

PLUMAS BANCORP
Form 10-Q
August 05, 2015
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark
One)

**QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE
ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2015**

**TRANSITION REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE
ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____ TO _____**

COMMISSION FILE NUMBER: 000-49883

PLUMAS BANCORP

(Exact Name of Registrant as Specified in Its Charter)

California **75-2987096**
(State or Other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification No.)

35 S. Lindan Avenue, Quincy, California **95971**
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code **(530) 283-7305**

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

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

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 the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	Accelerated Filer
Non-Accelerated Filer	Smaller Reporting Company

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

Yes No

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of August 3, 2015.
4,821,432 shares

PART I – FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****PLUMAS BANCORP****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

(In thousands, except share data)

	June 30, 2015	December 31, 2014
<u>Assets</u>		
Cash and cash equivalents	\$41,333	\$ 45,574
Investment securities available for sale	90,024	90,320
Loans, less allowance for loan losses of \$5,780 at June 30, 2015 and \$5,451 at December 31, 2014	388,786	366,787
Premises and equipment, net	12,296	11,642
Bank owned life insurance	12,016	11,845
Real estate acquired through foreclosure	2,970	3,590
Accrued interest receivable and other assets	10,162	9,104
Total assets	\$557,587	\$ 538,862
<u>Liabilities and Shareholders' Equity</u>		
Deposits:		
Non-interest bearing	\$ 190,932	\$ 180,649
Interest bearing	302,436	287,242
Total deposits	493,368	467,891
Repurchase agreements	3,915	9,626
Note payable	5,000	1,000
Subordinated debenture	-	7,454
Accrued interest payable and other liabilities	5,973	6,084
Junior subordinated deferrable interest debentures	10,310	10,310
Total liabilities	518,566	502,365
Commitments and contingencies (Note 5)		
Shareholders' equity:		
Common stock, no par value; 22,500,000 shares authorized; issued and outstanding – 4,821,432 shares at June 30, 2015 and 4,799,139 at December 31, 2014	6,389	6,312
Retained earnings	32,815	30,245

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Accumulated other comprehensive loss, net	(183)	(60)
Total shareholders' equity	39,021	36,497
Total liabilities and shareholders' equity	\$557,587	\$ 538,862

See notes to unaudited condensed consolidated financial statements.

1

PLUMAS BANCORP**CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

(In thousands, except per share data)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
Interest Income:				
Interest and fees on loans	\$5,148	\$4,758	\$10,090	\$9,366
Interest on investment securities	418	381	816	755
Other	28	26	64	55
Total interest income	5,594	5,165	10,970	10,176
Interest Expense:				
Interest on deposits	125	131	249	264
Interest on note payable	44	31	55	63
Interest on subordinated debenture	32	189	219	377
Interest on junior subordinated deferrable interest debentures	75	75	150	149
Other	1	1	3	3
Total interest expense	277	427	676	856
Net interest income before provision for loan losses	5,317	4,738	10,294	9,320
Provision for Loan Losses	300	300	600	450
Net interest income after provision for loan losses	5,017	4,438	9,694	8,870
Non-Interest Income:				
Service charges	1,006	1,064	1,945	2,058
Gain on sale of loans	317	444	974	776
Gain on sale of investments	-	-	30	-
Other	499	385	918	748
Total non-interest income	1,822	1,893	3,867	3,582
Non-Interest Expenses:				
Salaries and employee benefits	2,426	2,393	5,144	4,762
Occupancy and equipment	680	757	1,380	1,536
Other	1,523	1,314	2,811	2,727
Total non-interest expenses	4,629	4,464	9,335	9,025
Income before provision for income taxes	2,210	1,867	4,226	3,427
Provision for Income Taxes	855	742	1,656	1,360
Net income	\$1,355	\$1,125	\$2,570	\$2,067
Basic earnings per share	\$0.28	\$0.23	\$0.53	\$0.43
Diluted earnings per share	\$0.27	\$0.23	\$0.51	\$0.42

See notes to unaudited condensed consolidated financial statements.

2

PLUMAS BANCORP**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Unaudited)**

(In thousands)

	For the Three Months Ended June 30, 2015		For the Six Months Ended June 30, 2015		2014	
Net income	\$1,355	\$1,125	\$2,570	\$2,067		
Other comprehensive (loss) income :						
Change in net unrealized gain	(832)	984	(179)	1,522		
Less: reclassification adjustments for net gains included in net income	-	-	(30)	-		
Net unrealized holding gains (losses)	(832)	984	(209)	1,522		
Related tax effect:						
Change in net unrealized gain	343	(406)	74	(628)		
Reclassification of net gains included in net income	-	-	12	-		
Income tax effect	343	(406)	86	(628)		
Other comprehensive (loss) income	(489)	578	(123)	894		
Total comprehensive income	\$866	\$1,703	\$2,447	\$2,961		

See notes to unaudited condensed consolidated financial statements.

PLUMAS BANCORP**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

(In thousands)

	For the Six Months Ended June 30,	
	2015	2014
Cash Flows from Operating Activities:		
Net income	\$2,570	\$2,067
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	600	450
Change in deferred loan origination costs/fees, net	(279)	(399)
Depreciation and amortization	618	649
Stock-based compensation expense	41	33
Gain on sale of Investments	(30)	-
Amortization of investment security premiums	248	249
Gain on sale of OREO and other vehicles	(42)	(123)
Gain on sale of loans held for sale	(974)	(776)
Loans originated for sale	(16,530)	(9,075)
Proceeds from loan sales	13,971	11,769
Provision from change in OREO valuation	43	135
Earnings on bank-owned life insurance	(170)	(172)
Increase in accrued interest receivable and other assets	(290)	(149)
(Decrease) increase in accrued interest payable and other liabilities	(111)	175
Net cash (used in) provided by operating activities	(335)	4,833
Cash Flows from Investing Activities:		
Proceeds from matured and called available-for-sale investment securities	1,000	16,044
Proceeds from principal repayments from available-for-sale government-sponsored mortgage-backed securities	5,780	4,576
Purchases of available-for-sale securities	(13,994)	(19,767)
Proceeds from sale of available-for-sale securities	6,669	-
Net increase in loans	(19,427)	(20,756)
Proceeds from sale of OREO	834	2,805
Proceeds from sale of other vehicles	128	160
Purchase of premises and equipment	(1,202)	(81)
Net cash used in investing activities	(20,212)	(17,019)

Continued on next page.

PLUMAS BANCORP**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

(In thousands)

(Continued)

	For the Six Months Ended June 30, 2015 2014	
Cash Flows from Financing Activities:		
Net increase in demand, interest bearing and savings deposits	\$28,915	\$10,638
Net decrease in time deposits	(3,438)	(3,361)
Net decrease in securities sold under agreements to repurchase	(5,711)	(5,038)
Borrowing on note payable	4,000	-
Redemption of subordinated debenture	(7,500)	-
Proceeds from exercise of stock options	40	22
Net cash provided by financing activities	16,306	2,261
Decrease in cash and cash equivalents	(4,241)	(9,925)
Cash and Cash Equivalents at Beginning of Year	45,574	49,917
Cash and Cash Equivalents at End of Period	\$41,333	\$39,992
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest expense	\$596	\$772
Income taxes	\$2,295	\$1,200
Non-Cash Investing Activities:		
Real estate and vehicles acquired through foreclosure	\$412	\$432
Non-Cash Financing Activities:		
Common stock retired in connection with the exercise of stock options	\$32	\$-

See notes to unaudited condensed consolidated financial statements.

PLUMAS BANCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. GENERAL

During 2002, Plumas Bancorp (the "Company") was incorporated as a bank holding company for the purpose of acquiring Plumas Bank (the "Bank") in a one bank holding company reorganization. This corporate structure gives the Company and the Bank greater flexibility in terms of operation, expansion and diversification. The Company formed Plumas Statutory Trust I ("Trust I") for the sole purpose of issuing trust preferred securities on September 26, 2002. The Company formed Plumas Statutory Trust II ("Trust II") for the sole purpose of issuing trust preferred securities on September 28, 2005.

The Bank operates eleven branches in California, including branches in Alturas, Chester, Fall River Mills, Greenville, Kings Beach, Portola, Quincy, Redding, Susanville, Tahoe City, and Truckee. The Bank's administrative headquarters is in Quincy, California. In addition, the Bank operates a loan administrative and lending office in Reno, Nevada, lending offices specializing in government-guaranteed lending in Auburn, California and Beaverton, Oregon and a commercial/agricultural lending office in Chico, California. The Bank's primary source of revenue is generated from providing loans to customers who are predominately small and middle market businesses and individuals residing in the surrounding areas.

2. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements include the accounts of the Company and the accounts of its wholly-owned subsidiary, Plumas Bank. Plumas Statutory Trust I and Plumas Statutory Trust II are not consolidated into the Company's consolidated financial statements and, accordingly, are accounted for under the equity method. In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the Company's financial position at June 30, 2015 and the results of its operations and its cash flows for the three-month and six-month periods ended June 30, 2015 and 2014. Our condensed consolidated balance sheet at December 31, 2014 is derived from audited financial statements. Certain reclassifications have been made to prior period's balances to conform to classifications used in 2015.

The unaudited condensed consolidated financial statements of the Company have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for interim reporting on Form 10-Q. Accordingly, certain disclosures normally presented in the notes to the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been omitted. The Company believes that the disclosures are adequate to make the information not misleading. These interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2014 Annual Report to Shareholders on Form 10-K. The results of operations for the three-month and six-month periods ended June 30, 2015 may not necessarily be indicative of future operating results. In preparing such financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the periods reported. Actual results could differ significantly from those estimates.

Management has determined that because all of the commercial banking products and services offered by the Company are available in each branch of the Bank, all branches are located within the same economic environment and management does not allocate resources based on the performance of different lending or transaction activities, it is appropriate to aggregate the Bank branches and report them as a single operating segment. No single customer accounts for more than 10% of the revenues of the Company or the Bank.

3. INVESTMENT SECURITIES AVAILABLE FOR SALE

The amortized cost and estimated fair value of investment securities at June 30, 2015 and December 31, 2014 consisted of the following, in thousands:

<u>Available-for-Sale</u>	June 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government-sponsored agencies	\$6,086	\$ 34	\$ (5)	\$ 6,115
U.S. Government-sponsored agencies collateralized by mortgage obligations-residential	68,363	151	(537)	67,977
Obligations of states and political subdivisions	15,886	127	(81)	15,932
	\$90,335	\$ 312	\$ (623)	\$ 90,024

Net unrealized loss on available-for-sale investment securities totaling \$311,000 were recorded, net of \$128,000 in tax expense, as accumulated other comprehensive income within shareholders' equity at June 30, 2015. During the six months ended June 30, 2015 the Company sold eight available-for-sale investment securities for total proceeds of \$6,669,000 recording a \$30,000 gain on sale. The Company realized a gain on sale from five of these securities totaling \$37,000 and a loss on sale on three securities of \$7,000. No securities were sold during the three months ended June 30, 2015.

<u>Available-for-Sale</u>	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government-sponsored agencies	\$7,003	\$ 19	\$ (20)	\$ 7,002
U.S. Government-sponsored agencies collateralized by mortgage obligations-residential	70,610	192	(522)	70,280
Obligations of states and political subdivisions	12,307	234	(9)	12,532
Corporate debt	502	4	-	506
	\$90,422	\$ 449	\$ (551)	\$ 90,320

Net unrealized loss on available-for-sale investment securities totaling \$102,000 were recorded, net of \$42,000 in tax benefits, as accumulated other comprehensive income within shareholders' equity at December 31, 2014. No securities were sold during the six months ended June 30, 2014.

There were no transfers of available-for-sale investment securities during the six months ended June 30, 2015 and twelve months ended December 31, 2014. There were no securities classified as held-to-maturity at June 30, 2015 or December 31, 2014.

Investment securities with unrealized losses at June 30, 2015 and December 31, 2014 are summarized and classified according to the duration of the loss period as follows, in thousands:

June 30, 2015

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government- sponsored agencies	\$993	\$ 5			\$993	\$ 5
U.S. Government agencies collateralized by mortgage obligations-residential	23,169	188	\$14,278	\$ 349	37,447	537
Obligations of states and political subdivisions	6,527	81	-	-	6,527	81
	\$30,689	\$ 274	\$14,278	\$ 349	\$44,967	\$ 623

December 31, 2014

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government- sponsored agencies	\$994	\$ 6	\$2,985	\$ 14	\$3,979	\$ 20
U.S. Government agencies collateralized by mortgage obligations-residential	4,504	17	28,643	505	33,147	522
Obligations of states and political subdivisions	2,014	9	-	-	2,014	9
	\$7,512	\$ 32	\$31,628	\$ 519	\$39,140	\$ 551

At June 30, 2015, the Company held 129 securities of which 59 were in a loss position. Of the securities in a loss position, 44 were in a loss position for less than twelve months. Of the 59 securities 1 is a U.S. Government-sponsored agency, 34 are U.S. Government-sponsored agencies collateralized by residential mortgage obligations and 24 were obligations of states and political subdivisions. The unrealized losses relate principally to market rate conditions. All of the securities continue to pay as scheduled. When analyzing an issuer's financial condition, management considers the length of time and extent to which the market value has been less than cost; the historical and implied volatility of the security; the financial condition of the issuer of the security; and the Company's intent and ability to hold the security to recovery. As of June 30, 2015, management does not have the intent to sell these securities nor does it believe it is more likely than not that it will be required to sell these securities before the recovery of its amortized cost basis. Based on the Company's evaluation of the above and other relevant factors, the Company does not believe the securities that are in an unrealized loss position as of June 30, 2015 are other than temporarily impaired.

The amortized cost and estimated fair value of investment securities at June 30, 2015 by contractual maturity are shown below, in thousands.

	Amortized Cost	Estimated Fair Value
Within one year	\$ -	\$ -
After one year through five years	6,086	6,115
After five years through ten years	12,164	12,226
After ten years	3,722	3,706
Investment securities not due at a single maturity date:		
Government-sponsored mortgage-backed securities	68,363	67,977
	\$ 90,335	\$ 90,024

Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties. Investment securities with amortized costs totaling \$57,518,000 and \$57,793,000 and estimated fair values totaling \$57,368,000 and \$57,636,000 at June 30, 2015 and December 31, 2014, respectively, were pledged to secure deposits and repurchase agreements.

4. LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Outstanding loans are summarized below, in thousands:

	June 30, 2015	December 31, 2014
Commercial	\$36,458	\$31,465
Agricultural	38,542	35,355
Real estate - residential	27,346	29,284
Real estate – commercial	174,258	163,306
Real estate – construction and land development	26,594	24,572
Equity lines of credit	38,634	38,972
Auto	47,425	44,618
Other	3,315	2,818
	392,572	370,390
Deferred loan costs, net	1,994	1,848
Allowance for loan losses	(5,780)	(5,451)
	\$388,786	\$366,787

Changes in the allowance for loan losses, in thousands, were as follows:

	June 30, 2015	December 31, 2014
Balance, beginning of year	\$5,451	\$ 5,517
Provision charged to operations	600	1,100
Losses charged to allowance	(450)	(1,913)
Recoveries	179	747
Balance, end of year	\$5,780	\$ 5,451

The recorded investment in impaired loans totaled \$7,036,000 and \$8,582,000 at June 30, 2015 and December 31, 2014, respectively. The Company had specific allowances for loan losses of \$551,000 on impaired loans of \$2,295,000 at June 30, 2015 as compared to specific allowances for loan losses of \$564,000 on impaired loans of \$2,401,000 at December 31, 2014. The balance of impaired loans in which no specific reserves were required totaled \$4,741,000 and \$6,181,000 at June 30, 2015 and December 31, 2014, respectively. The average recorded investment in impaired loans for the six months ended June 30, 2015 and June 30, 2014 was \$7,096,000 and \$8,982,000, respectively. The Company recognized \$60,000 and \$64,000 in interest income on impaired loans during the six

months ended June 30, 2015 and 2014, respectively. No interest was recognized on impaired loans accounted for on a cash basis during the six months ended June 30, 2015 and 2014, respectively.

Included in impaired loans are troubled debt restructurings. A troubled debt restructuring is a formal restructure of a loan where the Company for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms to include one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company's internal underwriting policy.

The carrying value of troubled debt restructurings at June 30, 2015 and December 31, 2014 was \$4,817,000 and \$5,738,000, respectively. The Company has allocated \$276,000 and \$319,000 of specific reserves on loans to customers whose loan terms have been modified in troubled debt restructurings as of June 30, 2015 and December 31, 2014, respectively. The Company has not committed to lend additional amounts on loans classified as troubled debt restructurings at June 30, 2015 and December 31, 2014.

There were no troubled debt restructurings that occurred during the six months ended June 30, 2015 and 2014, respectively.

There were no troubled debt restructurings for which there was a payment default within twelve months following the modification during the six months ended June 30, 2015 and 2014, respectively.

