Oak Valley Bancorp
Form 10-Q
November 14, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2011

OR

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

Commission file number 001-34142

OAK VALLEY BANCORP

(Exact name of registrant as specified in its charter)

California	**26-2326676**
State or other jurisdiction of	I.R.S. Employer

incorporation or organization	Identification No.

125 N. Third Ave., Oakdale, CA 95361

(Address of principal executive offices)

(209) 848-2265

Issuer s telephone number

Not applicable

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 7,718,469 shares of common stock outstanding as of October 31, 2011.

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Oak Valley Bancorp

September 30, 2011

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PART I FINANCIAL STATEMENTS

Item 1. Consolidated Financial Statements (Unaudited)

OAK VALLEY BANCORP

CONDENSED CONSOLIDATED BALANCE SHEETS

AT SEPTEMBER 30, 2011 (UNAUDITED) AND DECEMBER 31, 2010

	September 30, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$ 74,468,079	$ 28,091,916
Federal funds sold	6,360,000	40,845,000
Cash and cash equivalents	80,828,079	68,936,916
Securities available for sale	86,799,674	53,267,982
Loans, net of allowance for loan loss of $8,857,422 at September 30, 2011 and $8,254,929 at December 31, 2010	381,817,959	395,206,208
Bank premises and equipment, net	13,393,214	10,173,822
Other real estate owned	244,375	778,174
Interest receivable and other assets	20,871,569	24,033,316
	$ 583,954,870	$ 552,396,418
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits	$ 505,505,125	$ 476,738,850
Interest payable and other liabilities	2,885,838	2,999,836
Federal Home Loan Bank advances	6,000,000	8,000,000
Total liabilities	514,390,963	487,738,686
Commitments and contingencies		
Shareholders equity		
Series A Preferred stock, no par value; $1,000 per share liquidation preference, 10,000,000 shares authorized and 13,500 issued and outstanding at December 31, 2010	0	13,013,945
Series B Preferred stock, no par value; $1,000 per share liquidation preference, 10,000,000 shares authorized and 13,500 issued and outstanding at September 30, 2011	13,500,000	0
Common stock, no par value; 50,000,000 shares authorized, 7,718,469 and 7,702,127 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively	23,180,206	24,003,549
Additional paid-in capital	2,121,136	2,080,218
Retained earnings	27,661,078	24,016,466
Accumulated other comprehensive income, net of tax	3,101,487	1,543,554
Total shareholders equity	69,563,907	64,657,732
	$ 583,954,870	$ 552,396,418

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

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

FOR THE THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND SEPTEMBER 30, 2010

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2011	2010	2011	2010
INTEREST INCOME				
Interest and fees on loans	$ 5,887,031	$ 6,405,225	$ 17,751,393	$ 19,232,421
Interest on securities available for sale	810,946	592,553	2,273,355	1,769,197
Interest on federal funds sold	4,101	3,346	30,923	7,220
Interest on deposits with banks	28,354	13,370	68,514	21,158
Total interest income	6,730,432	7,014,494	20,124,185	21,029,996
INTEREST EXPENSE				
Deposits	375,913	570,347	1,223,445	2,097,640
Federal Home Loan Bank advances	15,199	85,370	55,687	268,625
Federal funds purchased	51		51	110
Total interest expense	391,163	655,717	1,279,183	2,366,375
Net interest income	6,339,269	6,358,777	18,845,002	18,663,621
PROVISION FOR LOAN LOSSES	300,000	1,005,000	1,200,000	3,015,000
Net interest income after provision for loan losses	6,039,269	5,353,777	17,645,002	15,648,621
OTHER INCOME				
Service charges on deposits	306,081	272,136	846,217	787,142
Earnings on cash surrender value of life insurance	109,710	103,986	324,668	308,671
Mortgage commissions	37,080	30,849	63,900	74,984
Other	310,499	269,078	879,771	884,047
Total non-interest income	763,370	676,049	2,114,556	2,054,844
OTHER EXPENSES				
Salaries and employee benefits	2,356,589	2,143,094	7,069,980	6,483,605
Occupancy	731,512	690,209	2,063,759	2,031,127
Data processing fees	253,438	233,694	751,965	706,889
OREO expenses	8,497	35,051	358,776	598,894
Regulatory assessments	135,000	258,000	531,000	774,000
Other	723,095	828,155	2,359,473	2,355,381
Total non-interest expense	4,208,131	4,188,203	13,134,953	12,949,896
Net income before provision for income taxes	2,594,508	1,841,623	6,624,605	4,753,569
PROVISION FOR INCOME TAXES	845,565	700,700	2,260,925	1,626,221
NET INCOME	$ 1,748,943	$ 1,140,923	$ 4,363,680	$ 3,127,348
Preferred stock dividends and accretion	571,482	210,412	992,305	631,236
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$ 1,177,461	$ 930,511	$ 3,371,375	$ 2,496,112
NET INCOME PER COMMON SHARE	$ 0.15	$ 0.12	$ 0.44	$ 0.32

NET INCOME PER DILUTED COMMON SHARE	$ 0.15	$ 0.12	$ 0.44	$ 0.32

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

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

FOR THE YEAR ENDED DECEMBER 31, 2010 AND THE NINE-MONTH PERIOD ENDED SEPTEMBER 30, 2011 (UNAUDITED)

