3,392,582		
Balances, December 31, 2009	7,681,877	$ 23,933,440	13,500	$ 12,847,297	$ 1,997,747	$ 20,230,683		$ 1,683,084	$ 60,692,251
Stock options exercised	20,250	$ 70,110							$ 70,110
Preferred stock accretion				$ 124,986		$ (124,986)			0
Preferred stock dividend payments						(506,250)			(506,250)
Stock based compensation					69,684				69,684
Comprehensive income:									
Net changes in unrealized gain on available-for-sale securities (net of income tax of $455,775)							651,819	651,819	651,819

Net income						3,127,348	3,127,348		3,127,348
Comprehensive income							$ 3,779,167		
Balances, September 30, 2010	7,702,127	$ 24,003,550	13,500	$ 12,972,283	$ 2,067,431	$ 22,726,795		$ 2,334,903	$ 64,104,962

The accompanying notes are an integral part of these consolidated financial statements

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2010 AND SEPTEMBER 30, 2009

	NINE MONTHS ENDED SEPTEMBER 30,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 3,127,348	$ 1,264,398
Adjustments to reconcile net earnings to net cash from operating activities:		
Provision for loan losses	3,015,000	4,962,012
Depreciation	720,632	806,526
Amortization and accretion, net	660	(30,778)
Stock-based compensation expense	69,684	56,400
OREO Write downs and losses on sale	413,275	1,974,375
Gain on called available for sale securities	(172,561)	(132,192)
Earnings from BOLI cash surrender value	(308,671)	(302,634)
Decrease (increase) in accrued interest payable and other liabilities	750,553	(385,587)
Decrease in accrued interest receivable	76,316	113,663
Decrease (increase) in other assets	370,080	(1,545,829)
Net cash from operating activities	8,062,316	6,780,354
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available for sale securities	(11,090,604)	(16,925,358)
Proceeds from maturities, calls, and principal paydowns of securities available for sale	8,111,950	7,275,261
Net decrease (increase) in loans	13,679,367	(2,697,451)
Proceeds from sale of OREO	1,234,752	209,467
Proceeds from redemption of BOLI policies	175,771	0
Net purchases of premises and equipment	(887,968)	(82,872)
Net cash from (used in) investing activities	11,223,268	(12,220,953)
CASH FLOWS FROM FINANCING ACTIVITIES:		
FHLB advanced funds	7,100,000	50,700,000
FHLB payments	(20,800,000)	(92,700,000)
Federal funds advances	480,000	8,770,000
Federal funds payments	(480,000)	(8,770,000)
Shareholder cash dividends paid	0	(191,541)
Preferred stock dividend payment	(506,250)	(468,750)
Net increase in demand deposits and savings accounts	28,797,189	48,137,511
Net (decrease) increase in time deposits	(9,103,296)	5,146,855
Proceeds from sale of common stock and exercise of stock options	70,110	70,110
Net cash from financing activities	5,557,753	10,694,185
NET INCREASE IN CASH AND CASH EQUIVALENTS	24,843,337	5,253,586
CASH AND CASH EQUIVALENTS, beginning of period	21,648,548	9,837,860
CASH AND CASH EQUIVALENTS, end of period	$ 46,491,885	$ 15,091,446
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for:		

Interest	$	2,597,190	$	4,766,247
Income taxes	$	1,646,000	$	1,014,000
NON-CASH INVESTING ACTIVITIES:				
Real estate acquired through foreclosure	$	641,400	$	1,186,263
Change in unrealized gain/loss on available-for-sale securities	$	1,107,594	$	2,302,718
NON-CASH FINANCING ACTIVITIES:				
Accretion of preferred stock	$	124,986	$	124,986

The accompanying notes are an integral part of these consolidated financial statements.

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OAK VALLEY BANCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

On July 3, 2008 (the Effective Date), a bank holding company reorganization was completed whereby Oak Valley Bancorp became the parent holding company for Oak Valley Community Bank (the Bank). On the Effective Date, each outstanding share of the Bank was converted into one share of Oak Valley Bancorp and the Bank became a wholly-owned subsidiary of the holding company. The condensed consolidated financial statements and accompanying footnotes are presented as if the reorganization occurred as of the earliest periods presented and are consistent with those of Oak Valley Community Bank, since prior to the Effective Date, Oak Valley Bancorp had no material assets, liabilities or operations.

The accounting principles followed by the Company and the methods of applying these principles conform with accounting principles generally accepted in the United States of America (GAAP) and with general practices within the banking industry. In preparing financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts in the financial statements. Actual results could differ significantly from those estimates. Material estimates common to the banking industry that are particularly susceptible to significant change in the near term include, but are not limited to, the determination of the allowance for loan losses, the estimation of compensation expense related to stock options granted to employees and directors, and valuation allowances associated with deferred tax assets, the recognition of which are based on future taxable income.

The interim consolidated financial statements included in this report are unaudited but reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the interim periods presented. All such adjustments are of a normal recurring nature. The results of operations for the three and nine month periods ended September 30, 2010 are not necessarily indicative of the results of a full year s operations. For further information, refer to the audited financial statements and footnotes included in the Company s Form 10-K for the year ended December 31, 2009.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Standards Codification. The Financial Accounting Standards Board s (FASB) Accounting Standards Codification (ASC) became effective on July 1, 2009. At that date, the ASC became FASB s officially recognized source of authoritative U.S. generally accepted accounting principles (GAAP) applicable to all public and non-public non-governmental entities, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literature. Rules and interpretive releases of the SEC under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All other accounting literature is considered non-authoritative. The switch to the ASC affects the away companies refer to U.S. GAAP in financial statements and accounting policies. Citing particular content in the ASC involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure.

FASB ASC Topic 815, Derivatives and Hedging. New authoritative accounting guidance under ASC Topic 815, Derivatives and Hedging, amends prior guidance to amend and expand the disclosure requirements for derivatives and hedging activities to provide greater transparency about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedge items are accounted for under ASC Topic 815, and (iii) how derivative instruments and related hedged items affect an entity s financial position, results of operations and cash flows. To meet those objectives, the new authoritative accounting guidance requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. The new authoritative accounting guidance under ASC Topic 815 became effective for the Company on January 1, 2009 and did not have a significant impact on the Company s financial statements.

FASB ASC Topic 820, Fair Value Measurements and Disclosures. New authoritative accounting guidance under ASC Topic 820, Fair Value Measurements and Disclosures, affirms that the objective of fair value when the market for an asset is not active is the price that would be received to sell the asset in an orderly transaction, and clarifies and includes additional factors for determining whether there has been a significant decrease in market activity for an asset when the market for that asset is not active. ASC Topic 820 requires an entity to base its conclusion about whether a transaction was not orderly on the weight of the evidence. The new accounting guidance amended prior guidance to expand certain disclosure requirements. The Company adopted the new authoritative accounting guidance under ASC Topic 820 during the first quarter of 2009. Adoption of the new guidance did not significantly impact the Company s financial statements.

Further new authoritative accounting guidance (Accounting Standards Update No. 2009-5) under ASC Topic 820 provides guidance for measuring the fair value of a liability in circumstances in which a quoted price in an active market for the identical liability is not available. In such instances, a reporting entity is required to measure fair value utilizing a valuation technique that uses (i) the

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quoted price of the identical liability when traded as an asset, (ii) quoted prices for similar liabilities or similar liabilities when traded as assets, or (iii) another valuation technique that is consistent with the existing principles of ASC Topic 820, such as an income approach or market approach. The new authoritative accounting guidance also clarifies that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. The forgoing new authoritative accounting guidance under ASC Topic 820 became effective for the Company s financial statements beginning October 1, 2009 and did not have a significant impact on the Company s financial statements.

FASB ASC Topic 320, Investments - Debt and Equity Securities. New authoritative accounting guidance under ASC Topic 320, Investments - Debt and Equity Securities, (i) changes existing guidance for determining whether an impairment is other than temporary to debt securities and (ii) replaces the existing requirement that the entity s management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. Under ASC Topic 320, declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of the impairment related to other factors is recognized in other comprehensive income. The Company adopted the provisions of the new authoritative accounting guidance under ASC Topic 320 during the second quarter of 2009. Adoption of the new guidance did not significantly impact the Company s financial statements.

FASB ASC Topic 825 Financial Instruments. New authoritative accounting guidance under ASC Topic 825, Financial Instruments, requires an entity to provide disclosures about the fair value of financial instruments in interim financial information and amends prior guidance to require those disclosures in summarized financial information at interim reporting periods. The new interim disclosures required under Topic 825 were included in the Company s Form 10-Q beginning September 30, 2009.

FASB ASC Topic 825 Fair Value Measurements and Disclosures. In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements.* This ASU requires: (1) disclosure of the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurement categories and the reasons for the transfers; and (2) separate presentation of purchases, sales, issuances, and settlements in the reconciliation for fair value measurements using significant unobservable inputs (Level 3). In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures set forth in the Codification Subtopic 820-10: (1) For purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and (2) a reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and non-recurring fair value measurements. ASU 2010-06 is effective for interim and annual reporting periods beginning January 1, 2010, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, which are effective for fiscal years beginning January 1, 2011, and for interim periods within those fiscal years. As ASU 2010-06 is disclosure-related only, our adoption of this ASU in the first quarter of 2010 did not impact our financial condition or results of operations.