At June 30, 2015 and December 31, 2014, nonaccrual loans totaled \$5,078,000 and \$6,625,000, respectively. Interest foregone on nonaccrual loans totaled \$220,000 and \$204,000 for the six months ended June 30, 2015 and 2014, respectively. Interest foregone on nonaccrual loans totaled \$102,000 and \$103,000 for the three months ended June 30, 2015 and 2014, respectively. No loans were past due 90 days or more and on accrual status at June 30, 2015 and December 31, 2014.

The Company assigns a risk rating to all loans, with the exception of automobile and other loans and periodically, but not less than annually, performs detailed reviews of all such loans over \$100,000 to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Company and the Company's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan.

The risk ratings can be grouped into five major categories, defined as follows:

Pass – A pass loan is a strong credit with no existing or known potential weaknesses deserving of management's close attention.

Watch – A Watch loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Company's credit position at some future date. Watch loans are not adversely classified and do not expose the Company to sufficient

risk to warrant adverse classification.

Substandard – A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loss – Loans classified as loss are considered uncollectible and charged off immediately.

Other real estate owned totaled \$2,970,000 and \$3,590,000 at June 30, 2015 and December 31, 2014, respectively. Of these amount \$117,000 at June 30, 2015 and \$146,000 at December 31, 2014 represent foreclosed residential real estate property. The recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process totaled \$99,000 at June 30, 2015 and \$0 at December 31, 2014.

The following table shows the loan portfolio allocated by management's internal risk ratings at the dates indicated, in thousands:

June 30, 2015 Commercial Credit Exposure

Credit Risk Profile by Internally Assigned Grade

Grade:	Commercial	Agricultural	Real Estate-Residential	Real Estate-Commercial	Real Estate-Construction	Equity LOC	Total
Pass	\$35,199	\$ 37,805	\$ 26,830	\$ 168,886	\$ 25,020	\$38,175	\$331,915
Watch	496	354	83	1,278	665	146	3,022
Substandard	763	383	433	4,094	909	313	6,895
Doubtful	-	-	-	-	-	-	-
Total	\$36,458	\$ 38,542	\$ 27,346	\$ 174,258	\$ 26,594	\$38,634	\$341,832

December 31, 2014

Commercial Credit Exposure

Credit Risk Profile by Internally Assigned Grade

Grade:	Commercial	Agricultural	Real Estate-Residential	Real Estate-Commercial	Real Estate-Construction	Equity LOC	Total
Pass	\$30,176	\$ 34,609	\$ 28,048	\$ 156,329	\$ 22,924	\$38,373	\$310,459
Watch	789	355	233	2,297	537	146	4,357
Substandard	500	391	1,003	4,680	1,111	453	8,138
Doubtful	-	-	-	-	-	-	-
Total	\$31,465	\$ 35,355	\$ 29,284	\$ 163,306	\$ 24,572	\$38,972	\$322,954

Consumer Credit Exposure

Credit Risk Profile Based on Payment Activity

June 30, 2015

Consumer Credit Exposure

Credit Risk Profile Based on Payment Activity

December 31, 2014

Grade:	June 30, 2015			December 31, 2014		
	Auto	Other	Total	Auto	Other	Total
Performing	\$47,351	\$3,310	\$50,661	\$44,523	\$2,805	\$47,328
Non-performing	74	5	79	95	13	108
Total	\$47,425	\$3,315	\$50,740	\$44,618	\$2,818	\$47,436

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The following tables show the allocation of the allowance for loan losses at the dates indicated, in thousands:

	Commercial	Agricultural	Real Estate- Residential	Real Estate- Commercial	Real Estate- Construction	Equity LOC	Auto	Other	Total
Six months ended June 30, 2015:									
<u>Allowance for Loan Losses</u>									
Beginning balance	\$ 574	\$ 225	\$ 379	\$ 1,701	\$ 1,227	\$ 691	\$ 581	\$ 73	\$ 5,451
Charge-offs	(54)	(3)	(53)	-	(55)	(59)	(204)	(22)	(450)
Recoveries	90	-	4	-	-	3	55	27	179
Provision	18	20	69	439	(141)	(101)	285	11	600
Ending balance	\$ 628	\$ 242	\$ 399	\$ 2,140	\$ 1,031	\$ 534	\$ 717	\$ 89	\$ 5,780
Three months ended June 30, 2015:									
<u>Allowance for Loan Losses</u>									
Beginning balance	\$ 582	\$ 222	\$ 419	\$ 1,963	\$ 1,228	\$ 587	\$ 627	\$ 94	\$ 5,722
Charge-offs	(14)	(3)	(48)	-	(54)	(51)	(93)	(12)	(275)
Recoveries	9	-	2	-	-	1	12	9	33
Provision	51	23	26	177	(143)	(3)	171	(2)	300
Ending balance	\$ 628	\$ 242	\$ 399	\$ 2,140	\$ 1,031	\$ 534	\$ 717	\$ 89	\$ 5,780
Six months ended June 30, 2014:									
<u>Allowance for Loan Losses</u>									
Beginning balance	\$ 785	\$ 164	\$ 638	\$ 1,774	\$ 944	\$ 613	\$ 449	\$ 150	\$ 5,517
Charge-offs	(93)	-	(145)	(679)	-	(142)	(105)	(57)	(1,221)
Recoveries	27	-	27	1	491	13	21	32	612
Provision	(16)	47	(97)	590	(295)	119	101	1	450
Ending balance	\$ 703	\$ 211	\$ 423	\$ 1,686	\$ 1,140	\$ 603	\$ 466	\$ 126	\$ 5,358
Three months ended June 30, 2014:									
<u>Allowance for Loan Losses</u>									
Beginning balance	\$ 542	\$ 177	\$ 604	\$ 1,962	\$ 1,166	\$ 711	\$ 429	\$ 124	\$ 5,715
Charge-offs	(7)	-	(145)	(679)	-	(131)	(34)	(30)	(1,026)
Recoveries	14	-	8	-	329	1	9	8	369
Provision	154	34	(44)	403	(355)	22	62	24	300

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Ending balance	\$ 703	\$ 211	\$ 423	\$ 1,686	\$ 1,140	\$ 603	\$ 466	\$ 126	\$ 5,358
<u>June 30, 2015:</u>									
<u>Allowance for</u>									
<u>Loan Losses</u>									
Ending balance:									
individually	\$ 32	\$ -	\$ 56	\$ 204	\$ 220	\$ 34	\$ -	\$ 5	\$ 551
evaluated for									
impairment									
Ending balance:									
collectively	\$ 596	\$ 242	\$ 343	\$ 1,936	\$ 811	\$ 500	\$ 717	\$ 84	\$ 5,229
evaluated for									
impairment									
<u>Loans</u>									
Ending balance	\$ 36,458	\$ 38,542	\$ 27,346	\$ 174,258	\$ 26,594	\$ 38,634	\$ 47,425	\$ 3,315	\$ 392,572
Ending balance:									
individually	\$ 92	\$ 594	\$ 1,657	\$ 3,288	\$ 1,048	\$ 278	\$ 74	\$ 5	\$ 7,036
evaluated for									
impairment									
Ending balance:									
collectively	\$ 36,366	\$ 37,948	\$ 25,689	\$ 170,970	\$ 25,546	\$ 38,356	\$ 47,351	\$ 3,310	\$ 385,536
evaluated for									
impairment									

December 31, 2014	Commercial	Agricultural	Real Estate- Residential	Real Estate- Commercial	Real Estate- Construction	Equity LOC	Auto	Other	Tota
<u>Allowance for Loan Losses</u>									
Ending balance: individually evaluated for impairment	\$-	\$-	\$51	\$65	\$274	\$174	\$-	\$-	\$564
Ending balance: collectively evaluated for impairment	\$574	\$225	\$328	\$1,636	\$953	\$517	\$581	\$73	\$4,88
<u>Loans</u>									
Ending balance	\$31,465	\$35,355	\$29,284	\$163,306	\$24,572	\$38,972	\$44,618	\$2,818	\$370
Ending balance: individually evaluated for impairment	\$55	\$605	\$2,518	\$3,643	\$1,252	\$415	\$93	\$1	\$8,58
Ending balance: collectively evaluated for impairment	\$31,410	\$34,750	\$26,766	\$159,663	\$23,320	\$38,557	\$44,525	\$2,817	\$361

The following table shows an aging analysis of the loan portfolio by the time past due, in thousands:

<u>June 30, 2015</u>	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial	\$203	\$ -	\$ 53	\$256	\$36,202	\$36,458
Agricultural	7	-	332	339	38,203	38,542
Real estate – residential	1,546	-	139	1,685	25,661	27,346
Real estate – commercial	179	-	3,288	3,467	170,791	174,258
Real estate – construction and land	19	-	909	928	25,666	26,594
Equity lines of credit	66	-	278	344	38,290	38,634
Auto	542	-	74	616	46,809	47,425
Other	30	-	5	35	3,280	3,315
Total	\$2,592	\$ -	\$ 5,078	\$7,670	\$384,902	\$392,572