	YEAR ENDED DECEMBER 31, 2010 AND NINE MONTHS ENDED SEPTEMBER 30, 2011								
	Common Stock		Preferred Stock		Additional Paid-in	Retained		Accumulated Other Comprehensive	Total Shareholders
	Shares	Amount	Shares	Amount	Capital	Earnings	Comprehensive Income	Income	Equity
Balances, January 1, 2010	7,681,877	$ 23,933,440	13,500	$ 12,847,297	$ 1,997,747	$ 20,230,683		$ 1,683,084	$ 60,692,251
Stock options exercised	20,250	$ 70,109							$ 70,109
Preferred stock accretion				$ 166,648		$ (166,648)			0
Preferred stock dividend payments						(675,000)			(675,000)
Stock based compensation					82,471				82,471
Comprehensive income:									
Net changes in unrealized gain on available-for-sale securities (net of income tax benefit of $17,015)							(24,334)	(24,334)	(24,334)
Reclassification of realized gains (net of income tax benefit of $80,549)							(115,196)	(115,196)	(115,196)
Net income						4,627,431	4,627,431		4,627,431
Comprehensive income							$ 4,487,901		
Balances, December 31, 2010	7,702,127	$ 24,003,549	13,500	$ 13,013,945	$ 2,080,218	$ 24,016,466		$ 1,543,554	$ 64,657,732
Stock options exercised	3,037	$ 9,894							$ 9,894
Restricted stock issued	13,305								
Repurchase of Series A preferred stock			(13,500)	$ (13,500,000)					(13,500,000)
Series B preferred stock issued			13,500	13,500,000					13,500,000
Preferred stock accretion				486,055		$ (486,055)			0
Preferred stock dividend payments						(506,250)			(506,250)

Repurchase of U.S. Treasury Warrant		(833,237)				833,237			0
Payment to repurchase U.S. Treasury Warrant						(560,000)			(560,000)
Stock based compensation					40,918				40,918
Comprehensive income:									
Net changes in unrealized gain on available-for-sale securities (net of income tax of $1,116,698)							1,597,030	1,597,030	1,597,030
Reclassification of realized gains (net of income tax benefit of $27,338)							(39,097)	(39,097)	(39,097)
Net income						4,363,680	4,363,680		4,363,680
Comprehensive income							$ 5,921,613		
Balances, September 30, 2011	7,718,469	$ 23,180,206	13,500	$ 13,500,000	$ 2,121,136	$ 27,661,078		$ 3,101,487	$ 69,563,907

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

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OAK VALLEY BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE NINE MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND SEPTEMBER 30, 2010

	NINE MONTHS ENDED SEPTEMBER 30,	
	2011	**2010**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 4,363,680	$ 3,127,348
Adjustments to reconcile net earnings to net cash from operating activities:		
Provision for loan losses	1,200,000	3,015,000
Depreciation	718,160	720,632
Amortization of investment securities, net	20,452	660
Stock based compensation	40,918	69,684
OREO write downs and losses on sale	290,609	413,275
Gain on called available for sale securities	(66,435)	(172,561)
Earnings on cash surrender value of life insurance	(324,668)	(308,671)
(Decrease) increase in interest payable and other liabilities	(121,498)	750,553
(Increase) decrease in interest receivable	(37,872)	76,316
Decrease in other assets	2,434,927	370,080
Net cash from operating activities	8,518,273	8,062,316
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available for sale securities	(44,129,366)	(11,090,604)
Proceeds from maturities, calls, and principal paydowns of securities available for sale	13,290,950	8,111,950
Net decrease in loans	12,188,249	13,679,367
Proceeds from sale of OREO	243,190	1,234,752
Proceeds from redemption of BOLI policies	0	175,771
Net purchases of premises and equipment	(3,937,552)	(887,968)
Net cash (used in) from investing activities	(22,344,529)	11,223,268
CASH FLOWS FROM FINANCING ACTIVITIES:		
FHLB advanced funds	0	7,100,000
FHLB payments	(2,000,000)	(20,800,000)
Federal funds advances	0	480,000
Federal funds payments	0	(480,000)
Repurchase of Series A Preferred Stock	(13,500,000)	0
Proceeds from Series B Preferred Stock issued	13,500,000	0
Preferred stock dividend payment	(498,750)	(506,250)
Payment to repurchase U.S. Treasury Warrant	(560,000)	0
Net increase in demand deposits and savings accounts	40,067,219	28,797,189
Net decrease in time deposits	(11,300,944)	(9,103,296)
Proceeds from sale of common stock and exercise of stock options	9,894	70,110
Net cash from financing activities	25,717,419	5,557,753
NET INCREASE IN CASH AND CASH EQUIVALENTS	11,891,163	24,843,337
CASH AND CASH EQUIVALENTS, beginning of period	68,936,916	21,648,548
CASH AND CASH EQUIVALENTS, end of period	$ 80,828,079	$ 46,491,885

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:				
Cash paid during the period for:				
Interest	$	1,310,802	$	2,597,190
Income taxes	$	3,136,119	$	1,646,000
NON-CASH INVESTING ACTIVITIES:				
Real estate acquired through foreclosure	$	0	$	641,400
Change in unrealized gain on available-for-sale securities	$	2,647,293	$	1,107,594
NON-CASH FINANCING ACTIVITIES:				
Accretion of preferred stock	$	486,055	$	124,986

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

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OAK VALLEY BANCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

On July 3, 2008 (the Effective Date), a bank holding company reorganization was completed whereby Oak Valley Bancorp (the Company) became the parent holding company for Oak Valley Community Bank (the Bank). On the Effective Date, each outstanding share of the Bank was converted into one share of Oak Valley Bancorp and the Bank became a wholly-owned subsidiary of the holding company.

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

The interim consolidated financial statements included in this report are unaudited but reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the interim periods presented. All such adjustments are of a normal recurring nature. The results of operations for the three and nine month periods ended September 30, 2011 are not necessarily indicative of the results of a full year s operations. For further information, refer to the audited consolidated financial statements and footnotes included in the Company s Form 10-K for the year ended December 31, 2010.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (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. There was no significant impact on the Company s financial position or results of operations as a result of adopting this ASU.