FASB ASC Topic 310 Disclosures about the Credit Quality of Fincancing Receivables and the Allowance for Credit Losses. In July 2010, FASB issued Accounting Standards Update 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (Topic 310).* This standard expands disclosures about credit quality of financing receivables and the allowance for loan losses. The standard will require the Company to expand disclosures about the credit quality of our loans and the related reserves against them. The extra disclosures will include disaggregated matters related to our past due loans, credit quality indicators, and modifications of loans. The Company will adopt the standard beginning with our December 31, 2010 financial statements. This standard will not have an impact on the Company s financial position or results of operations.

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NOTE 3 SECURITIES

The amortized cost and estimated fair values of debt securities as of September 30, 2010 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
Available-for-sale securities:				
U.S. agencies	$ 29,699,856	$ 2,256,113	$	$ 31,955,969
Collateralized mortgage obligations	8,039,954	490,957	(6)	8,530,905
Municipalities	10,175,326	1,201,242		11,376,568
SBA Pools	1,532,923		(11,529)	1,521,394
Mutual Fund	1,607,382	31,245		1,638,627
	$ 51,055,441	$ 3,979,557	$ (11,535)	$ 55,023,463

The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2010.

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. agencies	$	$	$		$	$
Collateralized mortgage obligations	79,428	(6)			79,428	(6)
Municipalities						
SBA Pools			1,515,779	(11,529)	1,515,779	(11,529)
Asset Backed Securities						
Total temporarily impaired securities	$ 79,428	$ (6)	$ 1,515,779	$ (11,529)	$ 1,595,207	$ (11,535)

At September 30, 2010, a total of two SBA pools make up the total amount of securities in an unrealized loss position for greater than 12 months. Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due solely to interest rate changes and the Bank does not intend to sell the securities and it is not likely that we will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

The amortized cost and estimated fair value of debt securities at September 30, 2010, by contractual maturity or call date, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Estimated

	Amortized Cost	Fair Value
Available-for-sale securities:		
Due in one year or less	$ 1,025,000	$ 1,039,616
Due after one year through five years	5,408,997	5,992,891
Due after five years through ten years	20,084,019	21,983,253
Due after ten years	24,537,425	26,007,703
	$ 51,055,441	$ 55,023,463

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The amortized cost and estimated fair values of debt securities as of December 31, 2009, are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. agencies	$ 29,475,777	1,511,122	$ (2,181)	$ 30,984,718
Collateralized mortgage obligations	2,883,988	110,758		2,994,746
Municipalities	12,327,922	1,235,683	(6,454)	13,557,151
SBA Pools	1,588,867		(9,519)	1,579,348
Asset backed securities	81,867	707		82,574
Mutual Fund	1,546,465	20,312		1,566,777
	$ 47,904,886	$ 2,878,582	$ (18,154)	$ 50,765,314

The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2009.

	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. agencies	$ 425,908	$ (2,181)	$	$	$ 425,908	$ (2,181)
Collateralized mortgage obligations						
Municipalities	402,628	(6,454)			402,628	(6,454)
SBA pools			1,579,348	(9,519)	1,579,348	(9,519)
Asset backed securities						
Total temporarily impaired securities	$ 828,536	$ (8,635)	$ 1,579,348	$ (9,519)	$ 2,407,884	$ (18,154)

At December 31, 2009, two SBA pools make up the total amount of securities in an unrealized loss position for greater than 12 months. Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due solely to interest rate changes and the Bank does not intend to sell the securities and it is not likely that we will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

There were no realized gains or losses on sales of available-for-sale securities during 2010 and 2009, however the Company did recognize a gain of $46,030 and $172,561 for the three and nine month periods ended September 30, 2010, respectively, on certain available-for-sale securities that were partially called, which compares to $77,811 and $132,192 in the same periods of 2009, respectively. There were no other sales of available-for-sale securities during 2010 and 2009.

Securities carried at $49,023,289 and $34,545,513 at September 30, 2010 and December 31, 2009, respectively, were pledged to secure deposits of public funds.

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NOTE 4 LOANS

Loan totals were as follows:

	SEPTEMBER 30, 2010	DECEMBER 31, 2009
Loans		
Commercial real estate	$ 293,203,342	$ 283,387,329
Commercial	32,719,129	38,159,590
Real estate construction	32,168,954	52,951,968
Agriculture	28,093,824	29,659,656
Residential real estate and consumer	22,786,210	21,468,468
Total loans	408,971,459	425,627,011
Deferred loan fees and costs, net	(811,334)	(811,103)
Allowance for loan losses	(7,700,206)	(7,020,222)
Net loans	$ 400,459,919	$ 417,795,686

Changes in the allowance for loan losses were as follows:

	SEPTEMBER 30, 2010	DECEMBER 31, 2009
Balance, beginning of year	$ 7,020,222	$ 5,569,496
Provision charged to operations	3,015,000	5,862,012
Loans charged off	(2,340,217)	(4,419,335)
Loan recoveries	5,201	8,049
Balance, end of period	$ 7,700,206	$ 7,020,222

The total recorded investment in impaired loans at September 30, 2010, was $9,547,201 which had a loan loss reserve of $694,590. The total recorded investment in impaired loans at December 31, 2009, was $14,418,204 which had a loan loss reserve of $1,256,329. No interest income was recognized on impaired loans, while considered impaired during 2010 and 2009. As of September 30, 2010, we had undisbursed funding commitments on one impaired loan to one borrower totaling $151,738 with a maturity date of May 2010**.** As of September 30, 2010, we had three loans considered troubled debt restructurings totaling $1.4 million, which are included in nonaccrual loans.

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OAK VALLEY BANCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 OTHER REAL ESTATE OWNED

As of September 30, 2010, four loans with outstanding balances of $1,142,887 were reclassified to other real estate owned, as compared to six loans with outstanding balances of $2,149,514 as of December 31, 2009.

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at the lower of carrying amount of the loan or fair value of the property at the date of foreclosure less selling costs. Subsequent to foreclosure, valuations are periodically performed and any subject revisions in the estimate of fair value are reported as adjustment to the carrying value of the real estate, provided the adjusted carrying amount does not exceed the original amount at foreclosure. Revenues and expenses from operations and changes in the valuation allowance are included in other operating expenses.

NOTE 6 OTHER POST-RETIREMENT BENEFIT PLANS

During January 2008, the Bank awarded certain officers a salary continuation plan (the Plan). Under the Plan, the participants will be provided with a fixed annual retirement benefit for twenty years after retirement. The Bank is also responsible for certain pre-retirement death benefits under the Plan. In connection with the implementation of the Plan, the Bank purchased single premium life insurance policies on the life of each of the officers covered under the Plan. The Bank is the owner and partial beneficiary of these life insurance policies. The assets of the Plan, under Internal Revenue Service regulations, are owned by the Bank and are available to satisfy the Bank s general creditors.

During January 2008 the Bank awarded two of its directors a director retirement plan (DRP). Under the DRP, the participants will be provided with a fixed annual retirement benefit for ten years after retirement. The Bank is also responsible for certain pre-retirement death benefits under the DRP. In connection with the implementation of the DRP, the Bank purchased single premium life insurance policies on the life of each director covered under the DRP. The Bank is the owner and partial beneficiary of these life insurance policies. The assets of the DRP, under Internal Revenue Service regulations, are the property of the Bank and are available to satisfy the Bank s general creditors.

Future compensation under both plans is earned for services rendered through retirement. The Bank accrues for the salary continuation liability based on anticipated years of service and vesting schedules provided under the plans. The Bank s current benefit liability is determined based on vesting and the present value of the benefits at a corresponding discount rate. The discount rate used is an equivalent rate for investment-grade bonds with lives matching those of the service periods remaining for the salary continuation contracts, which average approximately 20 years. The salary continuation liability as of September 30, 2010 and December 31, 2009 was $1,247,251 and $1,147,125, respectively, and is reported in accrued interest and other liabilities in the consolidated balance sheet.

During January 2008, the Bank purchased $4.7 million in bank owned life insurance policies and entered into split-dollar life insurance agreements with certain officers and directors. In connection with the implementation of the split-dollar agreements, the Bank purchased single premium life insurance policies on the life of each of the officers and directors covered by the split-dollar life insurance agreements. The Bank is the owner of the policies and the partial beneficiary in an amount equal to the cash surrender value of the policies.

The combined cash surrender value of all Bank-owned life insurance policies recorded in other assets on the balance sheet was $10,400,761 and $10,267,862 at September 30, 2010 and December 31, 2009, respectively.

NOTE 7 FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Fair values of financial instruments The financial statements include various estimated fair value information as of September 30, 2010 and December 31, 2009. Such information, which pertains to the Bank s financial instruments, does not purport to represent the aggregate net fair value of the Bank. Further, the fair value estimates are based on various assumptions, methodologies, and subjective considerations, which vary widely among different financial institutions and which are subject to change. The following methods and assumptions are used by the Bank.

Cash and cash equivalents The carrying amounts of cash and cash equivalents approximate their fair value.

Securities (including mortgage-backed securities) Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

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Loans receivable For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. The fair values for other loans (e.g., real estate construction and mortgage, commercial, and installment loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Deposit liabilities The fair values estimated for demand deposits (interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). The carrying amounts for variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of the aggregate expected monthly maturities on time deposits.