<u>December 31, 2014</u>	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial	\$131	\$ -	\$ 38	\$169	\$31,296	\$31,465
Agricultural	-	-	339	339	35,016	35,355
Real estate – residential	292	-	985	1,277	28,007	29,284
Real estate – commercial	-	-	3,643	3,643	159,663	163,306
Real estate – construction and land	345	-	1,111	1,456	23,116	24,572
Equity Lines of credit	194	-	415	609	38,363	38,972
Auto	601	-	93	694	43,924	44,618
Other	43	-	1	44	2,774	2,818
Total	\$1,606	\$ -	\$ 6,625	\$8,231	\$362,159	\$370,390

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The following tables show information related to impaired loans at the dates indicated, in thousands:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<u>As of June 30, 2015:</u>					
With no related allowance recorded:					
Commercial	\$ 54	\$ 54		\$ 55	\$ 1
Agricultural	594	594		600	10
Real estate – residential	1,410	1,421		1,415	39
Real estate – commercial	2,072	2,718		2,105	-
Real estate – construction and land	375	375		383	4
Equity lines of credit	162	213		184	-
Auto	74	74		51	-
Other	-	-		-	-
With an allowance recorded:					
Commercial	\$ 38	\$ 38	\$ 32	\$ 12	\$ 1
Agricultural	-	-	-	-	-
Real estate – residential	247	247	56	247	5
Real estate – commercial	1,216	1,216	204	1,243	-
Real estate – construction and land	673	673	220	684	-
Equity lines of credit	116	116	34	116	-
Auto	-	-	-	-	-
Other	5	5	5	1	-
Total:					
Commercial	\$ 92	\$ 92	\$ 32	\$ 67	\$ 2
Agricultural	594	594	-	600	10
Real estate – residential	1,657	1,668	56	1,662	44
Real estate – commercial	3,288	3,934	204	3,348	-
Real estate – construction and land	1,048	1,048	220	1,067	4
Equity lines of credit	278	329	34	300	-
Auto	74	74	-	51	-
Other	5	5	5	1	-
Total	\$ 7,036	\$ 7,744	\$ 551	\$ 7,096	\$ 60

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<u>As of December 31, 2014:</u>					
With no related allowance recorded:					
Commercial	\$ 55	\$ 55		\$ 61	\$ 1
Agricultural	605	605		605	51
Real estate – residential	1,422	1,433		1,443	80
Real estate – commercial	3,389	4,036		2,460	-

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Real estate – construction and land	495	495		512	9
Equity lines of credit	121	121		130	-
Auto	93	93		81	-
Other	1	1		-	-
With an allowance recorded:					
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -
Agricultural	-	-	-	-	-
Real estate – residential	1,096	1,102	51	1,112	11
Real estate – commercial	254	254	65	589	-
Real estate – construction and land	757	757	274	778	-
Equity lines of credit	294	294	174	299	-
Auto	-	-	-	-	-
Other	-	-	-	-	-
Total:					
Commercial	\$ 55	\$ 55	\$ -	\$ 61	\$ 1
Agricultural	605	605	-	605	51
Real estate – residential	2,518	2,535	51	2,555	91
Real estate – commercial	3,643	4,290	65	3,049	-
Real estate – construction and land	1,252	1,252	274	1,290	9
Equity lines of credit	415	415	174	429	-
Auto	93	93	-	81	-
Other	1	1	-	-	-
Total	\$ 8,582	\$ 9,246	\$ 564	\$ 8,070	\$ 152

5. COMMITMENTS AND CONTINGENCIES

The Company is party to claims and legal proceedings arising in the ordinary course of business. In the opinion of the Company's management, the amount of ultimate liability with respect to such proceedings will not have a material adverse effect on the financial condition or result of operations of the Company taken as a whole.

In the normal course of business, there are various outstanding commitments to extend credit, which are not reflected in the financial statements, including loan commitments of \$81,901,000 and \$89,735,000 and stand-by letters of credit of \$210,000 and \$0 at June 30, 2015 and December 31, 2014, respectively.

Of the loan commitments outstanding at June 30, 2015, \$9,850,000 are real estate construction loan commitments that are expected to fund within the next twelve months. The remaining commitments primarily relate to revolving lines of credit or other commercial loans, and many of these are expected to expire without being drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements. Each loan commitment and the amount and type of collateral obtained, if any, are evaluated on an individual basis. Collateral held varies, but may include real property, bank deposits, debt or equity securities or business assets.

Stand-by letters of credit are conditional commitments written to guarantee the performance of a customer to a third party. These guarantees are primarily related to the purchases of inventory by commercial customers and are typically short-term in nature. Credit risk is similar to that involved in extending loan commitments to customers and accordingly, evaluation and collateral requirements similar to those for loan commitments are used. The deferred liability related to the Company's stand-by letters of credit was not significant at June 30, 2015 or December 31, 2014.

6. EARNINGS PER SHARE

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings of the Company. The treasury stock method has been applied to determine the dilutive effect of stock options in computing diluted earnings per share.

For the Three Months	For the Six Months
---------------------------------	-------------------------------

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	Ended June		Ended June	
	30,		30,	
(In thousands, except per share data)	2015	2014	2015	2014
Net Income:				
Net income	\$1,355	\$1,125	\$2,570	\$2,067
Earnings Per Share:				
Basic earnings per share	\$0.28	\$0.23	\$0.53	\$0.43
Diluted earnings per share	\$0.27	\$0.23	\$0.51	\$0.42
Weighted Average Number of Shares Outstanding:				
Basic shares	4,813	4,792	4,806	4,790
Diluted shares	5,069	4,958	5,058	4,944

Shares of common stock issuable under stock options and warrants for which the exercise prices were greater than the average market prices were not included in the computation of diluted earnings per share due to their antidilutive effect. Stock options and warrants not included in the computation of diluted earnings per share, due to shares not being in-the-money and having an antidilutive effect, were approximately 53,000 and 267,000 for the three month periods ended June 30, 2015 and 2014, respectively. Stock options and warrants not included in the computation of diluted earnings per share, due to shares not being in-the-money and having an antidilutive effect, were approximately 53,000 and 267,000 for the six month periods ended June 30, 2015 and 2014, respectively.

7. STOCK-BASED COMPENSATION

Stock Options

In 2001, the Company established a Stock Option Plan for which 206,593 shares of common stock remain reserved for issuance to employees and directors and no shares are available for future grants as of June 30, 2015.

As of June 30, 2015, all remaining shares in this plan have vested and no compensation cost remains unrecognized.

The total fair value of options vested was \$49,000 for the six months ended June 30, 2015 and 2014. The total intrinsic value of options at time of exercise was \$163,000 and \$30,000 for the six months ended June 30, 2015 and 2014, respectively.

Cash received from option exercises for the six months ended June 30, 2015 and 2014 was \$44,000 and \$22,000, respectively. The tax benefit realized for the tax deductions from option exercise totaled \$0 and \$8,000, respectively, for the six months ended June 30, 2015 and 2014.

A summary of the activity within the 2001 Stock Option Plan follows:

			Weighted	
			Weighted Average	
	Shares		Average	Intrinsic
			Exercise	Contractual
			Price	Term
				(Years)
Options outstanding at January 1, 2015	306,393	\$ 7.95		
Options cancelled	(74,100)	16.29		
Options exercised	(25,700)	2.95		

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Options outstanding at June 30, 2015	206,593	\$ 5.58	2.9	\$975,000
Options exercisable at June 30, 2015	206,593	\$ 5.58	2.9	\$975,000

In May 2013, the Company established the 2013 Stock Option Plan for which 500,000 shares of common stock are reserved and 389,600 shares are available for future grants as of June 30, 2015. The Plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid in full at the time the option is exercised. Payment in full for the option price must be made in cash, with Company common stock previously acquired by the optionee and held by the optionee for a period of at least six months, in options of the Optionee that are fully vested and exercisable or in any combination of the foregoing. The options expire on dates determined by the Board of Directors, but not later than ten years from the date of grant.

There were no options granted during the six months ended June 30, 2015.

During the six months ended June 30, 2014, a total of 110,400 options were granted with a weighted average exercise price of \$6.32. The fair value of each option was estimated on the date of grant using the following assumptions.

	Six Months Ended
	June 30, 2014
Expected life of stock options (in years)	5.2
Interest rate—stock options	1.64%
Volatility—stock options	63.8%
Dividend yields	2.0%
Weighted-average fair value of options granted during the period	\$3.02

As of June 30, 2015, there was \$165,000 of total unrecognized compensation cost related to non-vested, share-based compensation arrangements granted under the 2013 Plan. That cost is expected to be recognized over a weighted average period of 2.8 years.