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 explanation on how to measure fair value but do not require any additional fair value measurements and does 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 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 are that reclassified from other comprehensive income to net income are to be presented on the face of the entities financial statement regardless 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.

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NOTE 3 PREFERRED STOCK REPURCHASE AND WARRANT REDEMPTION

In August 2011, The Company repurchased the $13,500,000 of Series A Preferred Stock originally issued to the U.S. Treasury in December 2008 in connection with the Company s participation in the Capital Purchase Program (CPP). The Company simultaneously issued $13,500,000 in Series B Preferred Stock to the U.S. Treasury under the Small Business Lending Funding (SBLF) program. Subsequently, the Company fully redeemed a warrant to purchase 350,346 shares of its Common Stock, at the exercise price of $5.78 per share that the Company had granted to the U.S. Treasury pursuant to the CPP, for a purchase price of $560,000, which settled in September 2011. So long as the preferred stock remains outstanding under SBLF, it will pay quarterly cumulative dividends at a variable rate between 1% and 5% per year for the first 2.5 years depending on growth of our small business loan portfolio. If there is no loan growth after 2.5 years, the dividend rate could increase to 7% and if the preferred stock remains outstanding after 4.5 years, the rate increases to 9%, regardless of loan growth.

The repurchase of the original preferred stock shares under CPP resulted in preferred stock discount accretion of $389,000, the full remaining balance of the preferred stock discount at the time of the repurchase. This entry was recorded in the third quarter of 2011 and is reflected in the *Preferred stock dividends and accretion* line of the statements of income.

NOTE 4 SECURITIES

The amortized cost and estimated fair values of debt securities as of September 30, 2011 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
Available-for-sale securities:				
U.S. agencies	$ 50,612,981	3,283,600	$ 0	$ 53,896,581
Collateralized mortgage obligations	11,613,387	770,147	(14,231)	12,369,303
Municipalities	13,329,226	1,245,778	0	14,575,004
SBA Pools	1,246,015	0	(2,299)	1,243,716
Corporate debt	2,000,000	0	(32,199)	1,967,801
Mutual Fund	2,727,437	19,832	0	2,747,269
	$ 81,529,046	$ 5,319,357	$ (48,729)	$ 86,799,674

The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2011.

	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. agencies	$ 0	$ 0	$ 0	0	$ 0	$ 0
Collateralized mortgage obligations	2,042,958	(14,231)	0	0	2,042,958	(14,231)

Municipalities	0	0	0	0	0	0
SBA Pools	0	0	1,243,716	(2,299)	1,243,716	(2,299)
Corporate debt	1,967,801	(32,199)	0	0	1,967,801	(32,199)
Mutual Fund	0	0	0	0	0	0
Total temporarily impaired securities	$ 4,010,759	$ (46,430)	$ 1,243,716	$ (2,299)	$ 5,254,475	$ (48,729)

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At September 30, 2011, a total of two SBA pools make up the total amount of securities in an unrealized loss position for greater than 12 months. Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due solely to interest rate changes and the Company does not intend to sell the securities and it is not likely that we will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

The amortized cost and estimated fair value of debt securities at September 30, 2011, by contractual maturity or call date, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Available-for-sale securities:		
Due in one year or less	$ 8,579,110	$ 8,640,310
Due after one year through five years	9,731,982	10,669,401
Due after five years through ten years	22,408,617	24,331,252
Due after ten years	40,809,337	43,158,711
	$ 81,529,046	$ 86,799,674

The amortized cost and estimated fair values of debt securities as of December 31, 2010, are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Available-for-sale securities:				
U.S. agencies	$ 28,678,709	1,566,549	$ (54,870)	$ 30,190,388
Collateralized mortgage obligations	7,946,854	189,926	0	8,136,780
Municipalities	9,870,381	931,375	(2,257)	10,799,499
SBA Pools	1,517,332	0	(11,236)	1,506,096
Mutual Fund	2,631,371	14,063	(10,215)	2,635,219
	$ 50,644,647	$ 2,701,913	$ (78,578)	$ 53,267,982

The following tables detail the gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2010.

	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. agencies	$ 3,101,384	$ (54,870)	$ 0	$ 0	$ 3,101,384	$ (54,870)
Collateralized mortgage obligations	0	0	0	0	0	0
Municipalities	427,130	(2,257)	0	0	427,130	(2,257)
SBA Pools	0	0	1,499,228	(11,236)	1,499,228	(11,236)

Mutual Fund		989,786		(10,215)		0		0		989,786	(10,215)
Total temporarily impaired securities	$	4,518,300	$	(67,342)	$	1,499,228	$	(11,236)	$	6,017,528	$ (78,578)

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At December 31, 2010, two SBA pools make up the total amount of securities in an unrealized loss position for greater than 12 months. Management periodically evaluates each available-for-sale investment security in an unrealized loss position to determine if the impairment is temporary or other than temporary. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due solely to interest rate changes and the Company does not intend to sell the securities and it is not likely that we will be required to sell the securities before the earlier of the forecasted recovery or the maturity of the underlying investment security.

The Company recognized a gain of $27,611 and $66,435 for the three and nine month periods ended September 30, 2011, respectively, on certain available-for-sale securities that were partially called, which compares to $46,030 and $172,561 in the same periods of 2010. There were no sales of available-for-sale securities during the first nine months of 2011 and 2010.

Securities carried at $53,641,450 and $46,405,847 at September 30, 2011 and December 31, 2010, respectively, were pledged to secure deposits of public funds.

NOTE 5 LOANS

The Company s customers are primarily located in Stanislaus, San Joaquin, Tuolumne, Inyo, and Mono Counties. As of September 30, 2011, approximately 82% of the Company s loans are commercial real estate loans which includes construction loans. Approximately 8% of the Company s loans are for general commercial uses including professional, retail, and small business. Additionally, 7% of the Company s loans are for residential real estate and other consumer loans. The remaining 3% are agriculture loans.

