Bank of Marin Bancorp
Form 10-Q
August 08, 2011

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

FORM 10-Q
(Mark One)

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

For the quarterly period ended June 30, 2011

OR

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

For the transition period from __________________ to __________________

Commission File Number 001-33572

Bank of Marin Bancorp
(Exact name of Registrant as specified in its charter)

California	20-8859754
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)
504 Redwood Blvd., Suite 100, Novato, CA	94947
(Address of principal executive office)	(Zip Code)

Registrant's telephone number, including area code: (415) 763-4520

Indicate by check mark whether the registrant (1) has filed all reports to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, 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 x 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b(2) of the Exchange Act.

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

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

As of July 29, 2011 there were 5,326,686 shares of common stock outstanding.

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. Financial Statements

Table of Contents

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CONDITION
at June 30, 2011 and December 31, 2010

(in thousands, except share data; 2011 unaudited)	June 30, 2011	December 31, 2010
Assets		
Cash and due from banks	$88,043	$ 65,724
Short-term investments	22,116	19,508
Cash and cash equivalents	110,159	85,232
Investment securities		
Held to maturity, at amortized cost	35,514	34,917
Available for sale (at fair market value, amortized cost $164,731and $109,070 at June 30, 2011 and December 31, 2010,respectively)	167,406	111,736
Total investment securities	202,920	146,653
Loans, net of allowance for loan losses of $13,920 and $12,392at June 30, 2011 and December 31, 2010, respectively	972,714	929,008
Bank premises and equipment, net	9,280	8,419
Interest receivable and other assets	42,320	38,838
Total assets	$1,337,393	$ 1,208,150
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest bearing	$346,317	$ 282,195
Interest bearing		
Transaction accounts	133,429	105,177
Savings accounts	72,458	56,760
Money market accounts	403,782	371,352
CDARS® time accounts	31,674	67,261
Other time accounts	151,246	132,994
Total deposits	1,138,906	1,015,739
Federal Home Loan Bank borrowings	55,000	55,000
Subordinated debenture	5,000	5,000
Interest payable and other liabilities	9,429	10,491
Total liabilities	1,208,335	1,086,230
Stockholders' Equity		
Preferred stock, no par value, $1,000 per share liquidation preference		
Authorized - 5,000,000 shares; none issued	---	---
Common stock, no par value		

Authorized - 15,000,000 shares		
Issued and outstanding - 5,321,227 and 5,290,082 at June 30, 2011 and December 31, 2010, respectively	56,265	55,383
Retained earnings	71,241	64,991
Accumulated other comprehensive income, net	1,552	1,546
Total stockholders' equity	129,058	121,920
Total liabilities and stockholders' equity	$1,337,393	$ 1,208,150

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

Table of Contents

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts; unaudited)	Three months ended June 30, 2011	March 31, 2011	June 30, 2010	Six months ended June 30, 2011	June 30, 2010
Interest income					
Interest and fees on loans	$16,862	$15,900	$14,169	$32,762	$27,850
Interest on investment securities					
Securities of U.S. Government agencies	745	733	885	1,478	1,613
Obligations of state and political subdivisions	303	302	285	605	571
Corporate debt securities and other	171	111	138	282	308
Interest on Federal funds sold and short-term investments	56	40	28	96	50
Total interest income	18,137	17,086	15,505	35,223	30,392
Interest expense					
Interest on interest bearing transaction accounts	48	38	26	86	49
Interest on savings accounts	25	29	27	54	52
Interest on money market accounts	341	337	729	678	1,526
Interest on CDARS® time accounts	48	94	233	142	442
Interest on other time accounts	315	358	377	673	731
Interest on borrowed funds	357	352	356	709	707
Total interest expense	1,134	1,208	1,748	2,342	3,507
Net interest income	17,003	15,878	13,757	32,881	26,885
Provision for loan losses	3,000	1,050	1,350	4,050	2,900
Net interest income after provision for loan losses	14,003	14,828	12,407	28,831	23,985
Non-interest income					
Service charges on deposit accounts	468	443	463	911	909
Wealth Management and Trust Services	469	434	368	903	763
Other income	644	722	674	1,366	1,182
Total non-interest income	1,581	1,599	1,505	3,180	2,854
Non-interest expense					
Salaries and related benefits	5,220	4,929	4,561	10,149	9,167
Occupancy and equipment	1,093	907	914	2,000	1,812
Depreciation and amortization	314	308	360	622	698
Federal Deposit Insurance Corporation insurance	214	387	375	601	737
Data processing	909	582	485	1,491	931
Professional services	740	733	454	1,473	886
Other expense	1,508	1,284	1,442	2,792	2,582
Total non-interest expense	9,998	9,130	8,591	19,128	16,813
Income before provision for income taxes	5,586	7,297	5,321	12,883	10,026