A summary of the activity within the 2013 Plan follows:

			Weighted		
			Weighted	Average	
	Shares	Average	Remaining	Intrinsic	
		Exercise	Contractual	Value	
		Price	Term in		
			Years		
Options outstanding at January 1, 2015	110,400	\$ 6.32			
Options outstanding at June 30, 2015	110,400	\$ 6.32	6.8		\$331,000
Options exercisable at June 30, 2015	27,600	\$ 6.32	6.8		\$83,000
Expected to vest after June 30, 2015	71,746	\$ 6.32	6.8		\$215,000

Compensation cost related to stock options recognized in operating results under the two stock option plans was \$41,000 and \$33,000 for the six months ended June 30, 2015 and 2014, respectively. The associated income tax benefit recognized was \$4,000 for the six months ended June 30, 2015 and \$2,000 for the six months ended June 30, 2014. Compensation cost related to stock options recognized in operating results under the two stock option plans was \$12,000 and \$24,000 for the three months ended June 30, 2015 and 2014, respectively. The associated income tax benefit recognized was \$2,000 for the three months ended June 30, 2015 and \$2,000 for the three months ended June 30, 2014.

8. INCOME TAXES

The Company files its income taxes on a consolidated basis with its subsidiary. Income tax expense is the total of current year income tax due or refundable and the change in deferred tax assets and liabilities.

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. A valuation allowance is recognized if, based on the weight of available evidence management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the consolidated income statement. There have been no significant changes to unrecognized tax benefits or accrued interest and penalties for the six months ended June 30, 2015.

9. FAIR VALUE MEASUREMENT

The Company measures fair value under the fair value hierarchy described below.

Level 1: Quoted prices for identical instruments traded in active exchange markets.

Level 2: Quoted prices (unadjusted) for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3: Model based techniques that use one significant assumption not observable in the market. These unobservable assumptions reflect the Company's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

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.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

Fair Value of Financial Instruments

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The carrying amounts and estimated fair values of financial instruments, at June 30, 2015 and December 31, 2014 are as follows, in thousands:

	Carrying Value	Fair Value Measurements at June 30, 2015 Using:			Total Fair Value
		Level 1	Level 2	Level 3	
<u>Financial assets:</u>					
Cash and cash equivalents	\$41,333	\$41,333			\$41,333
Investment securities	90,024		\$90,024		90,024
Loans, net	388,786			\$389,372	389,372
FHLB stock	2,380				N/A
Accrued interest receivable	1,619	22	289	1,308	1,619
<u>Financial liabilities:</u>					
Deposits	493,368	440,465	52,915		493,380
Repurchase agreements	3,915		3,915		3,915
Note payable	5,000			5,000	5,000
Junior subordinated deferrable interest debentures	10,310			6,794	6,794
Accrued interest payable	107	7	49	51	107

	Carrying Value	Fair Value Measurements at December 31, 2014 Using:			Total Fair Value
		Level 1	Level 2	Level 3	
<u>Financial assets:</u>					
Cash and cash equivalents	\$ 45,574	\$ 45,574			\$ 45,574
Investment securities	90,320		\$ 90,320		90,320
Loans, net	366,787			\$ 368,442	368,442
FHLB stock	2,380				N/A
Accrued interest receivable	1,727		281	1,446	1,727
<u>Financial liabilities:</u>					
Deposits	467,891	411,549	56,364		467,913
Repurchase agreements	9,626		9,626		9,626
Note payable	1,000			1,000	1,000
Subordinated debenture	7,454			7,313	7,313
Junior subordinated deferrable interest debentures	10,310			6,636	6,636
Accrued interest payable	72	7	47	18	72

These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The following methods and assumptions were used by management to estimate the fair value of its financial instruments:

Cash and cash equivalents: The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

Investment securities: Fair values for securities available for sale are generally determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2).

Loans: Fair values of loans, excluding loans held for sale, are estimated as follows: For variable rate loans that repriced frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other 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 resulting in a Level 3

classification. Impaired loans are valued at the lower of cost or fair value. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

FHLB stock: It was not practicable to determine the fair value of the FHLB stock due to restrictions placed on its transferability.

Deposits: The fair values disclosed for demand deposits, including interest and non-interest demand accounts, savings, and certain types of money market accounts are, by definition, equal to the carrying amount at the reporting date resulting in a Level 1 classification. 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 aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Repurchase agreements: The fair value of securities sold under repurchase agreements is estimated based on bid quotations received from brokers using observable inputs and are included as Level 2.

Note payable: The fair value of the Company's Note Payable is estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

Subordinated debentures and Junior subordinated deferrable interest debentures: The fair values of the Company's Subordinated Debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

Accrued interest and payable: The carrying amounts of accrued interest approximate fair value and are considered to be linked in classification to the asset or liability for which they relate.

Commitments to extend credit and letters of credit: The fair value of commitments are estimated using the fees currently charged to enter into similar agreements and are not significant and, therefore, not presented. Commitments to extend credit are primarily for variable rate loans and letters of credit.

Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. Those estimates that are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision are included in Level 3. Changes in assumptions could significantly affect the fair values presented.

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of June 30, 2015 and December 31, 2014, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

Assets and liabilities measured at fair value on a recurring basis at June 30, 2015 are summarized below, in thousands:

	Fair Value Measurements at June 30, 2015 Using
Total	Quoted Significant Significant
Fair	Prices Other
Value	in Unobservable
	Observable Inputs
	Active Inputs
	Markets (Level 3)

			for (Level 2)		
			Identical		
			Assets		
			(Level		
			1)		
Assets:					
U.S. Government-sponsored agencies	\$6,115	\$-	\$ 6,115	\$	-
U.S. Government-sponsored agencies collateralized by mortgage obligations-residential	67,977		67,977		
Obligations of states and political subdivisions	15,932		15,932		
	\$90,024	\$-	\$ 90,024	\$	-

Assets and liabilities measured at fair value on a recurring basis at December 31, 2014 are summarized below, in thousands:

	Fair Value Measurements at December 31, 2014 Using Quoted Prices in			
	Total Fair Value	Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. Government-sponsored agencies	\$7,002	\$-	\$ 7,002	\$ -
U.S. Government-sponsored agencies collateralized by mortgage obligations- residential	70,280		70,280	
Obligations of states and political subdivisions	12,532		12,532	
Corporate debt	506		506	
	\$90,320	\$-	\$ 90,320	\$ -

The fair value of securities available-for-sale equals quoted market price, if available. If quoted market prices are not available, fair value is determined using quoted market prices for similar securities or matrix pricing. There were no changes in the valuation techniques used during 2015 or 2014. Transfers between hierarchy measurement levels are recognized by the Company as of the beginning of the reporting period. Changes in fair market value are recorded in other comprehensive income.

Assets and liabilities measured at fair value on a non-recurring basis at June 30, 2015 are summarized below, in thousands:

	Fair Value Measurements at June 30, 2015 Using				Six Months Ended
	Quoted Prices in Active Markets for Total Fair Value	Significant Other Inputs (Level 2) (Level 1)	Significant Observable Inputs (Level 3)	Unobservable Inputs	June 30, 2015
					Total Gains (Losses)
Assets:					
Impaired loans:					
Commercial	\$7	\$-	\$-	\$ 7	\$(27)
Agricultural	-	-	-	-	-
Real estate – residential	-	-	-	-	-
Real estate – commercial	1,267	-	-	1,267	-
Real estate – construction and land development	47	-	-	47	(16)
Equity lines of credit	93	-	-	93	2
Auto	-	-	-	-	-
Other	-	-	-	-	-
Total impaired loans	1,414	-	-	1,414	(41)
Other real estate:					
Commercial	-	-	-	-	(39)
Real estate – residential	117	-	-	117	-
Real estate – commercial	800	-	-	800	(106)
Real estate – construction and land development	1,920	-	-	1,920	116
Equity lines of credit	133	-	-	133	(14)
Total other real estate	2,970	-	-	2,970	(43)
	\$4,384	\$-	\$-	\$ 4,384	\$(84)

Assets and liabilities measured at fair value on a non-recurring basis at December 31, 2014 are summarized below, in thousands:

	Fair Value Measurements at December 31, 2014 Using				Six Months Ended June 30, 2014
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Inputs (Level 2)	Significant Inputs (Level 3)	Total	
Assets:					
Impaired loans:					
Commercial	\$-	\$-	\$-	\$-	\$-
Agricultural	-	-	-	-	-
Real estate – residential	838	-	838	-	(63)
Real estate – commercial	1,479	-	1,479	-	(50)
Real estate – construction and land development	27	-	27	-	(169)
Equity lines of credit	80	-	80	-	(81)
Auto	-	-	-	-	-
Other	-	-	-	-	-
Total impaired loans	2,424	-	2,424	-	(363)
Other real estate:					
Real estate –residential	146	-	146	-	11
Real estate – commercial	1,052	-	1,052	-	-
Real estate – construction and land development	1,984	-	1,984	-	(126)
Equity lines of credit	408	-	408	-	(20)
Total other real estate	3,590	-	3,590	-	(135)
	\$6,014	\$-	\$ 6,014	\$-	\$ (498)

The Company has no liabilities which are reported at fair value.