Loan totals were as follows:

	September 30, 2011	December 31, 2010
Commercial real estate:		
Commercial real estate- construction	$ 12,581,985	$ 13,669,527
Commercial real estate- mortgages	277,078,981	289,208,721
Land	17,344,184	18,975,637
Farmland	15,797,471	14,876,426
Commercial and industrial	31,773,238	30,755,651
Consumer	1,231,189	1,242,300
Consumer residential	24,253,685	21,843,935
Agriculture	11,318,631	13,621,952
Total loans	391,379,364	404,194,149
Less:		
Deferred loan fees and costs, net	(703,983)	(733,012)
Allowance for loan losses	(8,857,422)	(8,254,929)
Net loans	$ 381,817,959	$ 395,206,208

Loan Origination/Risk Management. The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower s ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower s management possesses sound ethics and solid business acumen, the Company s management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company s commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Company s exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Company avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Company also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. At September 30, 2011, approximately 37.1% of the outstanding principal balance of the Company s commercial real estate loans were secured by owner-occupied properties.

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Company may originate from time to time, the Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

The Company originates consumer loans utilizing a computer-based credit scoring analysis to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans follow bank policy, which include, but are not limited to, a maximum loan-to-value percentage of 80%, a maximum housing and total debt ratio of 36% and 42%, respectively and other specified credit and documentation requirements.

The Company maintains an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company s policies and procedures.

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Non-Accrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management s opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Non-accrual loans, segregated by class of loans, were as follows:

	September 30, 2011	December 31, 2010
Commercial real estate:		
Commercial real estate- construction	$ 967,666	$ 3,252,081
Commercial real estate- mortgages	4,174,385	4,190,665
Land	3,335,115	3,810,473
Farmland	0	0
Commercial and industrial	26,322	221,723
Consumer	0	0
Consumer residential	0	0
Agriculture	0	0
Total non-accrual loans	$ 8,503,488	$ 11,474,942

Had non-accrual loans performed in accordance with their original contract terms, the Company would have recognized additional interest income of approximately $167,000 and $529,000 in three and nine month periods ended September 30, 2011, respectively, as compared to $163,000 and $546,000 in the same periods of 2010.

The following table analyzes past due loans including the non-accrual loans in the above table, segregated by class of loans, as of September 30, 2011:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Greater Than 90 Days Past Due and Still Accruing
September 30, 2011						
Commercial real estate:						
Commercial R.E. - construction	$ 0	$ 549,109	$ 0	$ 549,109	$ 12,032,876	$ 0
Commercial R.E. - mortgages	0	0	4,174,386	4,174,386	272,904,595	0
Land	0	2,759,964	575,152	3,335,116	14,009,068	0
Farmland	0	0	0	0	15,797,471	0
Commercial and industrial	67,913	0	0	67,913	31,705,325	0
Consumer	0	0	0	0	1,231,189	0
Consumer residential	0	0	0	0	24,253,685	0
Agriculture	0	0	0	0	11,318,631	0
Total	$ 67,913	$ 3,309,073	$ 4,749,538	$ 8,126,524	$ 383,252,840	$ 0

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The following table analyzes past due loans including the non-accrual loans in the above table, segregated by class of loans, as of December 31, 2010:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Greater Than 90 Days Past Due and Still Accruing
December 31, 2010						
Commercial real estate:						
Commercial R.E. - construction	$ 0	$ 0	$ 2,663,126	$ 2,663,126	$ 11,006,401	$ 0
Commercial R.E. - mortgages	1,473,940	2,865,492	1,325,173	5,664,605	283,544,116	0
Land	0	0	3,810,473	3,810,473	15,165,164	0
Farmland	0	0	0	0	14,876,426	0
Commercial and industrial	0	0	0	0	30,755,651	0
Consumer	0	0	0	0	1,242,300	0
Consumer residential	0	0	0	0	21,843,935	0
Agriculture	0	0	0	0	13,621,952	0
Total	$ 1,473,940	$ 2,865,492	$ 7,798,772	$ 12,138,204	$ 392,055,945	$ 0

Impaired Loans. Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectibility of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

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Impaired loans as of September 30, 2011 and December 31, 2010 are set forth in the following table. No interest income was recognized on impaired loans subsequent to their classification as impaired.

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
September 30, 2011						
Commercial real estate:						
Commercial R.E. - construction	$ 1,049,448	$ 418,557	$ 549,109	$ 967,666	$ 86,303	$ 1,378,721
Commercial R.E. - mortgages	4,469,681	1,308,893	2,865,492	4,174,385	502,692	4,174,385
Land	7,707,585	703,731	2,631,384	3,335,115	465,798	3,337,616
Farmland	0	0	0	0	0	0
Commercial and Industrial	29,023	26,322	0	26,322	0	27,073
Consumer	0	0	0	0		0
Consumer residential	0	0	0	0		0
Agriculture	0	0	0	0		0
Total	$ 13,255,737	$ 2,457,503	$ 6,045,985	$ 8,503,488	$ 1,054,793	$ 8,917,795
December 31, 2010						
Commercial real estate:						
Commercial R.E. - construction	$ 3,405,167	$ 1,427,776	$ 1,824,305	$ 3,252,081	$ 179,725	$ 4,430,245
Commercial R.E. - mortgages	4,469,681	4,190,665	0	4,190,665	0	1,900,081
Land	7,710,271	739,732	3,070,741	3,810,473	768,118	4,231,514
Farmland	0	0	0	0	0	0
Commercial and industrial	222,023	221,723	0	221,723	0	207,384
Consumer	0	0	0	0	0	0
Consumer residential	0	0	0	0	0	2,417
Agriculture	0	0	0	0	0	0
Total	$ 15,807,142	$ 6,579,896	$ 4,895,046	$ 11,474,942	$ 947,843	$ 10,771,641

Troubled Debt Restructurings 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.