Federal Home Loan Bank (FHLB) advances Rates currently available to the Bank for borrowings with similar terms and remaining maturities are used to estimate the fair value of the existing debt.

Accrued interest The carrying amounts of accrued interest approximate their fair value.

Off-balance-sheet instruments Fair values for the Bank s off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the credit standing of the counterparties.

The estimated fair values of the Bank s financial instruments at September 30, 2010 are as follows:

		Carrying Amount	Estimated Fair Value
Financial assets:			
Cash and cash equivalents	$	46,491,885	46,491,885
Securities available for sale		55,023,463	55,023,463
Loans		408,971,459	414,347,568
Accrued interest receivable		1,658,016	1,658,016
Financial liabilities:			
Deposits		(448,904,177)	(449,552,905)
FHLB advance		(18,500,000)	(18,573,636)
Accrued interest payable		(169,354)	(169,354)
Off-balance-sheet assets (liabilities):			
Commitments and standby letters of credit			(543,390)

The estimated fair values of the Bank s financial instruments at December 31, 2009 are as follows:

	Carrying Amount	Fair Value
Financial assets:		
Cash and cash equivalents	$ 21,648,548	$ 21,648,548
Securities available for sale	50,765,314	50,765,314
Loans	425,627,011	434,698,550
Accrued interest receivable	1,734,332	1,734,332
Financial liabilities:		
Deposits	(429,210,284)	(429,780,364)
FHLB advance	(32,200,000)	(32,367,049)
Accrued interest payable	(400,169)	(400,169)
Off-balance-sheet assets (liabilities):		
Commitments and standby letters of credit		(631,324)

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OAK VALLEY BANCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Fair Value Measurements defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follow:

Level 1: Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment , and considers factors specific to the asset or liability.

Assets and liabilities measured at fair value on a recurring and non-recurring basis are summarized below:

		Fair Value Measurements at September 30, 2010		
	September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities:				
U.S. agencies	$ 31,955,969	$	$ 31,955,969	$
Collateralized mortgage obligations	$ 8,530,905	$	$ 8,530,905	$
Municipalities	$ 11,376,568	$	$ 11,376,568	$
SBA Pools	$ 1,521,394	$	$ 1,521,394	$
Mutual Fund	$ 1,638,627	$	$ 1,638,627	$
Assets and liabilities measured on a non-recurring basis:				
Impaired Loans	$ 3,781,621	$	$	$ 3,781,621

Other real estate owned	$	1,142,887	$	$	$	1,142,887

			Fair Value Measurements at December 31, 2009			
		December 31, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)
Assets and liabilities measured on a recurring basis:						
Available-for-sale securities:						
U.S. agencies	$	30,984,718	$	$ 30,984,718	$	
Collateralized mortgage obligations	$	2,994,746	$	$ 2,994,746	$	
Municipalities	$	13,557,151	$	$ 13,557,151	$	
Asset backed securities	$	1,579,348	$	$ 1,579,348	$	
SBA Pools	$	82,574	$	$ 82,574	$	
Mutual Fund	$	1,566,777	$	$ 1,566,777	$	
Assets and liabilities measured on a non-recurring basis:						
Impaired Loans	$	10,372,613	$	$	$	10,372,613
Other real estate owned	$	2,149,514	$	$	$	2,149,514

The fair value of securities available for sale equals quoted market price, if available. If quoted market prices are not available, fair value

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is determined using quoted market prices for similar securities. Changes in fair market value are recorded in other comprehensive income net of tax.

The fair value measurement applies to impaired loans, which includes impaired loans measured at an observable market price (if available), or at the fair value of the loan s collateral (if the loan is collateral dependent). Fair value of the loan s collateral, when the loan is dependent on collateral, is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the collateral. At September 30, 2010, impaired loans that had a specific loan loss reserve had a principal balance of $4,476,211 with a valuation allowance of $694,590. Upon being classified as impaired, either a charge off or a specific reserve or both may be taken to reduce the balance of each loan to an estimate of the collateral fair market value less cost to dispose. This estimate was a level 3 valuation. There was no direct impact on the income statement. The charge-offs were recorded as a debit to the allowance for loan losses.

Fair value of other real estate owned is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the property. Total fair market value at September 30, 2010 was $1,142,887 which was a level 3 valuation. There is a direct impact to the income statement as any market value write downs are charged directly to operating expenses. The Bank is required by internal bank policies to order real estate appraisals on OREO properties every six months. In addition, management evaluates the book values on a quarterly basis for reasonableness and makes fair value adjustments as necessary.

NOTE 8 EARNINGS (LOSS) PER SHARE

Earnings per share (EPS) is calculated based on the weighted average common shares outstanding during the period. Basic EPS excludes dilution and is calculated by dividing net income available to common shareholders by the weighted average common shares outstanding. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

	THREE MONTHS ENDED SEPTEMBER 30,	
In thousands (except share and per share amounts)	**2010**	**2009**
BASIC EARNINGS PER SHARE		
Net income available to common shareholders	$ 930,511	$ 668,740
Weighted average shares outstanding	7,692,900	7,668,891
Net income per common share	$ 0.12	$ 0.09
DILUTED EARNINGS PER SHARE		
Net income available to common shareholders	$ 930,511	$ 668,740
Weighted average shares outstanding	7,692,900	7,668,891
Effect of dilutive stock options	36,275	25,167
Weighted average shares of common stock and common stock equivalents	7,729,175	7,694,058
Net income per diluted common share	$ 0.12	$ 0.09

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In thousands (except share and per share amounts)	NINE MONTHS ENDED SEPTEMBER 30, 2010	2009
BASIC EARNINGS PER SHARE		
Net income available to common shareholders	$ 2,496,112	$ 633,165
Weighted average shares outstanding	7,685,592	7,664,075
Net income per common share	$ 0.32	$ 0.08
DILUTED EARNINGS PER SHARE		
Net income available to common shareholders	$ 2,496,112	$ 633,165
Weighted average shares outstanding	7,685,592	7,664,075
Effect of dilutive stock options	34,024	28,035
Weighted average shares of common stock and common stock equivalents	7,719,616	7,692,110
Net income per diluted common share	$ 0.32	$ 0.08

During the three and nine month periods ended September 30, 2010, anti-dilutive weighted average options to purchase 223,386 and 234,517 shares of common stock, respectively, were outstanding with prices ranging from $5.20 to $15.67. Anti-dilutive weighted average stock options of 240,187 and 241,888 were outstanding during the same three and nine month periods of 2009, respectively, with prices ranging from $4.58 to $15.67. These options were not included in the computation of diluted EPS because the options exercise price was greater than the average market price of the common shares. These options begin to expire in 2013. In addition, weighted average warrants of 350,346 issued to the U.S. Treasury Capital Purchase Program were anti-dilutive for the three and six-month periods of 2010 and 2009, as the price of $5.78 was more than the average market price of common shares.

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

The following discussion explains the significant factors affecting our operations and financial position for the periods presented. The discussion should be read in conjunction with our financial statements and the notes related thereto which appear or that are referenced to elsewhere in this report, and with the audited consolidated financial statements and accompanying notes included in our 2009 Annual Report on Form 10-K, as amended. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

The discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions. This discussion and analysis includes executive management s (Management) insight of the Company s financial condition and results of operations of Oak Valley Bancorp and its subsidiary. Unless otherwise stated, the Company refers to the consolidated entity, Oak Valley Bancorp, while the Bank refers to Oak Valley Community Bank

Forward-Looking Statements

Some matters discussed in this Form 10-Q may be forward-looking statements within the meaning of the Private Litigation Reform Act of 1995 and therefore may involve risks, uncertainties and other factors which may cause our actual results to be materially different from the results expressed or implied by our forward-looking statements. These statements generally appear with words such as anticipate, believe, estimate, may, intend, and expect. Although management believes that the assumptions and expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to be correct. Factors that could cause actual results to differ from results discussed in forward-looking statements include, but are not limited to: economic conditions (both generally and in the markets where the Bank operates); competition from other providers of financial services offered by the Bank; changes in government regulation and legislation; changes in interest rates; material unforeseen changes in the financial stability and liquidity of the Bank s credit customers; risks associated with concentrations in real estate related loans; changes in accounting standards and interpretations; and other risks as may be detailed from time to time in the Company s filings with the Securities and Exchange Commission, all of which are difficult to predict and which may be beyond the control of the Company or the Bank. The Company undertakes no obligation to revise forward-looking statements to reflect events or changes after the date of this discussion or to reflect the occurrence of unanticipated events.

Forward-looking statements speak only as of the date they are made, and the Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made, whether as a result of new information, future developments or otherwise, except as may be required by law.

Critical Accounting Estimates

Management has determined the following four accounting policies to be critical:

Allowance for Loan Losses

Accounting for allowance for loan losses involves significant judgment and assumptions by management and is based on historical data and management s view of the current economic environment. At least on a quarterly basis, our management reviews the methodology and adequacy of allowance for loan losses and reports its assessment to the Board of Directors for its review and approval.

We base our allowance for loan losses on an estimation of probable losses inherent in our loan portfolio. Our methodology for assessing loan loss allowances are intended to reduce the differences between estimated and actual losses and involves a detailed analysis of our loan portfolio in three phases:

- the specific review of individual loans,

- the segmenting and review of loan pools with similar characteristics and,

- our judgmental estimate based on various subjective factors.