The following methods were used to estimate fair value.

Impaired Loans: The fair value of collateral dependent impaired loans with specific allocations of the allowance for loan losses or loans that have been subject to partial charge-offs are generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Total losses of \$41,000 and \$363,000 represent impairment charges recognized during the six months ended June 30, 2015 and 2014, respectively, related to the above impaired loans.

Other Real Estate: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at fair value, less costs to sell. Fair values are based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including comparable sales and the income approach.

Appraisals for both collateral-dependent impaired loans and other real estate are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, a member of the Loan Administration Department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On a quarterly basis, the Company compares the actual selling price of similar collateral that has been liquidated to the most recent appraised value for unsold properties to determine what additional adjustment, if any, should be made to the appraisal value to arrive at fair value. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at June 30, 2015 and December 31, 2014 (dollars in thousands):

Description	Fair Value	Fair Value	Valuation Technique	Significant Unobservable Input	Range		Range	
	6/30/15	12/31/2014			(Weighted Average)	(Weighted Average)	6/30/2015	12/31/2014
<u>Impaired Loans:</u>								
Commercial	\$ 7	\$ -	Sales Comparison	Adjustment for differences between comparable sales	0% - 28%	(12%)	N/A	
Real estate – residential	\$ -	\$ 838	Sales Comparison	Adjustment for differences between comparable sales	N/A	8%	(8%)	
Real estate – commercial	\$ 1,267	\$ 1,479	Sales Comparison	Adjustment for differences between comparable sales	9% - 12%	(10%)	9% - 12%	(10%)
Construction and land	\$ 47	\$ 27	Sales Comparison	Adjustment for differences between comparable sales	8%	(8%)	8%	(8%)
Equity lines of credit	\$ 93	\$ 80	Sales Comparison	Adjustment for differences between comparable sales	8% - 10%	(8%)	8%	(8%)
<u>Other Real Estate:</u>								
Real estate – residential	\$ 117	\$ 146	Sales Comparison	Adjustment for differences between comparable sales	10%	(10%)	10%	(10%)
Real estate – commercial	\$ 800	\$ 1,052	Sales Comparison	Adjustment for differences between comparable sales	10%	(10%)	10%	(10%)

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Construction and land	\$ 1,920	\$ 1,984	Sales Comparison	Adjustment for differences between comparable sales	10%	(10%)	10%	(10%)
Equity lines of credit	\$ 133	\$ 408	Sales Comparison	Adjustment for differences between comparable sales	10%	(10%)	10%	(10%)

10. Adoption of New Accounting Standards

Recently Adopted Accounting Pronouncements

In January 2014, the FASB issued ASU No. 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The objective of this guidance is to clarify when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. ASU No. 2014-04 states that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, ASU No. 2014-04 requires interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU No. 2014-04 is effective for interim and annual reporting periods beginning after December 15, 2014. The adoption of ASU No. 2014-04 did not have a material impact on the Company's Financial Statements.

In June 2014, the FASB issued ASU No. 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. The Update improves the financial reporting of repurchase agreements and other similar transactions through a change in accounting for repurchase-to-maturity transactions and repurchase financings, and the introduction of two new disclosure requirements. New disclosures are required for (1) transfers accounted for as sales in transactions that are economically similar to repurchase agreements, in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction and (2) repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings about the nature of collateral pledged and the time to maturity of those transactions. The adoption of ASU No. 2014-11 did not have a material impact on the Company's Financial Statements.

Pending Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09 Revenue from Contracts with Customers. This update to the ASC is the culmination of efforts by the FASB and the International Accounting Standards Board (IASB) to develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards (IFRS). ASU 2014-09 supersedes Topic 605 – Revenue Recognition and most industry-specific guidance. The core principal of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or

services. The guidance in ASU 2014-09 describes a 5-step process entities can apply to achieve the core principle of revenue recognition and requires disclosures sufficient to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers and the significant judgments used in determining that information.

This update was originally effective for annual reporting periods beginning on or after December 15, 2016 and interim periods therein and requires expanded disclosures. In July 2015 the FASB issued a deferral of ASU 2014-09 of one year making it effective for annual reporting periods beginning on or after December 15, 2017 while also providing for early adoption but not before the original effective date. The Company is currently evaluating the effects of ASU 2014-09 on its financial statements and disclosures, if any.

PART I – FINANCIAL INFORMATION

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain matters discussed in this Quarterly Report are forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, among others, (1) significant increases in competitive pressures in the financial services industry; (2) changes in the interest rate environment resulting in reduced margins; (3) general economic conditions, either nationally or regionally, maybe less favorable than expected, resulting in, among other things, a deterioration in credit quality; (4) changes in regulatory environment; (5) loss of key personnel; (6) fluctuations in the real estate market; (7) changes in business conditions and inflation; (8) operational risks including data processing systems failures or fraud; and (9) changes in securities markets. Therefore, the information set forth herein should be carefully considered when evaluating the business prospects of Plumas Bancorp (the “Company”).

When the Company uses in this Quarterly Report the words “anticipate”, “estimate”, “expect”, “project”, “intend”, “commit”, “believe” and similar expressions, the Company intends to identify forward-looking statements. Such statements are not guarantees of performance and are subject to certain risks, uncertainties and assumptions, including those described in this Quarterly Report. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, expected, projected, intended, committed or believed. The future results and stockholder values of the Company may differ materially from those expressed in these forward-looking statements. Many of the factors that will determine these results and values are beyond the Company’s ability to control or predict. For those statements, the Company claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

INTRODUCTION

The following discussion and analysis sets forth certain statistical information relating to the Company as of June 30, 2015 and December 31, 2014 and for the six and three month periods ended June 30, 2015 and 2014. This discussion should be read in conjunction with the condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and the consolidated financial statements and notes thereto included in Plumas Bancorp’s Annual Report filed on Form 10-K for the year ended December 31, 2014.

Plumas Bancorp trades on The NASDAQ Capital Market under the ticker symbol “PLBC”.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

There have been no changes to the Company's critical accounting policies from those disclosed in the Company's 2014 Annual Report to Shareholders on Form 10-K.

This discussion should be read in conjunction with our unaudited condensed consolidated financial statements, including the notes thereto, appearing elsewhere in this report.

OVERVIEW - SIX MONTHS ENDED JUNE 30, 2015

Net income increased by \$503 thousand from \$2.1 million during the six months ended June 30, 2014 to \$2.6 million during the current six month period. Earnings benefited from increases of \$974 thousand in net interest income and \$285 thousand in non-interest income. Partially offsetting these increases in revenue were a \$150 thousand increase in the provision for loan losses, a \$310 thousand increase in non-interest expense and an increase in income tax expense of \$296 thousand. Diluted earnings per share increased to \$0.51 for the six months ended June 30, 2015 compared to \$0.42 during the six months ended June 30, 2014.

Total assets at June 30, 2015 were \$558 million, an increase of \$18.7 million from December 31, 2014. This increase resulted from an increase in net loans of \$22.0 million. Net loan balances increased from \$367 million at December 31, 2014 to \$389 million at June 30, 2015. The largest reduction in assets was a decline in cash and cash equivalents totaling \$4.3 million from \$45.6 million at December 31, 2014 to \$41.3 million at June 30, 2015.

Deposits totaled \$493.4 million at June 30, 2015, an increase of \$25.5 million from \$467.9 million at December 31, 2014. Increases included \$10.3 million in non-interest bearing demand deposits, \$1.8 million in interest bearing transaction accounts (NOW) accounts and \$16.8 million in savings and money market accounts. Time deposits declined by \$3.4 million. Shareholders' equity increased by \$2.5 million from \$36.5 million at December 31, 2014 to \$39.0 million at June 30, 2015.

The annualized return on average assets was 0.94% for the six months ended June 30, 2015 up from 0.80% for the six months ended June 30, 2014. The annualized return on average equity increased from 12.8% during the first six months of 2014 to 13.5% during the current six month period.

The following is a detailed discussion of each component affecting change in net income and the composition of our balance sheet.

RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2015

Net interest income before provision for loan losses. Net interest income, on a nontax-equivalent basis, for the six months ended June 30, 2015 was \$10.3 million, an increase of \$974 thousand from the \$9.3 million earned during the same period in 2014. The increase in net interest income includes an increase of \$794 thousand in interest income and a decline of \$180 thousand in interest expense. Net interest margin, which benefited from an increase in loans as a percentage of interest earning assets, an increase in yield on investment securities and a reduction in interest expense

on deposits and other borrowings , increased 14 basis points, or 3%, to 4.16%, up from 4.02% for the same period in 2014.

Interest income increased by \$794 thousand, or 8%, to \$11.0 million for the six months ended June 30, 2015, up from \$10.2 million during the same period in 2014. Interest and fees on loans increased \$724 thousand to \$10.1 million for the six months ended June 30, 2015 as compared to \$9.4 million during the first half of 2014. The Company’s average loan balances were \$379 million for the six months ended June 30, 2015, up \$34.7 million, or 10%, from \$344 million for the same period in 2014. The Company is focused on growing loan balances through a balanced and diversified approach.

The following table compares loan balances by type at June 30, 2015 and 2014.

(dollars in thousands)	Balance	Percent	Balance	Percent
	at	of	at	of
End of	End of	Loans in	End of	Loans in
Period	Period	Each	Period	Each
	06/30/15	06/30/15	06/30/14	06/30/14
Commercial	\$36,458	9.3%	\$32,882	9.2%
Agricultural	38,542	9.8%	32,152	9.0%
Real estate - residential	27,346	7.0%	29,364	8.2%
Real estate – commercial	174,258	44.4%	161,205	45.2%
Real estate – construction	26,594	6.8%	20,904	5.9%
Equity Lines of Credit	38,634	9.8%	37,701	10.6%
Auto	47,425	12.1%	37,981	10.7%
Other	3,315	0.8%	4,124	1.2%
Total Gross Loans	\$392,572	100%	\$356,313	100%

The average rate earned on the Company's loan balances decreased by 11 basis points to 5.37% during the first six months of 2015 compared to 5.48% during the first six months of 2014. We attribute much of the decrease in yield to price competition in our service area.

Interest on investment securities increased by \$61 thousand as a result of an increase in yield of 13 basis points from 1.69% during the first half of 2014 to 1.82% during the six months ended June 30, 2015. The average balance in investment securities increased slightly from \$90.1 million during the first half of 2014 to \$90.3 million during the six months ended June 30, 2015. During the current period yield benefited from an increase in municipal securities as a percentage of total securities and a reduction in securities of U.S. Government-sponsored agencies. At June 30, 2015 municipal securities totaled \$15.9 million or 18% of the investment portfolio compared to \$5.9 million or 7% of the portfolio at June 30, 2014. U.S. Government-sponsored agencies were \$6.1 million at June 30, 2015 and \$13.1 million at June 30, 2014.

Interest expense on deposits decreased by \$15 thousand, or 6%, to \$249 thousand for the six months ended June 30, 2015, down from \$264 thousand during the 2014 period. This decrease relates to decreases in the average balance and rate paid on time deposits.

Interest on time deposits declined by \$23 thousand. Average time deposits declined by \$6.0 million from \$60.8 million during the six months ended June 30, 2014 to \$54.8 million during the current period. We attribute much of the reduction in time deposit to the unusually low interest rate environment as we have seen a movement out of time into more liquid deposit types. The average rate paid on time deposits decreased from 0.38% during the six months ended June 30, 2014 to 0.33% during the current period. This decrease primarily relates to a decline in market rates paid in the Company's service area and the maturity of higher rate time deposits.

Partially offsetting the decrease in interest expense on time deposits was a \$10 thousand increase in interest expense on savings accounts related to growth in this deposit category. Average savings balances increased from \$100.2 million during the six months ended June 30, 2014 to \$112.1 million during the current six month period. Plumas Bank's savings accounts provide an attractive interest rate, in the current rate environment, and we have seen continued growth in savings accounts for the last few years. The average rate paid on savings accounts was 16 basis points during both periods.

Interest expense on other interest-bearing liabilities decreased by \$165 thousand from \$592 thousand during the six months ended June 30, 2014 to \$427 thousand during the current six month period. On April 15, 2013, to help fund the repurchase of preferred stock during 2013, the Company issued a \$7.5 million subordinated debenture. On April 16, 2015 we paid off the subordinated debenture resulting in a reduction in interest expense related to this debt of \$158 thousand from \$377 thousand during the first six months of 2014 to \$219 thousand during the current period.

Interest expense on the Company's note payable declined by \$8 thousand to \$55 thousand during the six months ended June 30, 2015. This decline was mostly related to a decline in average borrowings on this note from \$3 million during the 2014 period to \$2.7 million during the six months ended June 30, 2015. The average rate paid on the note payable was 4.10% during 2015 and 4.23% during the six months ended June 30, 2014.

Interest expense on junior subordinated debentures, which increased by \$1 thousand to \$150 thousand, fluctuates with changes in the 3-month London Interbank Offered Rate (LIBOR) rate.

The following table presents for the six-month periods indicated the distribution of consolidated average assets, liabilities and shareholders' equity. It also presents the amounts of interest income from interest-earning assets and the resultant annualized yields, as well as the amounts of interest expense on interest-bearing liabilities and the resultant cost expressed in both dollars and annualized rate percentages. Average balances are based on daily averages. Nonaccrual loans are included in the calculation of average loans while nonaccrued interest thereon is excluded from the computation of yields earned:

	For the Six Months Ended June 30, 2015			For the Six Months Ended June 30, 2014		
	Average Balance (in thousands)	Interest (in thousands)	Yield/ Rate	Average Balance (in thousands)	Interest (in thousands)	Yield/ Rate
Interest-earning assets:						
Loans (1) (2) (3)	\$ 379,143	\$ 10,090	5.37 %	\$ 344,433	\$ 9,366	5.48 %
Investment securities (1)	90,346	816	1.82 %	90,083	755	1.69 %
Interest-bearing deposits	29,308	64	0.44 %	33,254	55	0.33 %
Total interest-earning assets	498,797	10,970	4.44 %	467,770	10,176	4.39 %
Cash and due from banks	16,961			14,396		
Other assets	33,170			36,043		
Total assets	\$ 548,928			\$ 518,209		
Interest-bearing liabilities:						
NOW deposits	\$ 85,132	37	0.09 %	\$ 82,736	38	0.09 %
Money market deposits	45,167	32	0.14 %	47,862	33	0.14 %
Savings deposits	112,081	89	0.16 %	100,217	79	0.16 %
Time deposits	54,839	91	0.33 %	60,837	114	0.38 %
Total deposits	297,219	249	0.17 %	291,652	264	0.18 %
Note Payable	2,703	55	4.10 %	3,000	63	4.23 %
Subordinated debentures	4,334	219	10.19 %	7,331	377	10.37 %
Junior subordinated debentures	10,310	150	2.93 %	10,310	149	2.91 %
Other interest-bearing liabilities	7,192	3	0.08 %	6,450	3	0.09 %
Total interest-bearing liabilities	321,758	676	0.42 %	318,743	856	0.54 %
Non-interest bearing deposits	182,779			161,029		
Other liabilities	5,999			5,994		
Shareholders' equity	38,392			32,443		
Total liabilities & equity	\$ 548,928			\$ 518,209		
Cost of funding interest-earning assets (4)			0.28 %			0.37 %
Net interest income and margin (5)		\$ 10,294	4.16 %		\$ 9,320	4.02 %

(1) Not computed
on a
tax-equivalent
basis.

- Average nonaccrual loan balances of \$6.0 million for 2015 and \$7.3 million for 2014 are included in average loan balances for computational purposes.
- (2) Net loan costs included in loan interest income for the six-month periods ended June 30, 2015 and 2014 were \$353,000 and \$263,000, respectively.
- (3) Total annualized interest expense divided by the average balance of total earning assets.
- (4) Annualized net interest income divided by the average balance of total earning assets.
- (5)

The following table sets forth changes in interest income and interest expense for the six-month periods indicated and the amount of change attributable to variances in volume, rates and the combination of volume and rates based on the relative changes of volume and rates:

	2015 over 2014 change in net interest income			
	for the six months ended June 30 (in thousands)			
	Volume (1)	Rate (2)	Mix (3)	Total
Interest-earning assets:				
Loans	\$944	\$(200)	\$(20)	\$724
Investment securities	2	59	-	61
Interest bearing deposits	(7)	18	(2)	9
Total interest income	939	(123)	(22)	794
Interest-bearing liabilities:				
NOW deposits	1	(2)	-	(1)
Money market deposits	(2)	1	-	(1)
Savings deposits	9	1	-	10
Time deposits	(11)	(13)	1	(23)
Note payable	(6)	(2)	-	(8)
Subordinated debentures	(154)	(7)	3	(158)
Junior subordinated debentures	-	1	-	1
Other	-	-	-	-
Total interest expense	(163)	(21)	4	(180)
Net interest income	\$1,102	\$(102)	\$(26)	\$974

(1) The volume change in net interest income represents the change in average balance multiplied by the previous year's rate.