Provision for income taxes	2,147	2,788	1,983	4,935	3,741
Net income	$3,439	$4,509	$3,338	$7,948	$6,285
Net income per common share:					
Basic	$0.65	$0.85	$0.64	$1.50	$1.20
Diluted	$0.64	$0.84	$0.63	$1.48	$1.19
Weighted average shares used to compute net income per common share:					
Basic	5,300	5,283	5,234	5,292	5,226
Diluted	5,385	5,366	5,308	5,376	5,302
Dividends declared per common share	$0.16	$0.16	$0.15	$0.32	$0.30

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

Table of Contents

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
for the year ended December 31, 2010 and the six months ended June 30, 2011

(dollars in thousands; 2011 unaudited)	Preferred Stock	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income, Net of Taxes	Total
Balance at December 31, 2009	---	5,229,529	$53,789	$54,644	$ 618	$109,051
Comprehensive income:						
Net income	---	---	---	13,552	---	13,552
Other comprehensive income						
Net change in unrealized gain on available for sale securities (net of tax effect of $672)	---	---	---	---	928	928
Comprehensive income	---	---	---	13,552	928	14,480
Stock options exercised	---	49,940	895	---	---	895
Excess tax benefit - stock-based compensation	---	---	132	---	---	132
Stock issued under employee stock purchase plan	---	563	17	---	---	17
Restricted stock granted	---	6,150	---	---	---	---
Restricted stock forfeited / cancelled	---	(2,320)	---	---	---	---
Stock-based compensation - stock options	---	---	241	---	---	241
Stock-based compensation - restricted stock	---	---	109	---	---	109
Cash dividends paid on common stock	---	---	---	(3,205)	---	(3,205)
Stock issued in payment of director fees	---	6,220	200	---	---	200
Balance at December 31, 2010	---	5,290,082	$55,383	$64,991	$ 1,546	$121,920
Comprehensive income:						
Net income	---	---	---	7,948	---	7,948
Other comprehensive income						
Net change in unrealized gain on available for sale securities (net of tax effect of $4)	---	---	---	---	6	6
Comprehensive income	---	---	---	7,948	6	7,954
Stock options exercised	---	22,168	472	---	---	472
Excess tax benefit - stock-based compensation	---	---	89	---	---	89
Stock issued under employee stock purchase plan	---	502	17	---	---	17
Restricted stock granted	---	5,675	---	---	---	---
Stock-based compensation - stock options	---	---	135	---	---	135

Stock-based compensation - restricted stock	---	---	69	---	---	69
Cash dividends paid on common stock	---	---	---	(1,698)	---	(1,698)
Stock issued in payment of director fees	---	2,800	100	---	---	100
Balance at June 30, 2011	---	5,321,227	$56,265	$71,241	$ 1,552	$129,058

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

Table of Contents

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
for the six months ended June 30, 2011 and 2010

(in thousands, unaudited)	June 30, 2011	June 30, 2010
Cash Flows from Operating Activities:		
Net income	$7,948	$6,285
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	4,050	2,900
Compensation expense--common stock for director fees	110	100
Stock-based compensation expense	204	219
Excess tax benefits from exercised stock options	(73)	(63)
Amortization of investment security premiums, net of accretion of discounts	776	563
Accretion of discount on acquired loans	(2,211)	---
Depreciation and amortization	622	698
Bargain purchase gain on acquisition, net of tax	(85)	---
Loss on sale of repossessed assets	36	5
Net change in operating assets and liabilities:		
Interest receivable	(196)	140
Interest payable	25	100
Deferred rent and other rent-related expenses	162	124
Other assets	1,362	(318)
Other liabilities	(1,668)	528
Total adjustments	3,114	4,996
Net cash provided by operating activities	11,062	11,281
Proceeds from sale of furniture and equipment	18	---
Purchase of securities held-to-maturity	(700)	---
Purchase of securities available-for-sale	(76,537)	(27,390)
Proceeds from paydowns/maturity of securities available-for-sale	20,203	15,647
Loans originated and principal collected, net	16,156	(22,270)
Purchase of bank owned life insurance policies	(2,500)	---
Purchase of premises and equipment	(1,466)	(702)
Proceeds from sale of repossessed assets	199	114
Cash receipt from acquisition	44,042	---
Net cash used in investing activities	(585)	(34,601)
Cash Flows from Financing Activities:		
Net increase in deposits	29,086	55,117
Proceeds from stock options exercised	472	226
Repayment of Federal Home Loan Bank borrowings	(13,500)	---
Cash dividends paid on common stock	(1,698)	(1,572)
Stock issued under employee stock purchase plan	17	9
Excess tax benefits from exercised stock options	73	63
Net cash provided by financing activities	14,450	53,843
Net increase in cash and cash equivalents	24,927	30,523
Cash and cash equivalents at beginning of period	85,232	38,660
Cash and cash equivalents at end of period	$110,159	$69,183
Supplemental disclosure of non-cash investing and financing activities:		