The first phase of our methodology involves the specific review of individual loans to identify and measure impairment. We evaluate each loan by use of a risk rating system, except for homogeneous loans, such as automobile loans and home mortgages. Specific

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risk rated loans are deemed impaired if all amounts, including principal and interest, will likely not be collected in accordance with the contractual terms of the related loan agreement. Impairment for commercial and real estate loans is measured either based on the present value of the loan s expected future cash flows or, if collection on the loan is collateral dependent, the estimated fair value of the collateral, less selling and holding costs.

The second phase involves the segmenting of the remainder of the risk rated loan portfolio into groups or pools of loans, together with loans with similar characteristics, for evaluation. We determine the calculated loss ratio to each loan pool based on its historical net losses and benchmark it against the levels of other peer banks.

In the third phase, we consider relevant internal and external factors that may affect the collectibility of loan portfolio and each group of loan pool. The factors considered are, but are not limited to:

- concentration of credits,
- nature and volume of the loan portfolio,
- delinquency trends,
- non-accrual loan trend,
- problem loan trend,
- loss and recovery trend,
- quality of loan review,
- lending and management staff,
- lending policies and procedures,

• economic and business conditions, and

• other external factors including regulatory review.

Our management estimates the probable effect of such conditions based on our judgment, experience and known or anticipated trends. Such estimation may be reflected as an additional allowance to each group of loans, if necessary. Management reviews these conditions with our senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management s estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specific, identifiable problem credit or portfolio segment as of the evaluation date, management s evaluation of the inherent loss related to such condition is reflected in the unallocated allowance.

Central to our credit risk management and our assessment of appropriate loss allowance is our loan risk rating system. Under this system, the originating credit officer assigns borrowers an initial risk rating based on a thorough analysis of each borrower s financial capacity in conjunction with industry and economic trends. Approvals are made based upon the amount of inherent credit risk specific to the transaction and are reviewed for appropriateness by senior line and credit administration personnel. Credits are monitored by line and credit administration personnel for deterioration in a borrower s financial condition which may impact the ability of the borrower to perform under the contract. Although management has allocated a portion of the allowance to specific loans, specific loan pools, and off-balance sheet credit exposures (which are reported separately as part of other liabilities), the adequacy of the allowance is considered in its entirety.

Non-Accrual Loan Policy

Interest on loans is credited to income as earned and is accrued only if deemed collectible. Accrual of interest is discontinued when a loan is over 90 days delinquent or if management believes that collection is highly uncertain. Generally, payments received on nonaccrual loans are recorded as principal reductions. Interest income is recognized after all principal has been repaid or an improvement in the condition of the loan has occurred that would warrant resumption of interest accruals.

Stock-Based Compensation

The Company recognizes in the income statement the grant-date fair value of stock options and other equity-based forms of compensation issued to employees over the employees requisite service period (generally the vesting period). The Bank uses the

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straight-line recognition of expenses for awards with graded vesting. The Bank utilizes a binomial pricing model for all grants. Expected volatility is based on the historical volatility of the price of the Bank s stock for the period equal to the contractual stock option term. The Bank uses historical data to estimate option exercise and stock option forfeiture rates within the valuation model. The expected term of options granted for the binomial model is derived from applying a historical suboptimal exercise factor to the contractual term of the grant. For binomial pricing, the risk-free rate for periods is equal to the U.S. Treasury yield at the time of grant and commensurate with the contractual term of the grant.

Other Real Estate Owned

Other real estate owned, which represents real estate acquired through foreclosure, or deed in lieu of foreclosure in satisfaction of commercial and real estate loans, is carried at the lower of cost or estimated fair value less the estimated selling costs of the real estate. The fair value of the property is based upon a current appraisal. The difference between the fair value of the real estate collateral and the loan balance at the time of transfer is recorded as a loan charge off if fair value is lower. Subsequent to foreclosure, management periodically performs valuations and the OREO property is carried at the lower of carrying value or fair value, less costs to sell. The determination of a property s estimated fair value incorporates (1) revenues projected to be realized from disposal of the property, (2) construction and renovation costs, (3) marketing and transaction costs, and (4) holding costs (e.g., property taxes, insurance and homeowners association dues). Any subsequent declines in the fair value of the OREO property after the date of transfer are recorded through a write-down of the asset. Any subsequent operating expenses or income, reduction in estimated fair values, and gains or losses on disposition of such properties are charged or credited to current operations.

Introduction

Oak Valley Community Bank commenced operations in May 1991. We are an insured bank under the Federal Deposit Insurance Act and are a member of the Federal Reserve. Since its formation, the Bank has provided basic banking services to individuals and business enterprises in Oakdale, California and the surrounding areas. The focus of the Bank is to offer a range of commercial banking services designed for both individuals and small to medium-sized businesses in the two main areas of service of the Bank: the Central Valley and the Eastern Sierras.

The Bank offers a complement of business checking and savings accounts for its business customers. The Bank also offers commercial and real estate loans, as well as lines of credit. Real estate loans are generally of a short-term nature for both residential and commercial purposes. Longer-term real estate loans are generally made with adjustable interest rates and contain normal provisions for acceleration. In addition, the Bank offers traditional residential mortgages through a partner financial institution under Community Bank Lending Exchange (CBLX).

The Bank also offers other services for both individuals and businesses including online banking, remote deposit capture, merchant services, night depository, extended hours, traveler s checks, wire transfer of funds, note collection, and automated teller machines in a national network. The Bank does not currently offer international banking or trust services although the Bank may make such services available to the Bank s customers through financial institutions with which the Bank has correspondent banking relationships. The Bank does not offer stock transfer services nor does it directly issue credit cards.

Effective July 3, 2008, Oak Valley Community Bank became a subsidiary of Oak Valley Bancorp, a newly established bank holding company. Oak Valley Bancorp operates Oak Valley Community Bank as a community bank in the general commercial banking business, with our primary market encompassing the California Central Valley around Oakdale and Modesto, and the Eastern Sierras. As such, unless otherwise noted, all

references are about Oak Valley Bancorp.

Overview of Results of Operations and Financial Condition

The purpose of this summary is to provide an overview of the items management focuses on when evaluating the condition of the Company and its success in implementing its business and shareholder value strategies. The Company s business strategy is to operate the Bank as a well-capitalized, profitable and independent community oriented bank. The Company s shareholders value strategy has three major themes: (1) enhancing shareholders value; (2) making its retail banking franchise more valuable; and (3) efficiently utilizing its capital.

Management believes the following were important factors in the Company s performance during the three and nine month periods ended September 30, 2010:

- Thanks to our deep roots in the communities that we serve, our focus on customer care and our selectivity in lending, during the first nine months of 2010, our performance has been better than most institutions of our size that compete in our market. Despite the severity of the recession affecting our primary market areas, we have been able to increase our core deposits to $405.3 million and have posted net income available to common shareholders of $0.12 and $0.32 per diluted share for the three and nine month periods of 2010, respectively.

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- While recently published economic data indicate that the current downturn may be easing, it is not clear when or at what speed the recession will end. To the extent that the recession continues, it will affect the market areas that we serve and our results accordingly.

- The Company recognized net income available to common shareholders of $931,000 and $2,496,000 for the three and nine month periods ended September 30, 2010, respectively, as compared to $669,000 and $633,000 for the same periods in 2009. The Company recognized net income before preferred stock dividends and accretion of $1,141,000 and $3,127,000, respectively, for the third quarter and nine month period of 2010. The factors contributing to these results will be discussed below.

- The Company recognized $210,000 and $631,000, respectively, in the third quarter and nine month period of 2010 and 2009 associated with the accrual for preferred stock dividends and accretion of the preferred stock discount in connection with the 13,500 shares of Series A Preferred Stock that the U.S. Treasury purchased from the Company in December 2008 under the TARP Program. So long as such preferred stock remains outstanding, it will pay quarterly cumulative dividends at a rate of 5% per year for the first five years and thereafter at a rate of 9% per year.

- The Company has taken significant steps to reduce the risk of loan losses. In the three and nine month periods ended September 30, 2010, the provision for loan loss was $1,005,000 and $3,015,000, respectively, which was an increase of $80,000 for the quarter and a decrease of $1,947,000 for the nine month period compared to 2009. The year-to-date decrease was mainly due to management s assessment of the appropriate level for the allowance for loan losses and a decrease in the level of non-accrual loans. The Company continues to monitor its loan portfolio with the objective of avoiding defaults or write-downs. Despite these actions, the possibility of additional losses cannot be eliminated, but the Board of Directors and all employees continue to work hard to make the best of these continuing challenging conditions.

- Net interest income increased $339,000 or 5.6% and $1,100,000 or 6.3% for the three and nine month periods ended September 30, 2010, respectively, compared to the same periods in 2009. This increase was primarily due to the net interest margin increase of 17 and 31 basis points, respectively, for the three and nine month periods ended September 30, 2010, as compared to the same periods of 2009. The net interest margin increase is attributable primarily to liabilities repricing faster than assets in the declining rate environment as described in further detail below.