As a result of adopting the amendments in Accounting Standards Update No. 2011-02, the Company reassessed all restructurings that occurred on or after the beginning of the current fiscal year (January 1, 2011) for identification as troubled debt restructurings. The Company identified as troubled debt restructurings two loans with carrying values totaling $2.6 million that was not previously identified as a troubled debt restructure. However, the receivables were previously identified as collateral dependent impaired loans and the related allowance for loan losses of $409,000 was measured in accordance with the guidance in Section 310-10-35. The amendments in Accounting Standards Update No. 2011-02 require prospective application of the impairment measurement guidance in Section 310-10-35 for those receivables newly identified as impaired at the end of the first interim period of adoption (September 30, 2011), there were no newly identified trouble debt restructures for which the allowance for loan losses was previously measured under general allowance for loan losses methodology and are now impaired under Section 310-10-35.

At September 30, 2011, there were 7 loans and leases that were considered to be troubled debt restructurings. Of these loans and leases, one is modified and is currently performing (less than ninety days past due) totaling $604,000 and 6 are considered nonperforming totaling $4,329,000. At September 30, 2011 there were unfunded commitments of $1,274,000 on one loan classified as a troubled debt restructure because of an agreement with a borrower to continue advancing funds and covering overhead costs on a residential development project. The Company will receive proceeds to pay down the principal as the residential properties sell. As of December 31, 2010, there were no unfunded commitments on those loans considered troubled debt restructures.

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The Company has allocated $552,000 and $119,000 of specific reserves to loans whose terms have been modified in troubled debt restructurings as of September 30, 2011 and December 31, 2010, respectively. The Company has commitments to lend an additional $1,274,000, as described above, to one of these borrowers as of September 30, 2011. The Company had not committed to lend additional amounts to these borrowers as of December 31, 2010.

During the nine-month period ended September 30, 2011, the terms of four loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date; or a temporary payment modification in which the payment amount allocated towards principal was reduced. In some cases, a permanent reduction of the accrued interest on the loan was conceded.

The following table presents loans by class modified as troubled debt restructurings that occurred during the three and nine month period ended September 30, 2011:

	Three Months Ended September 30, 2011			Nine Months Ended September 30, 2011		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial real estate:						
Commercial R.E. - construction	0	$ 0	$ 0	2	$ 2,294,219	$ 2,294,219
Commercial R.E. - mortgages	0	0	0	0	0	0
Land	0	0	0	2	3,224,764	3,224,764
Farmland	0	0	0	0	0	0
Commercial and Industrial	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Consumer residential	0	0	0	0	0	0
Agriculture	0	0	0	0	0	0
Total	0	$ 0	$ 0	4	$ 5,518,983	$ 5,518,983

The troubled debt restructurings during the nine-month period ended September 30, 2011 did not increase the allowance for loan losses as a result of the loan modification and there were no charge offs as a result of the loan modifications.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the three and nine month periods ended September 30, 2011.

	Three Months Ended September 30, 2011		Nine Months Ended September 30, 2011	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Commercial real estate:				
Commercial R.E. - construction	1	$ 549,109	1	$ 549,109

Commercial R.E. - mortgages	0		0	0		0
Land	2		2,631,384	2		2,631,384
Farmland	0		0	0		0
Commercial and Industrial	0		0	0		0
Consumer	0		0	0		0
Consumer residential	0		0	0		0
Agriculture	0		0	0		0
Total	3	$	3,180,493	3	$	3,180,493

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A loan is considered to be in payment default once it is ninety days contractually past due under the modified terms.

The troubled debt restructuring that subsequently defaulted above did not result in an increase to the allowance for loan losses or a charge-off during the three and nine month periods ended September 30, 2011.

Quality ratings (Risk Grades) are assigned to all commitments and stand-alone notes. Risk grades define the basic characteristics of commitments or stand-alone note in relation to their risk. All loans are graded using a system that maximizes the loan quality information contained in loan review grades, while ensuring that the system is compatible with the grades used by bank examiners.

We grade loans using the following letter system:

1 Exceptional Loan

2 Quality Loan

3A Better Than Acceptable Loan

3B Acceptable Loan

3C Marginally Acceptable Loan

4 (W) Watch Acceptable Loan

5 Other Loans Especially Mentioned

6 Substandard Loan

7 Doubtful Loan

8 Loss

1. Exceptional Loan - Loans with A+ credits that contain very little, if any, risk. Grade 1 loans are considered Pass. To qualify for this rating, the following characteristics must be present:

- A high level of liquidity and whose debt-servicing capacity exceeds expected obligations by a substantial margin.
- Where leverage is below average for the industry and earnings are consistent or growing without severe vulnerability to economic cycles.

•Also included in this rating (but not mandatory unless one or more of the preceding characteristics are missing) are loans that are fully secured and properly margined by our own time instruments or U.S. blue chip securities. To be properly margined cash collateral must be equal to, or greater than, 110% of the loan amount.

2. Quality Loan - Loans with excellent sources of repayment that conform in all respects to bank policy and regulatory requirements. These are also loans for which little repayment risk has been identified. No credit or collateral exceptions. Grade 2 loans are considered Pass. Other factors include:

•Unquestionable debt-servicing capacity to cover all obligations in the ordinary course of business from well-defined primary and secondary sources.

•Consistent strong earnings.

•A solid equity base.