Loans transferred to repossessed assets	100	$135
Stock issued in payment of director fees	$100	$100
Acquisition:		
Fair value of assets acquired	$107,763	---
Fair value of liabilities assumed	$107,678	---

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

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Introductory Explanation

References in this report to "Bancorp" mean the Bank of Marin Bancorp as the parent holding company for Bank of Marin, the wholly-owned subsidiary (the "Bank"). References to "we," "our," "us" mean the holding company and the Bank that are consolidated for financial reporting purposes.

Note 1: Basis of Presentation

The consolidated financial statements include the accounts of Bancorp and its only wholly-owned bank subsidiary, the Bank. All material intercompany transactions have been eliminated. In the opinion of Management, the unaudited interim consolidated financial statements contain all adjustments necessary to present fairly our financial position, results of operations, changes in stockholders' equity and cash flows. All adjustments are of a normal, recurring nature. Management has evaluated subsequent events through the date of filing, and has determined that there are no subsequent events that require recognition or disclosure.

Certain information and footnote disclosures presented in the annual consolidated financial statements are not included in the interim consolidated financial statements. Accordingly, the accompanying unaudited interim consolidated financial statements should be read in conjunction with our 2010 Annual Report on Form 10-K. The results of operations for the three months and six months ended June 30, 2011 are not necessarily indicative of the operating results for the full year.

The following table shows: 1) weighted average basic shares, 2) potential common shares related to stock options, non-vested restricted stock and stock warrant, and 3) weighted average diluted shares. Basic earnings per share ("EPS") are calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each period. Diluted EPS are calculated using the weighted average diluted shares. The number of potential common shares included in quarterly diluted EPS is computed using the average market prices during the three months included in the reporting period. Our calculation of weighted average shares includes two forms of our outstanding common stock: common stock and unvested restricted stock awards. Holders of restricted stock awards receive non-forfeitable dividends at the same rate as common stockholders and they both share equally in undistributed earnings.

	Three months ended			Six months ended	
(in thousands, except per share data; unaudited)	June 30, 2011	March 31, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Weighted average basic shares outstanding	5,300	5,283	5,234	5,292	5,226
Add: Potential common shares related to stock options	43	42	45	43	47
Potential common shares related to non-vested restricted stock	3	5	3	4	4
Potential common shares related to warrant	39	36	26	37	25
Weighted average diluted shares outstanding	5,385	5,366	5,308	5,376	5,302
Net income available to common stockholders	$ 3,439	$ 4,509	$ 3,338	$ 7,948	$ 6,285

Basic EPS	$	0.65	$	0.85	$	0.64	$	1.50	$	1.20
Diluted EPS	$	0.64	$	0.84	$	0.63	$	1.48	$	1.19
Weighted average anti-dilutive shares not included in the calculation of diluted EPS Stock options		73		64		170		66		163
Non-vested restricted stock		6		---		---		3		---
Total anti-dilutive shares		79		64		170		69		163

Table of Contents

Note 2: Recently Issued Accounting Standards

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-05 Comprehensive Income (Topic 220) Presentation of Comprehensive Income. The ASU improves the comparability, consistency, and transparency of financial reporting and increases the prominence of items reported in other comprehensive income. The amendments to Topic 220, Comprehensive Income, require entities to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Entities are no longer permitted to present components of other comprehensive income as part of the statement of changes in stockholders' equity. Any adjustments for items that are reclassified from other comprehensive income to net income are to be presented on the face of the entities' financial statement regardless of the method of presentation for comprehensive income. The amendments do not change items to be reported in comprehensive income or when an item of other comprehensive income must be reclassified to net income, nor do the amendments change the option to present the components of other comprehensive income either net of related tax effects or before related tax effects. ASU 2011-05 is effective for fiscal years, and interim periods beginning on or after December 15, 2011. We do not expect this ASU to have an impact on our financial condition or result of operations as it affects presentation only.