- Non-interest income decreased by $102,000 or 13.1% for the third quarter and increased by $32,000 or 1.6% for the nine month period of 2010 as compared to the same periods in 2009. Year-to-date results show an increase in other income which includes the gain on called securities and bank debit card fees. This was partially offset by a decrease in NSF fee income and mortgage commissions as described below.

- Non-interest expense decreased by $556,000 or 11.7% and $520,000 or 3.9% for the three and nine month periods ended September 30, 2010, respectively, as compared to the same periods in 2009. The primary reason for the decrease was a significant reduction in the write downs of OREO property values, which was offset in part by increased salaries and benefits as described below.

- Total assets increased $10.2 million or 1.9% from December 31, 2009. Total net loans decreased by $17.3 million or 4.1% and investment securities increased by $4.3 million or 8.4% from December 31, 2009 to September 30, 2010, while deposits increased by $19.7

million or 4.6% for the same period.

Income Summary

For the three and nine month periods ended September 30, 2010, the Company recorded net income available to common shareholders of $931,000 and $2,496,000, respectively, representing increases of $262,000 and $1,863,000, as compared to the same periods in 2009. Return on average assets (annualized) was 0.86% and 0.81% for the third quarter and nine month periods of 2010, respectively, as compared with 0.67% and 0.32% for the same periods in 2009. Annualized return on average common equity was 7.38% and 6.83% for the third quarter and nine month period of 2010, respectively, as compared to 5.73% and 1.85% for the same periods of 2009.

Net income before provisions for income taxes and preferred stock dividends and accretion was up $714,000 and $3,599,000 for the third quarter and nine month period of 2010, respectively, from the comparable 2009 periods. The income statement components of these variances are as follows:

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Pre-Tax Income Variance Summary

(In thousands)	Effect on Pre-Tax Income Increase (Decrease) Three Months	Effect on Pre-Tax Income Increase (Decrease) Nine months
Change from 2009 to 2010 in:		
Net interest income	$ 339	$ 1,100
Provision for loan losses	(80)	1,947
Non-interest income	(102)	32
Non-interest expense	557	520
Change in income before income taxes	$ 714	$ 3,599

These variances will be explained in the discussion below.

Net Interest Income

Net interest income is the largest source of the Bank s operating income. For the three and nine month periods ended September 30, 2010, net interest income was $6.4 million and $18.7 million, respectively, which represented an increase of $339,000 or 5.6% and $1,100,000 or 6.3%, respectively, from the comparable periods in 2009.

The net interest margin (net interest income as a percentage of average interest earning assets) was 5.23% and 5.27% for the three and nine month periods ended September 30, 2010, an increase of 17 and 31 basis points, respectively, as compared to the same periods in 2009. The increase in the net interest margin in 2010 was primarily attributable to the impact that the decline in market interest rates had on our liability sensitive balance sheet which caused interest-bearing liabilities to decrease faster than the yields on earning assets. The total cost of funds decreased 71 and 67 basis points in the third quarter and nine month period of 2010, respectively, compared to 2009 due to a shift from high cost CDs and FHLB borrowed funds into demand deposit and money market accounts. Average non-interest-bearing demand deposit balances increased by $17.7 million and $11.1 million for the three and nine month periods of 2010, respectively, as compared to the same periods of 2009. Compared to cost of funds, the decrease in our earning asset yield was not as significant at only 44 and 27 basis points for the three and nine month periods of 2010, respectively, compared to the same periods of 2009. Yield on loans remained relatively flat at 6.20% for the third quarter 2010 versus 6.32% in the third quarter of 2009, partly as a result of the significant portion of our loans that are at their contractual rate floors.

The following tables shows the relative impact of changes in average balances of interest earning assets and interest bearing liabilities, and interest rates earned and paid by the Company on those assets and liabilities for the three and nine month periods ended September 30, 2010 and 2009:

Net Interest Analysis

(Dollars in thousands)

	Three Months Ended September 30, 2010			Three Months Ended September 30, 2009		
	Average Balance	Interest Income / Expense	Avg Rate/ Yield	Average Balance	Interest Income/ Expense	Avg Rate/ Yield
Assets:						
Earning assets:						
Gross loans (1) (2)	$ 409,992	$ 6,408	6.20%	$ 423,947	$ 6,751	6.32%
Investment securities (2)	49,626	652	5.21%	51,811	777	5.95%
Federal funds sold	5,792	3	0.21%	2,095	1	0.25%
Interest-earning deposits	21,452	13	0.24%	3,347	2	0.23%
Total interest-earning assets	486,862	7,076	5.77%	481,200	7,531	6.21%
Total noninterest earning assets	38,028			40,084		
Total Assets	524,890			521,284		
Liabilities and Shareholders Equity:						
Interest-bearing liabilities:						
Money market deposits	207,921	311	0.59%	191,740	630	1.30%
NOW deposits	60,583	48	0.31%	58,643	70	0.47%
Savings deposits	14,880	15	0.40%	13,362	20	0.58%
Time certificates of deposit $100,000 or more	40,528	98	0.96%	47,678	264	2.19%
Other time deposits	35,637	98	1.09%	52,821	263	1.97%
Other borrowings	18,500	85	1.82%	31,752	153	1.91%
Total interest-bearing liabilities	378,049	655	0.69%	395,996	1,400	1.40%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	80,196			62,498		
Other liabilities	3,101			3,020		
Total noninterest-bearing liabilities	83,297			65,518		
Shareholders equity	63,544			59,770		
Total liabilities and shareholders equity	$ 524,890			$ 521,284		
Net interest income		$ 6,421			$ 6,131	
Net interest spread (3)			5.08%			4.81%
Net interest margin (4)			5.23%			5.06%

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(1) Loan fees have been included in the calculation of interest income.

(2) Yields on municipal securities and loans have been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 34.0%.

(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(4) Represents net interest income as a percentage of average interest-earning assets.

	Nine months ended September 30, 2010			Nine months ended September 30, 2009		
	Average Balance	Interest Income / Expense	Avg Rate/ Yield	Average Balance	Interest Income / Expense	Avg Rate/ Yield
Assets:						
Earning assets:						
Gross loans (1) (2)	$ 413,504	$ 19,262	6.23%	$ 427,513	$ 20,081	6.28%
Investment securities (2)	48,696	1,956	5.37%	50,422	2,249	5.96%
Federal funds sold	4,248	7	0.22%	1,661	3	0.24%
Interest-earning deposits	12,608	21	0.22%	2,201	4	0.22%
Total interest-earning assets	479,056	21,246	5.93%	481,797	22,337	6.20%
Total noninterest earning assets	38,613			38,626		
Total Assets	517,669			520,423		
Liabilities and Shareholders Equity:						
Interest-bearing liabilities:						
Money market deposits	208,576	1,133	0.73%	176,878	1,910	1.44%
NOW deposits	59,301	145	0.33%	56,654	215	0.51%
Savings deposits	14,629	47	0.43%	14,003	86	0.83%
Time certificates of deposit $100,000 or more	39,778	401	1.35%	46,598	850	2.44%
Other time deposits	36,519	372	1.36%	53,081	858	2.16%
Other borrowings	20,719	269	1.74%	49,123	540	1.47%
Total interest-bearing liabilities	379,522	2,367	0.83%	396,337	4,459	1.50%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	72,947			61,776		
Other liabilities	2,811			2,954		
Total noninterest-bearing liabilities	75,758			64,730		
Shareholders equity	62,389			59,356		
Total liabilities and shareholders equity	$ 517,669			$ 520,423		
Net interest income		$ 18,879			$ 17,878	
Net interest spread (3)			5.10%			4.69%
Net interest margin (4)			5.27%			4.96%

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(1) Loan fees have been included in the calculation of interest income.

(2) Yields on municipal securities and loans have been adjusted to their fully-taxable equivalents, based on a federal marginal tax rate of 34.0%.

(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(4) Represents net interest income as a percentage of average interest-earning assets.

Shown in the following tables are the relative impacts on net interest income of changes in the average outstanding balances (volume) of earning assets and interest bearing liabilities and the rates earned and paid by the Company on those assets and liabilities for the three and nine month periods ended September 30, 2010 and 2009. Changes in interest income and expense that are not attributable specifically to either rate or volume are allocated to the rate column below.

Rate / Volume Variance Analysis

(In thousands)

	For the Three Months Ended September 30, 2010 vs 2009 Increase (Decrease) in interest income and expense due to changes in:		
	Volume	**Rate**	**Total**
Interest income:			
Gross loans (1)	$ (222)	$ (121)	$ (343)
Investment securities	(33)	(92)	(125)
Federal funds sold	2	(1)	1
Interest-earning deposits	11	1	12
Total interest income	**$ (242)**	**$ (213)**	**$ (455)**
Interest expense:			
Money market deposits	53	(372)	(319)
NOW deposits	2	(24)	(22)
Savings deposits	2	(7)	(5)
Time CD $100K or more	(40)	(126)	(166)
Other time deposits	(85)	(79)	(164)
Other borrowings	(64)	(5)	(69)
Total interest expense	**$ (132)**	**$ (613)**	**$ (745)**
Change in net interest income	**$ (110)**	**$ 400**	**$ 290**

(1) Loan fees have been included in the calculation of interest income.

The table above reflects the market interest rate decline has impacted liabilities more than assets as indicated by the increase of $400,000 in net interest income due to the rate change for the three month period of 2010. The decreased loan volume and the overall change in mix of balances resulted in a decrease of $110,000 to net interest income over the same period.