(2) The rate change in net interest income represents the change in rate multiplied by the previous year's average balance.

(3) The mix change in net interest income represents the change in average balance multiplied by the change in rate.

Provision for loan losses. During the six months ended June 30, 2015 we recorded a provision for loan losses of \$600 thousand up \$150 thousand from the \$450 thousand provision recorded during the first half of 2014. During the six months ended June 30, 2014 net loans increased by \$18.2 million while during the current period net loans

increased by \$22.0 million. The increase in provision is consistent with additional loan growth during the six months ended June 30, 2015. See “Analysis of Asset Quality and Allowance for Loan Losses” for further discussion of loan quality trends and the provision for loan losses.

The allowance for loan losses is maintained at a level that management believes will be appropriate to absorb probable incurred losses on existing loans based on an evaluation of the collectability of the loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to repay their loan. The allowance for loan losses is based on estimates, and ultimate losses may vary from the current estimates. These estimates are reviewed not less than quarterly and, as adjustments become necessary, they are reported in earnings in the periods in which they become known.

Based on information currently available, management believes that the allowance for loan losses is appropriate to absorb probable incurred losses in the portfolio. However, no assurance can be given that the Company may not sustain charge-offs which are in excess of the allowance in any given period.

Non-interest income. During the six months ended June 30, 2015 non-interest income totaled \$3.9 million an increase of \$285 thousand from the six months ended June 30, 2014. The largest component of this increase was an increase of \$198 thousand in gains on the sale of government guaranteed SBA loans. During the current period, proceeds from SBA loan sales totaled \$14.0 million resulting in a gain on sale of \$974 thousand. This compares to proceeds of \$11.8 million and a gain on sale of \$776 thousand during the first half of 2014. Additionally, during the first quarter of 2015 we sold eight available-for-sale investment securities having a value of \$6.7 million and recorded a net gain of \$30 thousand on sale. Loan servicing income, which increased by \$31 thousand, represents servicing income received on the guaranteed portion of SBA loans sold into the secondary market. At June 30, 2015 we were servicing over \$81 million in guaranteed portions of loans an increase of \$8 million from over \$73 million at June 30, 2014. Other non-interest income increased by \$141 thousand to \$486 thousand mostly related to an increase of \$101 thousand in dividends received on Federal Home Loan Bank of San Francisco (FHLB) stock. Of the \$101 thousand, \$88 thousand was a one-time special dividend paid by the FHLB during June 2015. The largest decrease in non-interest income was \$113 thousand in service charge income most of which was related to a reduction in NSF and overcharge income which we attribute to improved economic conditions as well as working with our customers to help them reduce NSF activity.

The following table describes the components of non-interest income for the six-month periods ended June 30, 2015 and 2014, dollars in thousands:

	For the Six Months		Dollar Change	Percentage Change	
	Ended June 30				
	2015	2014			
Service charges on deposit accounts	\$1,945	\$2,058	\$ (113)	(5.5)	%
Gain on sale of loans, net	974	776	198	25.5	%
Loan servicing fees	262	231	31	13.4	%
Earnings on life insurance policies	170	172	(2)	(1.2)	%
Gain on sale of investments	30	-	30	100	%
Other	486	345	141	40.9	%
Total non-interest income	\$3,867	\$3,582	\$ 285	8.0	%

Non-interest expense. During the six months ended June 30, 2015, total non-interest expense increased by \$310 thousand, or 3%, to \$9.3 million, up from \$9.0 million for the comparable period in 2014. While the Company continued to experience declines in several categories of non-interest expense, these were offset by increases in other items the largest of which were \$382 thousand in salary and benefit expense, \$104 thousand in professional fees and a decrease in gain on sale of OREO of \$80 thousand. The largest declines in non-interest expense were \$156 thousand in occupancy and equipment expense, \$128 thousand in OREO costs and \$92 thousand in the provision from change in OREO valuation.

The increase in salary and benefits includes an increase in salary expense, exclusive of commissions, of \$273 thousand mostly related to merit and promotion increases, new hires including two loan officers; one serving Reno, Nevada and one located in Chico, California and a branch manager for our new Reno, Nevada location. Other significant increases in salary and benefit expense include an increase of \$72 thousand in commission expense, \$52 thousand in payroll taxes and \$63 thousand in 401k plan contributions. The increase in commission expense is mostly related to an increase in SBA activity. Effective January 1, 2015, we reestablished a 401k matching benefit resulting in \$63 thousand in matching contributions.

The increase in professional fees is mostly related to an increase of \$64 thousand in audit expense related to lending functions, including the cost of our semi-annual loan review, an annual review of our SBA loan operations by the SBA and a review of our loan compliance systems. The second largest increase in professional fees was an increase of \$62 thousand in legal expense related to various corporate activities including costs associated with our Redding branch acquisition and our future Reno, Nevada branch.

Gains on sale of OREO decreased by \$80 thousand; we disposed of four OREO properties during the current period recording an \$11 thousand gain on sale. During the 2014 period we disposed of ten properties recording a gain on sale of \$91 thousand.

The decline in occupancy and equipment expense includes several reductions the largest of which was a savings of \$87 thousand in equipment expense. During 2014 equipment expense was high as we chose to replace all of our personal computers running Windows XP with machines running Windows 7. The decline in OREO costs includes a decrease in OREO legal expense of \$91 thousand and a decline in repair costs of \$46 thousand. During 2014 we incurred \$101 thousand in legal costs, related to OREO, pursuing additional recoveries on selected OREO properties through legal channels. In addition, OREO repair expense during 2014 totaled \$65 thousand much of which was used to fix up several properties in an effort to increase their marketability.

OREO represents real property taken by the Bank either through foreclosure or through a deed in lieu thereof from the borrower. When other real estate is acquired, any excess of the Bank's recorded investment in the loan balance and accrued interest income over the estimated fair market value of the property less costs to sell is charged against the allowance for loan losses. A valuation allowance for losses on other real estate is maintained to provide for temporary declines in value. The allowance is established through a provision for subsequent losses on other real estate which is included in other expenses. Subsequent gains or losses on sales or from impairment are recorded as incurred. The provision from change in OREO valuation declined by \$92 thousand from \$135 thousand during the six months ended June 30, 2014 to \$43 thousand during the current period. OREO provision during the three months ended June 30, 2015 totaled \$172; however, during the first three months of 2015 we recorded a net credit provision of \$129 thousand. The credit resulted from a significant increase in value of one OREO property based on a recent appraisal. This property was originally transferred to OREO at a value, net of estimated costs selling costs, of \$1 million. Subsequently, based on declines in value it was written down to \$0.7 million with a \$0.3 million valuation allowance; however, recently the surrounding area in which the property is located has enjoyed significant new business activity and the value of this property has increased resulting in a reduction in the valuation allowance of \$0.2 million. The \$0.2 million was offset by declines in value on two other OREO properties totaling \$68 thousand.

The following table describes the components of non-interest expense for the six-month periods ended June 30, 2015 and 2014, dollars in thousands:

	For the Six Months Ended June 30		Dollar	Percentage	
	2015	2014	Change	Change	
Salaries and employee benefits	\$5,144	\$4,762	\$ 382	8.0	%
Occupancy and equipment	1,380	1,536	(156)	(10.2)	%
Outside service fees	985	1,019	(34)	(3.3)	%
Professional fees	355	251	104	41.4	%
Deposit insurance	188	206	(18)	(8.7)	%
Telephone and data communication	182	166	16	9.6	%
Business development	165	131	34	26.0	%
Director compensation and retirement	149	142	7	4.9	%
Advertising and shareholder relations	148	131	17	13.0	%
Loan and collection expenses	130	98	32	32.7	%
Armored car and courier	114	109	5	4.6	%
OREO costs	99	227	(128)	(56.4)	%
Stationery and supplies	54	60	(6)	(10.0)	%
Insurance expense	50	60	(10)	(16.7)	%
Provision from change in OREO valuation	43	135	(92)	(68.1)	%
Postage	20	22	(2)	(9.1)	%
Gain on sale of OREO	(11)	(91)	80	87.9	%
Other	140	61	79	129.5	%
Total non-interest expense	\$9,335	\$9,025	\$ 310	3.4	