In May 2011, the FASB issued ASU No. 2011-04 Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The ASU improves the comparability of fair value measurements presented and disclosed in accordance with U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRSs) by changing the wording used to describe many of the requirements in U.S GAAP for measuring fair value and disclosure of information. The amendments to this ASU provide explanations on how to measure fair value but do not require any additional fair value measurements and do not establish valuation standards or affect valuation practices outside of financial reporting. The amendments clarify existing fair value measurements and disclosure requirements to include application of the highest and best use and valuation premises concepts; measuring fair value of an instrument classified in a reporting entity's shareholders' equity; and disclosures requirements regarding quantitative information about unobservable inputs categorized within Level 3 of the fair value hierarchy. In addition, clarification is provided for measuring the fair value of financial instruments that are managed in a portfolio and the application of premiums and discounts in a fair value measurement. For public entities, ASU 2011-04 is effective during interim and annual periods beginning after December 15, 2011. We do not expect this ASU to have a significant impact on our financial condition or result of operations.

In April 2011, the FASB issued ASU No. 2011-02, Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. The ASU clarifies which loan modifications constitute troubled debt restructurings. It is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring ("TDR"), both for purposes of recording an impairment loss and for disclosure of a TDR. In evaluating whether a restructuring constitutes a TDR, a creditor must separately conclude that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. The amendments to ASU Topic 310, Receivables, clarify the guidance on a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. ASU No. 2011-02 is effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after the beginning of the fiscal year of adoption. We do not expect this ASU to have a significant impact on our financial condition or result of operations.

In December 2010, the FASB issued ASU No. 2010-29, Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations to address diversity in practice about the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. This ASU is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning January 1, 2011. It requires a public entity to disclose pro forma revenue and earnings of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period. If comparative financial statements are presented, the pro forma revenue and earnings of the combined entity for the comparable prior reporting period should be reported as though the acquisition date for all business combinations that occurred during the current year had been as of the beginning of the comparable prior annual reporting period. The amendments also expand the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. We have provided the applicable disclosure in Note 3 herein.

Table of Contents

In December 2010, the FASB also issued ASU No. 2010-28, Intangibles—Goodwill and Other (Topic 350), When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. The amendments in this ASU affect all entities that have recognized goodwill and have one or more reporting units whose carrying amount for purposes of performing Step 1 of the goodwill impairment test is zero or negative. The amendments in this ASU modify Step 1 so that for those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with existing guidance, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The above two ASUs did not have a significant impact on our financial condition or results of operations.

In July 2010, the FASB issued ASU No. 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. The ASU amends FASB Accounting Standards Codification™ (the "Codification" or "ASC") Topic 310, Receivables, to improve the disclosures about the credit quality of an entity's financing receivables and the related allowance for credit losses. As a result of these amendments, an entity is required to disaggregate, by portfolio segment or class of financing receivable, certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses.

Existing disclosures are amended to require an entity to provide the following disclosures about its financing receivables on a disaggregated basis:

(1) A rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the reporting period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the impairment method;

(2) For each disaggregated ending balance in item (1) above, the related recorded investment in financing receivables;

(3) The nonaccrual status of financing receivables by class of financing receivables;

(4) Impaired financing receivables by class of financing receivables.

The amendments in the ASU also require an entity to provide the following additional disclosures about its financing receivables:

(1) Credit quality indicators of financing receivables at the end of the reporting period by class of financing receivables;

(2) The aging of past due financing receivables at the end of the reporting period by class of financing receivables;

(3) A description of the entity's accounting policies and methodology used to estimate the allowance for credit losses by portfolio segments;

(4) The nature and extent of TDR that occurred during the period by class of financing receivables and their effect on the allowance for credit losses, as well as the nature and extent of financing receivables modified as TDR within the previous twelve months that defaulted during the reporting period by class of financing receivables and their effect on the allowance for credit losses; and

(5) Significant purchases and sales of financing receivables during the reporting period disaggregated by portfolio segments.

Table of Contents

The disclosures were effective for interim and annual reporting periods ended December 31, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods that began January 1, 2011. We have provided for the relevant disclosures in Note 6. As this ASU is disclosure-related only, it did not have an impact on our financial condition or results of operations.