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	For the Nine months Ended September 30, 2010 vs 2009 Increase (Decrease) in interest income and expense due to changes in:		
	Volume	Rate	Total
Interest income:			
Gross loans (1)	$ (658)	$ (163)	$ (821)
Investment securities	(77)	(216)	(293)
Federal funds sold	5	0	5
Interest-earning deposits	17	1	18
Total interest income	**$ (713)**	**$ (378)**	**$ (1,091)**
Interest expense:			
Money market deposits	342	(1,120)	(778)
NOW deposits	10	(80)	(70)
Savings deposits	4	(43)	(39)
Time CD $100K or more	(124)	(325)	(449)
Other time deposits	(268)	(218)	(486)
Other borrowings	(312)	42	(270)
Total interest expense	**$ (348)**	**$ (1,744)**	**$ (2,092)**
Change in net interest income	**$ (365)**	**$ 1,366**	**$ 1,001**

(1) Loan fees have been included in the calculation of interest income.

The table above reflects the market interest rate decline has impacted liabilities more than assets as indicated by the increase of $1,366,000 in net interest income due to the rate change for the nine month period of 2010. The decreased loan volume and the overall change in mix of balances resulted in a decrease of $365,000 to net interest income over the same period.

Non-Interest Income

Non-interest income represents service charges on deposit accounts and other non-interest related charges and fees, including fees from mortgage commissions and investment service fee income. For the three and nine month periods ended September 30, 2010, non-interest income was $676,000 and $2,055,000, respectively, a decrease of $102,000 or 13.1% and an increase of $32,000 or 1.6%, compared to the same periods in 2009.

The following tables show the major components of non-interest income:

	For the Three Months Ended September 30,			
	2010	2009	$ change	% change
Service charges on deposits	$ 272,136	$ 300,282	$ (28,146)	(9.4)%
Earnings on cash surrender value of life insurance	103,986	101,057	2,929	2.9%

Mortgage commissions		30,849		38,143		(7,294)	(19.1)%
Other		269,078		338,154		(69,076)	(20.4)%
Total non-interest income	$	676,049	$	777,636	$	(101,587)	(13.1)%

The decrease to total non-interest income for the quarter is due in part to the gain on called securities of 46,000 in the third quarter of 2010 compared to $78,000 recorded in the third quarter of 2009. In addition, investment service fee income decreased by $49,000 or 63.3%, mortgage commissions decreased by $7,000 or 19.1% and service charges on deposits decreased by $28,000 or 9.4% in the third quarter of 2010 compared to 2009. Offsetting these decreases was in increase of $30,000 in bank debit card fees in the three month period ended September 30, 2010, as compared to the same period in 2009. Gain on called securities, investment service fee income and bank debit card fees are all included in the other income line item in the above table.

	For the Nine Months Ended September 30,						
		2010		**2009**		**$ change**	**% change**
Service charges on deposits	$	787,142	$	875,229	$	(88,087)	(10.1)%
Earnings on cash surrender value of life insurance		308,671		303,170		5,501	1.8%
Mortgage commissions		74,984		127,160		(52,176)	(41.0)%
Other		884,047		717,763		166,284	23.2%
Total non-interest income	$	2,054,844	$	2,023,322	$	31,522	1.6%

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The year-to-date increase to total non-interest income is primarily due to bank debit card fees and the gain on called securities of $260,000 and $172,000, respectively, in the nine month period of 2010, which represent increases of $79,000 and $40,000, respectively. Gain on called securities investment service fee income and bank debit card fees are included in the other income line item in the above table. In addition, rental income from OREO and bank owned properties increased by $33,000 compared to prior year mainly due to the relocation of our Mammoth Lakes branch and the subsequent lease agreement for the old branch property. Offsetting these increases was a decrease in service charges on deposits of $88,000 or 10.1%, combined with a decrease in mortgage commissions of $52,000 or 41.0% for the nine month period ended September 30, 2010, as compared to the same period in 2009. The Bank continues to expand its offerings to the consumer and business depositor.

Non-Interest Expense

Non-interest expense represents salaries and benefits, occupancy expenses, professional expenses, outside services, and other miscellaneous expenses necessary to conduct business.

The following tables show the major components of non-interest expenses:

	For the Three Months Ended September 30,			
	2010	2009	$ change	% change
Salaries and employee benefits	$ 2,143,094	$ 1,974,022	$ 169,072	8.6%
Occupancy expenses	690,209	658,928	31,281	4.7%
Data processing fees	233,694	220,181	13,513	6.1%
OREO expenses	35,051	915,623	(880,572)	(96.2)%
Assessments (FDIC & DFI)	258,000	230,269	27,731	12.0%
Other operating expenses	828,155	745,563	82,592	11.1%
Total non-interest expense	$ 4,188,203	$ 4,744,586	$ (556,383)	(11.7)%

	For the Nine Months Ended September 30,			
	2010	2009	$ change	% change
Salaries and employee benefits	$ 6,483,605	$ 5,889,247	$ 594,358	10.1%
Occupancy expenses	2,031,127	2,031,844	(717)	(0.0)%
Data processing fees	706,889	672,597	34,292	5.1%
OREO expenses	598,894	1,974,375	(1,375,481)	(69.7)%
Assessments (FDIC & DFI)	774,000	667,355	106,645	16.0%
Other operating expenses	2,355,381	2,234,073	121,308	5.4%
Total non-interest expense	$ 12,949,896	$ 13,469,491	$ (519,595)	(3.9)%

Non-interest expenses decreased by $556,000 or 11.7% and $520,000 or 3.9% for the three and nine months ended September 30, 2010, respectively, as compared to the same periods of 2009. Salaries and employee benefits increased $169,000 and $594,000 for the three and nine months ended September 30, 2010, respectively, as compared to the same periods of 2009 as a result of hiring to fill existing positions. Data processing fees increased by $14,000 and $34,000 for the three and nine month periods of 2010, as compared to the same periods of 2009, as a result of an increased number of transaction accounts.

FDIC and DFI assessments increased by $28,000 and $107,000 for the three and nine months ended September 30, 2010, as compared to the same periods of 2009. Effective April 1, 2009, the FDIC adopted a final rule revising its risk-based insurance assessment system and effectively increasing the overall assessment rate. The increase of FDIC insurance in 2010 over 2009 is primarily due to an increase in the industry-wide FDIC assessment rate and growth in our deposit level. In addition, in November 2008, we elected to participate in the FDIC Transaction Account Guarantee Program, which provides unlimited insurance coverage on non-interest-bearing transaction

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accounts defined by the FDIC, on which we currently pay a 15 basis point surcharge per $100 covered balances in excess of $250 thousand through December 31, 2010, at which time the program expires. Increases to the assessment fees were also due in part to an overall increase in deposits.

OREO expenses were $35,000 and $599,000 in the third quarter and nine month period of 2010, respectively, compared to $916,000 and $1,974,000 for the comparable periods of 2009. These expenses resulted from various overhead costs and market value write downs associated with the properties classified as other real estate owned. OREO expenses are decreasing compared to 2009 as a result of managements effort to actively conduct market valuations on the properties and record writedowns to bring carrying balances to the appropriate market values, which were higher in 2009, as well as selling various properties to bring our OREO balance down to $1.1 million compared to the $2.0 million at September 30, 2009.

Management anticipates that noninterest expense will continue to increase as we continue to grow. However, management remains committed to cost-control and efficiency, and we expect to keep these increases to a minimum relative to growth.

Income Taxes

Provision for income taxes for the third quarter and nine month periods of 2010 were $701,000 and $1,626,000, respectively, an increase of $452,000 and $1,736,000 compared to $249,000 and a tax benefit of $109,000, respectively, in the same periods of 2009. The effective tax rates of 38.05% and 34.21% for the third quarter and nine month period of 2010, respectively, are returning to a more normal level compared to 2009 in which we recorded tax benefits. The 2009 tax rates, in particular, are considerably lower compared to some of our peers and our historical tax rates, and are disproportional compared to pre-tax income assuming marginal tax rates or historical effective tax rates are applied to pre-tax income. This is primarily due to tax credits from California Enterprise Zones and low income housing projects as well as tax free-income on loans within these enterprise zones and municipal securities and loans that comprise a larger proportion of pre-tax income in 2010 and 2009 as compared other historical periods or peers. Certain tax credits and deductions are recognized by the Company regardless of the amount of pre-tax income or loss, which further increases the tax benefit and exaggerates the effective tax rates.

Asset Quality

Nonperforming assets consist of loans on non-accrual status, loans 90 days or more past due and still accruing interest, loans restructured, where the terms of repayment have been renegotiated resulting in a reduction or deferral of interest or principal, and other real estate owned (OREO).

Loans are generally placed on non-accrual status when they become 90 days past due, unless management believes the loan is adequately collateralized and in the process of collection. The past due loans may or may not be adequately collateralized, but collection efforts are continuously pursued. Loans may be restructured by management when a borrower has experienced some changes in financial status, causing an inability to meet the original repayment terms, and where we believe the borrower will eventually overcome those circumstances and repay the loan in full. OREO consists of properties acquired by foreclosure or similar means and which management intends to offer for sale.