3A. Better than Acceptable Loan - In the interest of better delineating the loan portfolio s true credit risk for reserve allocation, further granularity has been sought by splitting the grade 3 category into three classifications. The distinction between the three are bank-defined guidelines and represent a further refinement of the regulatory definition of a pass, or grade 3 loan. Grade 3A is the stronger third of the pass category, but is not strong enough to be a grade 2 and is characterized by:

•Strong earnings with no loss in last three years and ample cash flow to service all debt well above policy guidelines.

•Long term experienced management with depth and defined management succession.

•The loan has no exceptions to policy.

•Loan-to-value on real estate secured transactions is 10% to 20% less than policy guidelines.

•Very liquid balance sheet that may have cash available to pay off our loan completely.

•Little to no debt on balance sheet.

3B. Acceptable Loan - 3B loans are simply defined as all loans that are less qualified than 3A loans and are stronger than 3C loans. These loans are characterized by acceptable sources of repayment that conform to bank policy and regulatory requirements. Repayment risks are acceptable for these loans. Credit or collateral exceptions are minimal, are in the process of correction, and do not represent repayment risk. These loans:

•Are those where the borrower has average financial strengths, a history of profitable operations and experienced management.

•Are those where the borrower can be expected to handle normal credit needs in a satisfactory manner.

3C. Marginally Acceptable - 3C loans have similar characteristics as that of 3Bs with the following additional characteristics:

Requires collateral. A credit facility where the borrower has average financial strengths, but usually lacks reliable secondary sources of repayment other than the subject collateral. Other common characteristics can include some or all of the following: minimal background experience of management, lacking continuity of management, a start-up operation, erratic historical profitability (acceptable reasons-well identified), lack of or marginal sponsorship of guarantor, and government guaranteed loans.

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4W *Watch Acceptable* - Watch grade will be assigned to any credit that is adequately secured and performing but monitored for a number of indicators. These characteristics may include any unexpected short-term adverse financial performance from budgeted projections or prior period s results (i.e., declining profits, sales, margins, cash flow, or increased reliance on leverage, including adverse balance sheet ratios, trade debt issues, etc.). Additionally, any managerial or personal problems of company management, decline in the entire industry or local economic conditions failure to provide financial information or other documentation as requested; issues regarding delinquency, overdrafts, or renewals; and any other issues that cause concern for the company. Loans to individuals or loans supported by guarantors with marginal net worth and/or marginal collateral. Weakness identified in a Watch credit is short-term in nature. Loans in this category are usually accounts the Company would want to retain providing a positive turnaround can be expected within a reasonable time frame. Grade 4 loans are considered Pass.

5 *Other Loans Especially Mentioned (Special Mention)* - A special mention extension of credit is defined as having potential weaknesses that deserve management s close attention. If left uncorrected, these potential weaknesses may, at some future date result in the deterioration of the repayment prospects for the credit or the institution s credit position. Extensions of credit that might be detailed in this category include the following:

•The lending officer may be unable to properly supervise the credit because of an inadequate loan or credit agreement.

•Questions exist regarding the condition of and/or control over collateral.

•Economic or market conditions may unfavorably affect the obligor in the future.

•A declining trend in the obligor s operations or an imbalanced position in the balance sheet exists, but not to the point that repayment is jeopardized.

6 *Substandard Loan* - A substandard extension of credit is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Extensions of credit so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard credits, does not have to exist in individual extensions of credit classified substandard.

7 *Doubtful Loan* - An extension of credit classified doubtful has all the weaknesses inherent in one classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high but because of certain important and reasonably specific pending factors that may work to the advantage of and strengthen the credit, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors may include a proposed merger or acquisition, liquidation proceedings, capital injection, perfecting liens on additional collateral or refinancing plans. The entire loan need not be classified doubtful when collection of a specific portion appears highly probable. An example of proper use of the doubtful category is the case of a company being liquidated, with the trustee-in-bankruptcy indicating a minimum disbursement of 40 percent and a maximum of 65 percent to unsecured creditors, including the Company. In this situation, estimates are based on liquidation value appraisals with actual values yet to be realized. By definition, the only portion of the credit that is doubtful is the 25 percent difference between 40 and 65 percent. A proper classification of such a credit would show 40 percent substandard, 25 percent doubtful, and 35 percent loss. A credit classified as doubtful should be resolved within a reasonable period of time. Reasonable is generally defined as the period between examinations. In other words, a credit classified doubtful at an examination should be cleared up before the next exam. However, there may be situations that warrant continuation of the doubtful classification a while longer.

8. Loss - Extensions of credit classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the credit has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off, even though partial recovery may be affected in the future. It should not be the Company s practice to attempt long-term recoveries while the credit remains on the books. Losses should be taken in the period in which they surface as uncollectible.

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The following table presents weighted average risk grades of our loan portfolio:

	September 30, 2011 Weighted Average Risk Grade	December 31, 2010 Weighted Average Risk Grade
Commercial real estate:		
Commercial real estate - construction	3.23	4.83
Commercial real estate - mortgages	3.26	3.27
Land	5.23	5.37
Farmland	3.30	3.45
Commercial and Industrial	3.30	3.28
Consumer	2.71	2.77
Consumer residential	3.05	3.01
Agriculture	3.19	3.20
Total gross loans	3.34	3.42

The following table presents risk grade totals by class of loans as of September 30, 2011. Risk grades 1 through 4 have been aggregated in the Pass line.