Note 3: Acquisition

On February 18, 2011, we entered into a modified whole-bank purchase and assumption agreement without loss share (the “P&A Agreement”) with the Federal Deposit Insurance Corporation (the “FDIC”), the receiver of Charter Oak Bank of Napa, California, to purchase certain assets and assume certain liabilities of the former Charter Oak Bank to enhance our market presence (the “Acquisition”). The purchase price reflected an asset discount of $19.8 million and no deposit premium.

The P&A Agreement only covers designated assets and liabilities of Charter Oak Bank. Common stock of Charter Oak Bank, certain assets and certain liabilities, such as claims against any officer, director, employee, accountant, attorney, or any other person employed by the former Charter Oak Bank, were not purchased or assumed by us. In addition, loans of the former Charter Oak Bank at their book values totaling approximately $24.4 million as of the acquisition date were retained by the FDIC. The excluded loans mainly represent loans delinquent more than sixty days or more as of the bid valuation date (October 18, 2010) and certain types of land and construction loans.

The assets acquired and liabilities assumed, both tangible and intangible, were recorded at their fair values as of acquisition date in accordance with ASC 805, Business Combinations. These fair value estimates are subject to change for up to one year after the acquisition date as additional information relative to acquisition date fair values becomes available. In addition, the tax treatment of FDIC-assisted acquisitions is complex and subject to interpretations that may result in future adjustments of deferred taxes as of the acquisition date.

In FDIC-assisted transactions, only certain assets and liabilities are transferred to the acquirer and, depending on the nature and amount of the acquirer’s bid, the FDIC may be required to make a cash payment to the acquirer or the acquirer may be required to make payment to the FDIC. We received cash totaling $32.6 million from the FDIC upon initial settlement of the transaction and recorded a receivable from the FDIC of $196 thousand (included in other assets on the consolidated statements of condition), for consideration of the net liabilities assumed (i.e., the net difference between the liabilities assumed and the assets acquired). This amount is receivable within one year of the acquisition date and is outstanding at June 30, 2011.

The following table presents the net liabilities assumed from Charter Oak and the estimated fair value adjustments, which resulted in a bargain purchase gain as of the acquisition date as the loans were purchased at a discount:

(Dollars in thousands, unaudited)	Acquisition Date (February 18, 2011)
Book value of net liabilities assumed from Charter Oak Bank	$ (15,750)
Cash received from the FDIC upon initial settlement	32,588
Receivable from the FDIC	196
Fair value adjustments:	
Loans	(17,406)
Core deposit intangible asset	725
Vehicles and equipment	16

Deferred tax liabilities		(62)
Deposits		(220)
Advances from the Federal Home Loan Bank		(2)
Total purchase accounting adjustments		(16,949)
Bargain purchase gain, net of tax	$	85

Page -11

Table of Contents

The bargain purchase gain represents the excess of the estimated fair value of the assets acquired over the estimated fair value of the liabilities assumed. We did not immediately acquire the banking facilities, including outstanding lease agreements, furniture, fixtures and equipment, as part of the P&A Agreement as of the acquisition date. We have since acquired all data processing equipment and the Napa branch fixed assets of $206 thousand and renegotiated a new lease with the landlord. The smaller St. Helena branch acquired from Charter Oak Bank was closed effective April 29, 2011.

The following table reflects the estimated fair values of the assets acquired and liabilities assumed related to the Acquisition, including cash received and receivable from the FDIC on the acquisition date:

(Dollars in thousands, unaudited)	Acquisition Date (February 18, 2011)
Assets:	
Cash and due from banks	$ 34,144
Interest bearing deposits in banks	5,663
Federal funds sold	4,235
Total cash and cash equivalents	44,042
Loans	61,765
Core deposit intangible	725
Other assets (including the receivable from the FDIC)	1,231
Total assets acquired	107,763
Liabilities:	
Deposits:	
Noninterest bearing	27,874
Interest bearing	65,987
Total deposits	93,861
Advances from the Federal Home Loan Bank	13,502
Deferred tax liabilities	62
Other liabilities	253
Total liabilities assumed	107,678
Bargain purchase gain, net of tax (included in other non-interest income)	$ 85

The following is a description of the methods used to determine the acquisition date fair values of significant assets and liabilities presented above.

Loans

The fair values for acquired loans were developed based upon the present values of the expected cash flows utilizing market-derived discount rates. Expected cash flows for each acquired loan were projected based on contractual cash flows adjusted for expected prepayment, expected default (i.e. probability of default and loss severity), and principal recovery.