Non-accrual loans totaled $9.5 million at September 30, 2010, as compared to $14.4 million at December 31, 2009. The non-accrual loans as of September 30, 2010 are loans made to eleven borrowers primarily for purposes of real estate construction and commercial real estate. As of September 30, 2010, we had three loans considered troubled debt restructurings totaling $1.4 million, which are included in nonaccrual loans.

OREO totaled $1.1 million as of September 30, 2010 and consists of four properties that were acquired through foreclosure including residential land lots and a commercial real estate property.

The following table presents information about the Company s non-performing loans, including asset quality ratios as of September 30, 2010 and December 31, 2009:

Non-Performing Assets

(in thousands)

	September 30, 2010	December 31, 2009
Loans in nonaccrual status	$ 8,145	$ 14,418
Loans past due 90 days or more and accruing		
Restructured loans	1,402	
Total nonperforming loans	9,547	14,418
Other real estate owned	1,143	2,150
Total nonperforming assets	$ 10,690	$ 16,568
Allowance for loan losses	$ 7,700	$ 7,020
Asset quality ratios:		
Non-performing assets to total assets	2.00%	3.16%
Non-performing loans to total loans	2.33%	3.39%
Allowance for loan losses to total loans	1.88%	1.65%
Allowance for loan losses to total non-performing loans	80.66%	48.69%

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Allowance for Loan and Lease Losses (ALLL)

In anticipation of credit risk inherent in our lending business, we routinely set aside allowances through charges to earnings. Such charges are not only made for the outstanding loan portfolio, but also for off-balance sheet items, such as commitments to extend credits or letters of credit. Charges made for the outstanding loan portfolio have been credited to the allowance for loan losses, whereas charges for off-balance sheet items have been credited to the reserve for off-balance sheet items, which is presented as a component of other liabilities. The Bank recorded loan loss provisions of $1,005,000 and $3,015,000 for the three and nine month periods in 2010, respectively, which represented an $80,000 increase and a $1,947,000 decrease, respectively, as compared to the provisions recorded in the same periods of 2009.

The allowance for loan losses increased by $680,000 or 9.7%, to $7.7 million at September 30, 2010, as compared with $7.02 million at December 31, 2009. The Bank recognized the increase in the allowance for loan losses during the first nine months of the year due to the loan loss provision of $3.02 million which was partially offset by net loan charge-offs of $2.34 million. The weak business climate has continued to adversely impact the financial conditions of certain Bank clients in addition to decrease collateral values. The increase to the allowance for loan losses combined with the decrease in our loan portfolio resulted in an increase in the allowance for loan losses as a percentage of total loans to 1.88% at September 30, 2010, as compared to 1.65% at December 31, 2009.

The Bank will continue to monitor the adequacy of the allowance for loan losses and make additions to the allowance in accordance with the analysis referred to above. Because of uncertainties inherent in estimating the appropriate level of the allowance for loan losses, actual results may differ from management s estimate of credit losses and the related allowance.

The following table provides an analysis of the changes in the ALLL for the nine month periods ended September 30, 2010 and 2009:

(dollars in thousands)

	Nine months Ended September 30,	
	2010	**2009**
Balance at beginning of period	$ 7,020	$ 5,569
Provision for loan losses	3,015	4,962
Loans charged off	(2,340)	(4,139)
Recoveries of previous charge-offs	5	4
Net charge-offs	(2,335)	(4,135)
Balance at end of period	$ 7,700	$ 6,396
Allowance for loan losses to total loans	1.88%	1.50%
Net charge-offs to average loans (annualized)	0.75%	1.29%
Provision for loan losses to average loans (annualized)	0.97%	1.55%

The Bank makes provisions for loan losses when required to bring the total allowance for loan and lease losses to a level deemed appropriate for the level of risk in the loan portfolio. At least quarterly, management conducts an assessment of the overall quality of the loan portfolio and general economic trends in the local market. The determination of the appropriate level for the allowance is based on

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that review, considering such factors as historical experience, the volume and type of lending conducted, the amount of and identified potential loss associated with specific nonperforming loans, regulatory policies, general economic conditions, and other factors related to the collectibility of loans in the portfolio.

Although management believes the allowance at September 30, 2010 was adequate to absorb probable losses from any known and inherent risks in the portfolio, no assurance can be given that the adverse effect of current and future economic conditions on our service areas, or other variables, will not result in increased losses in the loan portfolio in the future.

Investment Activities

Investments are a key source of interest income. Management of our investment portfolio is set in accordance with strategies developed and overseen by our Investment Committee. Investment balances, including cash equivalents and interest-bearing deposits in other financial institutions, are subject to change over time based on our asset/liability funding needs and interest rate risk management objectives. Our liquidity levels take into consideration anticipated future cash flows and all available sources of credits, and are maintained at levels management believes are appropriate to assure future flexibility in meeting anticipated funding needs.

Cash Equivalents and Interest-bearing Deposits in other Financial Institutions

The Bank holds federal funds sold, unpledged available-for-sale securities and salable government guaranteed loans to help meet liquidity requirements and provide temporary holdings until the funds can be otherwise deployed or invested. As of September 30, 2010, and December 31, 2009, we had $46.5 million and $21.6 million, respectively, in cash and cash equivalents.

Investment Securities

Management of our investment securities portfolio focuses on providing an adequate level of liquidity and establishing an interest rate-sensitive position, while earning an adequate level of investment income without taking undue risk. Investment securities that we intend to hold until maturity are classified as held-to-maturity securities, and all other investment securities are classified as available-for-sale. Currently, all of our investment securities are classified as available-for-sale. The carrying values of available-for-sale investment securities are adjusted for unrealized gains or losses as a valuation allowance and any gain or loss is reported on an after-tax basis as a component of other comprehensive income.

Management has evaluated the investment securities portfolio to determine if the impairment of any security in an unrealized loss position is temporary or other than temporary. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due solely to interest rate changes.

Deposits

Total deposits at September 30, 2010 were $448.9 million, a $19.7 million or 4.6% increase from the deposit total of $429.2 million at December 31, 2009. Average deposits increased $22.8 million to $431.8 million for the nine month period ended September 30, 2010 as compared to the same period in 2009. We attracted deposits due to the safety and soundness of the Bank and our focus on customer service.

(in thousands)

	September 30, 2010	December 31, 2009	Nine months change $	%
Demand	$ 88,248	$ 69,647	$ 18,601	26.7%
NOW	58,683	57,378	1,305	2.3%
MMDA	214,880	202,947	11,933	5.9%
Savings	14,136	17,178	(3,042)	(17.7)%
Time < 100K	29,210	36,215	(7,005)	(19.3)%
Time > $100K	43,747	45,845	(2,098)	(4.6)%
	$ **448,904**	$ **429,210**	$ **19,694**	**4.6%**

Because our client base is comprised primarily of commercial and industrial accounts, individual account balances are generally higher than those of consumer-oriented banks. Four of our clients carry deposit balances of more than 1% of our total deposits, one of which had a deposit balance of more than 3% of total deposits at September 30, 2010.

Since our deposit growth strategy emphasizes core deposit growth we have avoided relying on brokered deposits as a consistent source of funds. The only brokered deposits the Bank holds are from CDARS, a certificate of deposit program that exchanges funds with other

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network banks to offer full FDIC insurance coverage to the customer. The Bank had $4.8 million in brokered deposits as of September 30, 2010 as compared to $11.4 million at December 31, 2009.

Borrowings

Although deposits are the primary source of funds for our lending and investment activities and for general business purposes, we may obtain advances from the Federal Home Loan Bank of San Francisco (FHLB) as an alternative to retail deposit funds. Our outstanding FHLB advances decreased by $13.7 million at September 30, 2010 to $18.5 million, compared to $32.2 million at December 31, 2009 due to the increase in deposits and loan repayments. See Liquidity Management below for the details on the FHLB borrowings program.

Capital Ratios

We are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can trigger regulatory actions that could have a material adverse effect on our financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that rely on quantitative measures of our assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The following table shows the Oak Valley Community Bank s and Oak Valley Bancorp s capital ratios, as calculated under regulatory guidelines, compared to the regulatory minimum capital ratios and the regulatory minimum capital ratios needed to qualify as a well-capitalized institution at September 30, 2010 and December 31, 2009:

Oak Valley Community Bank Capital Ratios

(dollars in thousands)

			Amount of Capital Required			
	Actual		To Be Well-Capitalized		To Be Adequately Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2010:						
Total Capital (to Risk-Weighted Assets)	$ 67,326	14.8%	$ 45,645	10%	$ 36,516	8%
Tier 1 Capital (to Risk-Weighted Assets)	$ 61,580	13.5%	$ 27,387	6%	$ 18,258	4%
Tier 1 Capital (to Average Assets)	$ 61,580	11.7%	$ 26,242	5%	$ 20,994	4%
As of December 31, 2009:						

Total Capital (to Risk-Weighted Assets)	$	64,821	13.6%	$	47,844	10%	$	38,275	8%
Tier 1 Capital (to Risk-Weighted Assets)	$	58,817	12.3%	$	28,706	6%	$	19,137	4%
Tier 1 Capital (to Average Assets)	$	58,817	11.3%	$	26,024	5%	$	20,819	4%

Oak Valley Bancorp Capital Ratios

(dollars in thousands)

				Amount of Capital Required				
				To Be Well-Capitalized			To Be Adequately Capitalized	
		Actual						
		Amount	Ratio	Amount	Ratio		Amount	Ratio
As of September 30, 2010								
Total Capital (to Risk-Weighted Assets)	$	67,516	14.8%	N/A	N/A	$	36,519	8%
Tier 1 Capital (to Risk-Weighted Assets)	$	61,769	13.5%	N/A	N/A	$	18,259	4%
Tier 1 Capital (to Average Assets)	$	61,769	11.8%	N/A	N/A	$	20,996	4%
As of December 31, 2009:								
Total Capital (to Risk-Weighted Assets)	$	65,014	13.6%	N/A	N/A	$	38,285	8%
Tier 1 Capital (to Risk-Weighted Assets)	$	59,009	12.3%	N/A	N/A	$	19,142	4%
Tier 1 Capital (to Average Assets)	$	59,009	11.3%	N/A	N/A	$	20,824	4%

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Liquidity Management

Since the Company is a holding company and does not conduct regular banking operations, its primary sources of liquidity are dividends from the Bank. Under the California Financial Code, payment of a dividend from the Bank to the Company is restricted to the lesser of the Bank s retained earnings or the amount of the Bank s undistributed net profits from the previous three fiscal years. The primary uses of funds for the Company are stockholder dividends, investment in the Bank and ordinary operating expenses. Management anticipates that there will be sufficient earnings at the Bank level to provide dividends to the Company to meet its funding requirements for the foreseeable future.