Dollars in thousands	Commercial R.E. Construction	Commercial R.E. Mortgages	Land	Farmland	Commercial and Industrial	Consumer	Consumer Residential	Agriculture	Total
September 30, 2011									
Pass	$ 11,614,320	$ 257,532,950	$ 11,054,691	$ 14,411,272	$ 30,792,695	$ 1,214,764	$ 23,857,454	$ 10,602,599	$ 361,080,745
Special mention		10,010,295			85,549				10,095,844
Substandard	967,665	9,535,736	6,289,493	1,386,199	894,994	16,425	396,231	716,032	20,202,775
Doubtful									
Total loans	$ 12,581,985	$ 277,078,981	$ 17,344,184	$ 15,797,471	$ 31,773,238	$ 1,231,189	$ 24,253,685	$ 11,318,631	$ 391,379,364
December 31, 2010									
Pass	$ 10,417,446	$ 265,361,186	$ 4,076,121	$ 12,225,807	$ 28,295,716	$ 1,225,072	$ 21,723,935	$ 12,593,405	$ 355,918,688
Special mention		10,352,335		1,190,402	1,573,044			278,548	13,394,329
Substandard	3,252,081	13,495,200	14,899,516	1,460,217	886,891	17,228	120,000	749,999	34,881,132
Doubtful									
Total loans	$ 13,669,527	$ 289,208,721	$ 18,975,637	$ 14,876,426	$ 30,755,651	$ 1,242,300	$ 21,843,935	$ 13,621,952	$ 404,194,149

Allowance for Loan Losses. The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management s best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Company s allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, Receivables and allowance allocations calculated in accordance with ASC Topic 450, Contingencies. Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Company s process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

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The level of the allowance reflects management s continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management s judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company s control, including, among other things, the performance of the Company s loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company s allowance for loan losses consists of three elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other qualitative risk factors both internal and external to the Company.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor s ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a calculated grade of 5 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower s ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower s industry, among other things.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. The Company s pools of similar loans include similarly risk-graded groups of commercial and industrial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Company s lending management and staff; (ii) the effectiveness of the Company s loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, moderate or low degree of risk. The results are then input into a general allocation matrix to determine an appropriate general valuation allowance.

Included in the general valuation allowances are allocations for groups of similar loans with risk characteristics that exceed certain concentration limits established by management. Concentration risk limits have been established, among other things, for certain industry concentrations, large balance and highly leveraged credit relationships that exceed specified risk grades, and loans originated with policy exceptions that exceed specified risk grades.

Loans identified as losses by management, internal loan review and/or bank examiners are charged-off. Furthermore, consumer loan accounts are charged-off automatically based on regulatory requirements.

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The following table details activity in the allowance for loan losses by portfolio segment for the three and nine months ended September 30, 2011 and 2010. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Allowance for Loan Losses

For the Three and Nine Months Ended September 30, 2011 and 2010

	Commercial Real Estate	Commercial and industrial	Consumer	Consumer Residential	Agriculture	Unallocated	Total
Three Months Ended September 30, 2011							
Beginning balance	$ 6,777,668	$ 768,046	$ 43,630	$ 393,923	$ 159,119	$ 448,653	$ 8,591,039
Charge-offs	(29,001)	0	(1,296)	(38,078)	0	0	(68,375)
Recoveries	28,581	4,707	1,240	230	0	0	34,758
Provision	125,007	37,876	21,482	16,731	118,746	(19,842)	300,000
Ending balance	$ 6,902,255	$ 810,629	$ 65,056	$ 372,806	$ 277,865	$ 428,811	$ 8,857,422
Nine Months Ended September 30, 2011							
Beginning balance	$ 6,577,011	$ 686,303	$ 61,115	$ 375,349	$ 152,526	$ 402,625	$ 8,254,929
Charge-offs	(565,368)	(35,000)	(4,152)	(38,078)	0	0	(642,598)
Recoveries	28,581	10,983	5,264	263	0	0	45,091
Provision	862,031	148,343	2,829	35,272	125,339	26,186	1,200,000
Ending balance	$ 6,902,255	$ 810,629	$ 65,056	$ 372,806	$ 277,865	$ 428,811	$ 8,857,422
Three Months Ended September 30, 2010							
Beginning balance	$ 6,304,934	$ 584,500	$ 41,437	$ 167,935	$ 137,309	$ 378,023	$ 7,614,138
Charge-offs	(912,555)	0	(8,263)	0	0	0	(920,818)
Recoveries	0	0	1,886	0	0	0	1,886
Provision	771,558	184,367	26,127	2,315	(250)	20,883	1,005,000
Ending balance	$ 6,163,937	$ 768,867	$ 61,187	$ 170,250	$ 137,059	$ 398,906	$ 7,700,206
Nine Months Ended September 30, 2010							
Beginning balance	$ 5,844,793	$ 648,523	$ 43,822	$ 201,741	$ 142,009	$ 139,334	$ 7,020,222
Charge-offs	(2,298,688)	0	(12,528)	(29,001)	0	0	(2,340,217)
Recoveries	0	1,218	3,983	0	0	0	5,201
Provision	2,617,832	119,126	25,910	(2,490)	(4,950)	259,572	3,015,000
Ending balance	$ 6,163,937	$ 768,867	$ 61,187	$ 170,250	$ 137,059	$ 398,906	$ 7,700,206

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The following table details the allowance for loan losses and ending gross loan balances as of September 30, 2011 and December 31, 2010, summarized by collective and individual evaluation methods of impairment.