For purchased non-credit-impaired loans, prepayment rates were applied to the principal outstanding based on the following assumptions depending on type of loan:

•

For commercial and agriculture loans, a ten percent constant prepayment rate (“CPR”) was assumed based on current research associated with these loan types;

- A one percent CPR was assumed for commercial real estate, construction and land loans as research data indicate limited prepayment activity over the life of these loans;
- For single family residential loans, a twenty percent CPR was used, based on current research associated with these loan types;
- For home equity lines of credit, a CPR of fifteen percent was assumed based on the refinance likelihood and other research; and,
- For other consumer loans, a CPR of one and a half percent was used based on current capital markets research data for consumer unsecured credit.

Table of Contents

Prepayment assumptions were not factored into the calculation of expected cash flows on purchased credit-impaired loans. For purchased non-credit impaired loans, the total gross contractual amounts receivable were $69.7 million as of the acquisition date.

Loans with similar characteristics were grouped together and were treated in the aggregate when applying the discount rate on the expected cash flows. Aggregation factors considered include the type of loan and related collateral, risk classification, fixed or variable interest rate, term of loan and whether or not the loan was amortizing. The discount rates used for the similar groups of loans are based on current market rates for new originations of comparable loans, where available, and include adjustments for credit and liquidity factors. To the extent comparable market rates are not readily available, a discount rate was derived based on the assumptions of a market participant's cost of funds, servicing costs, and return requirements for comparable risk assets.

Deposits

The fair values used for the transaction, savings and money market deposits are equal to the amount payable on demand at the reporting date. The fair values for time deposits are estimated using a discounted cash flow calculation that applies interest rates offered by market participants as of the acquisition date on time deposits with similar maturity terms as the discount rates. The core deposit intangible assets recognized as a result of the acquisition of core deposits are deductible for income tax purposes over fifteen years.

Advances from the Federal Home Loan Bank

The advances from the Federal Home Loan Bank San Francisco (“FHLB”) were recorded at their estimated fair value, which was based on quoted prices supplied by the FHLB. Subsequent to the acquisition dates, all of these advances were repaid in full.

Pro Forma Results of Operations

The contribution of the acquired operations of the former Charter Oak Bank to our results of operations for the period February 18 to June 30, 2011 is as follows: revenue of $5.4 million, expenses of $3.0 million (including a provision for loan losses of $994 thousand) and income after income taxes of $1.5 million. These amounts include the bargain purchase gain, acquisition-related costs, accretion of the discount on the acquired loans, and amortization of the fair value mark on time deposits and the core deposit intangible amortization. Charter Oak Bank’s results of operations prior to the acquisition date are not included in our operating results for 2011.

We acquired only certain assets and assumed certain liabilities from the former Charter Oak Bank. A significant portion of the former Charter Oak Bank’s operations, including certain delinquent loans, its St. Helena facilities and its central operations and administrative functions were not retained by us. Therefore, disclosure of supplemental pro forma financial information, especially prior period comparison is deemed neither practical nor meaningful given the troubled nature of Charter Oak Bank prior to the date of Acquisition.

Acquisition-related expenses are recognized as incurred and continue until all systems have been converted and operational functions become fully integrated. We incurred third-party acquisition-related expenses in the following line items in the consolidated statements of income for the three month and six month periods ended June 30, 2011 as follows:

Acquisiton-related Expenses (in thousands)	Three months ended June 30, 2011	Six months ended June 30, 2011

Professional services	$	153	$	457
Data processing		378		408
Other		111		125
Total	$	642	$	990

Table of Contents

Note 4: Fair Value of Assets and Liabilities

Fair Value Hierarchy and Fair Value Measurement

We group our assets and liabilities that are recorded at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1: Valuations are based on quoted prices in active markets for identical assets or liabilities. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not involve a significant degree of judgment.

Level 2: Valuations are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuations for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3: Valuations are based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Values are determined using pricing models and discounted cash flow models and includes management judgment and estimation which may be significant.

The following table summarizes our assets and liabilities that were required to be recorded at fair value on a recurring basis.

(in thousands) Description of Financial Instruments	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Balance at June 30, 2011 (unaudited):				
Securities available for sale:				
Mortgage-backed securities and collaterized mortgage obligations issued by U.S. government agencies	$119,507	$---	$ 119,507	$ ---
Debentures of government sponsored agencies	$29,893	$---	$ 29,893	$ ---
Corporate collateralized mortgage obligations	$18,006	$---	$ 18,006	$ ---
Derivative financial liabilities (interest rate contracts)	$2,691	$---	$ 2,691	$ ---