Maintenance of adequate liquidity requires that sufficient resources be available at all time to meet our cash flow requirements. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of its customers and to take advantage of investment opportunities as they arise. Liquidity management involves our ability to convert assets into cash or cash equivalents without incurring significant loss, and to raise cash or maintain funds without incurring excessive additional cost. For this purpose, we maintain a portion of our funds in cash and cash equivalents, salable government guaranteed loans and securities available for sale. We obtain funds from the repayment and maturity of loans as well as deposit inflows, investment security maturities and paydowns, Federal funds purchased, FHLB advances, and other borrowings. Our primary uses of funds are the origination of loans, the purchase of investment securities, withdrawals of deposits, maturity of certificate of deposits, repayment of borrowings and dividends to common and preferred stockholders. Our liquid assets at September 30, 2010 were $108.0 million compared to $80.1 million at December 31, 2009. Our liquidity level measured as the percentage of liquid assets to total assets was 20.2% and 15.3% at September 30, 2010 and December 31, 2009, respectively. We anticipate that cash and cash equivalents on hand and other sources of funds will provide adequate liquidity for our operating, investing and financing needs and our regulatory liquidity requirements for the foreseeable future. Management monitors our liquidity position daily, balancing loan funding/payments with changes in deposit activity and overnight investments.

As a secondary source of liquidity, we rely on advances from the FHLB to supplement our supply of lendable funds and to meet deposit withdrawal requirements. Advances from the FHLB are typically secured by a portion of our loan portfolio. The FHLB determines limitations on the amount of advances by assigning a percentage to each eligible loan category that will count towards the borrowing capacity. As of September 30, 2010, our borrowing capacity from the FHLB was approximately $118.4 million and the outstanding balance was $18.5 million, or approximately 15.6% of our borrowing capacity. We also maintain 2 lines of credit with correspondent banks to purchase up to $15 million in federal funds, for which there were no advances as of September 30, 2010.

Off-Balance-Sheet Arrangements

During the ordinary course of business, we provide various forms of credit lines to meet the financing needs of our customers. These commitments, which represent a credit risk to us, are not represented in any form on our balance sheets.

As of September 30, 2010 and December 31, 2009, we had commitments to extend credit of $54.4 million and $63.1 million, respectively, which includes obligations under letters of credit of $0.9 million and $2.8 million, respectively.

The effect on our revenues, expenses, cash flows and liquidity from the unused portion of the commitments to provide credit cannot be reasonably predicted because there is no guarantee that the lines of credit will be used.

Recent Legislation and Other Regulatory Initiatives

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act), a landmark financial reform bill comprised of new rules and restrictions that will impact banks going forward. It includes key provisions aimed at preventing a repeat of the 2008 financial crisis and a new process for winding down failing, systemically important institutions in a manner as close to a controlled bankruptcy as possible. The Act includes other key provisions as follows:

(1) The Act establishes a new Financial Stability Oversight Council to monitor systemic financial risks. The Board of Governors of the Federal Reserve (Fed) are given extensive new authorities to impose strict controls on large bank holding companies with total consolidated assets equal to or in excess of $50 billion and systemically significant nonbank financial companies to limit the risk they might pose for the economy and to other large interconnected companies. The Fed can also take direct control of troubled financial companies that are considered systemically significant.

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(2) The Act also establishes a new independent Federal regulatory body for consumer protection within the Federal Reserve System known as the Bureau of Consumer Financial Protection (the Bureau), which will assume responsibility for most consumer protection laws (except the Community Reinvestment Act). It will also be in charge of setting appropriate consumer banking fees and caps. The Office of Comptroller of the Currency will continue to have authority to preempt state banking and consumer protection laws if these laws prevent or significantly interfere with the business of banking.

(3) The Act restricts the amount of trust preferred securities (TPS) that may be considered as Tier 1 Capital. For depository institution holding companies below $15 billion in total assets, TPS issued before May 19, 2010 will be grandfathered, so their status as Tier 1 capital does not change. However going forward, TPS will be disallowed as Tier 1 capital. Beginning January 1, 2013, bank holding companies above $15 billion in assets will have a three-year phase-in period to fill the capital gap caused by the disallowance of the TPS issued before May 19, 2010.

(4) The Act effects changes in the FDIC assessment base with stricter oversight. A new council of regulators led by the U.S. Treasury will set higher requirements for the amount of cash banks must keep on hand. FDIC insurance coverage is made permanent at the $250 thousand level retroactive to January 1, 2008 and unlimited FDIC insurance is provided for noninterest-bearing transaction accounts in all banks effective December 31, 2010 through the end of 2012. Further, the Act removes the prohibition on payments of interest on demand deposit accounts as of July 21, 2011. Thus, if a depositor sweeps any amount in excess of $250 thousand from a noninterest-bearing transaction account to an interest bearing demand deposit, there is no FDIC insurance coverage on the portion that is over $250 thousand coverage limit.

(5) The Act places certain limitations on investment and other activities by depository institutions, holding companies and their affiliates.

The impact of the Act on our banking operations is still uncertain due to the large volume of new rules still subject to adoption and interpretation.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4. Controls and Procedures

The Company s Chief Executive Officer and its Chief Financial Officer, after evaluating the effectiveness of the Company s disclosure controls and procedures, as defined in Exchange Act Rules 13 a-15(e)and 15(d)-15(e) promulgated under the Exchange Act, as of the end of the period covered by this report (the Evaluation Date) have concluded that as of the Evaluation Date, the Company s disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company would be made known to them by others within the Company, particularly during the period in which this report was being prepared. Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no significant change in the our internal control over financial reporting during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting subsequent to the Evaluation Date, nor there were any significant deficiencies or material weaknesses in such controls requiring corrective actions.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

There are no pending, or to management s knowledge, any threatened, material legal proceedings to which we are a defendant, or to which any of our properties are subject. There are no material legal proceedings to which any director, any nominee for election as a director, any executive officer, or any associate of any such director, nominee or officer is a party adverse to us.

Item 1A. Risk Factors

Not applicable.

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

We did not have any unregistered sales of our equity securities during the three months ended September 30, 2010.

Item 3. Defaults Upon Senior Securities

None.

Item 4. (Removed and Reserved)

None.

Item 5. Other Information

None.

Item 6. Exhibits

The following exhibits are filed as part of this report or hereby incorporated by reference to filings previously made with the SEC:

3.1	Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company s Registration Statement on Form 10-12B filed with the Securities and Exchange Commission on July 31, 2008).
3.2	First Amendment to Articles of Incorporation (incorporated by reference to Exhibit 3.2 to the Company s Registration Statement on Form 10-12B filed with the Securities and Exchange Commission on July 31, 2008).
3.3	Bylaws (incorporated by reference to Exhibit 3.3 to the Company s Registration Statement on Form 10-12B filed with the Securities and Exchange Commission on July 31, 2008).
3.4	Certificate of Amendment of Bylaws (incorporated by reference to Exhibit 3.5 to the Company s Registration Statement on Form 8-A12B filed with the Securities and Exchange Commission on January 14, 2009).
4.1	Certificate of Determination filed with the California Secretary of State for Fixed Rate Cumulative Perpetual Preferred Stock, Series A (incorporated by reference to Exhibit 3.4 to the Company s Registration Statement on Form 8-A12B filed with the Securities and Exchange Commission on January 14, 2009).
4.2	Warrant to Purchase Common Stock dated December 5, 2008 (incorporated by reference to Exhibit 3.4 to the Company s Registration Statement on Form 8-A12B filed with the Securities and Exchange Commission on January 14, 2009).
31.01	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.01	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

	Oak Valley Bancorp	
Date: November 12, 2010	By:	/s/ RICHARD A. MCCARTY **Richard A. McCarty** **Executive Vice President and Chief Financial Officer** **(Principal Financial Officer and duly authorized signatory)**

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EXHIBIT INDEX

Exhibit	Description
31.01	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
31.02	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
32.01	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2003