	Commercial Real Estate	Commercial and industrial	Consumer	Consumer Residential	Agriculture	Unallocated	Total
September 30, 2011							
Allowance for loan losses for loans:							
Individually evaluated for impairment	$ 1,054,793	$ 0	$ 0	$ 0	$ 0	$ 0	$ 1,054,793
Collectively evaluated for impairment	5,847,462	810,629	65,056	372,806	277,865	428,811	7,802,629
	$ 6,902,255	$ 810,629	$ 65,056	$ 372,806	$ 277,865	$ 428,811	$ 8,857,422
Ending gross loan balances:							
Individually evaluated for impairment	$ 8,477,166	$ 26,322	$ 0	$ 0	$ 0	$ 0	$ 8,503,488
Collectively evaluated for impairment	$ 314,325,455	$ 31,746,916	$ 1,231,189	$ 24,253,685	$ 11,318,631	$ 0	$ 382,875,876
	$ 322,802,621	$ 31,773,238	$ 1,231,189	$ 24,253,685	$ 11,318,631	$ 0	$ 391,379,364
December 31, 2010							
Allowance for loan losses for loans:							
Individually evaluated for impairment	$ 947,843	$ 0	$ 0	$ 0	$ 0	$ 0	$ 947,843
Collectively evaluated for impairment	$ 5,629,168	$ 686,303	$ 61,115	$ 375,349	$ 152,526	$ 402,625	$ 7,307,086
	$ 6,577,011	$ 686,303	$ 61,115	$ 375,349	$ 152,526	$ 402,625	$ 8,254,929
Ending balances of loans:							
Individually evaluated for impairment	$ 11,253,219	$ 221,723	$ 0	$ 0	$ 0	0	$ 11,474,942
Collectively evaluated for impairment	$ 325,477,092	$ 30,533,928	$ 1,242,300	$ 21,843,935	$ 13,621,952	0	$ 392,719,207
	$ 336,730,311	$ 30,755,651	$ 1,242,300	$ 21,843,935	$ 13,621,952	$ 0	$ 404,194,149

Changes in the reserve for off-balance-sheet commitments were as follows:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2011	2010	2011	2010
Balance, beginning of year	$ 133,078	$ 153,838	$ 157,001	$ 171,900
Provision Charged to Operations for Off Balance Sheet	(3,922)	(13,373)	(27,845)	(31,435)
Balance, end of year	$ 129,156	$ 140,465	$ 129,156	$ 140,465

The method for calculating the reserve for off-balance-sheet loan commitments is based on an reserve percentage which is less than other outstanding loan types because they are at a lower risk level. This reserve percentage, based on many factors including historical losses and existing economic conditions, is evaluated by management periodically and is applied to the total undisbursed loan commitment balance to calculate the reserve for off-balance-sheet commitments. Reserves for off-balance-sheet commitments are recorded in interest payable and other liabilities on the condensed consolidated balance sheets.

At September 30, 2011 and December 31, 2010, loans carried at $318,529,495 and $331,288,636, respectively, were pledged as collateral on advances from the Federal Home Loan Bank.

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NOTE 6 OTHER REAL ESTATE OWNED

As of September 30, 2011, the Company owned two properties with balances of $244,375 that were classified as other real estate owned, as compared to three properties with outstanding balances of $778,174 as of December 31, 2010. Each of these properties was acquired through loan foreclosure.

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

NOTE 7 OTHER POST-RETIREMENT BENEFIT PLANS

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

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

Future compensation under both plans is earned for services rendered through retirement. The Company accrues for the salary continuation liability based on anticipated years of service and vesting schedules provided under the plans. The Company s current benefit liability is determined based on vesting and the present value of the benefits at a corresponding discount rate. The discount rate used is an equivalent rate for investment-grade bonds with lives matching those of the service periods remaining for the salary continuation contracts, which average approximately 20 years. The salary continuation liability as of September 30, 2011 and December 31, 2010 was $1,444,320 and $1,300,062, respectively, and is reported in interest payable and other liabilities on the condensed consolidated balance sheet.

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

The combined cash surrender value of all Bank-owned life insurance policies recorded in other assets on the condensed consolidated balance sheet was $11,148,310 and $11,098,636 at September 30, 2011 and December 31, 2010, respectively.

NOTE 8 FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Fair values of financial instruments The financial statements include various estimated fair value information as of September 30, 2011 and December 31, 2010. Such information, which pertains to the Company s financial instruments, does not purport to represent the aggregate net fair value of the Company. Further, the fair value estimates are based on various assumptions, methodologies, and subjective considerations, which vary widely among different financial institutions and which are subject to change. The following methods and assumptions are used by the Company.

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

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

Loans receivable The fair values for variable rate loans and all other loans (e.g., real estate construction and mortgage, commercial, and installment loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The allowance for loan losses is considered to be a reasonable estimate of loan discount for credit quality concerns.

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

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

Interest payable and receivable The carrying amounts of interest payable and receivable approximate their fair value.

Commitments Loan commitments and standby letters of credit generate ongoing fees, which are recognized over the term of the commitment period. In situations where the borrower s credit quality has declined, we record a reserve for these off-balance sheet commitments. Given the uncertainty in the likelihood and timing of a commitment being drawn upon, a reasonable estimate of the fair value of these commitments is the carrying value of the related unamortized loan fees plus the reserve, which is not material.

The table below is a summary of fair value estimates for financial instruments as of September 30, 2011 and December 31, 2010. The carrying amounts in the following table are recorded in the condensed consolidated balance sheets under the indicated captions. We have excluded non-financial assets and non-financial liabilities defined by the Codification (ASC 820-10-15-1A), such as bank premises and equipment, deferred taxes and other liabilities. In addition, we have not disclosed the fair value of financial instruments specifically excluded from disclosure requirements of the Financial Instruments Topic of the Codification (ASC 825-10-50-8), such as bank owned life insurance policies.

	September 30, 2011	
	Carrying Amount	**Fair Value**
Financial assets:		
Cash and cash equivalents	$ 80,828,079	$ 80,828,079
Securities available for sale	86,799,674	86,799,674
Loans, net	381,817,959	389,156,866
Interest receivable	1,679,734	1,679,734
Financial liabilities:		
Deposits	(505,505,125)	(506,133,929)
FHLB advance	(6,000,000)	(6,012,682)
Interest payable	(135,658)	(135,658)

	December 31, 2010	
	Carrying Amount	**Fair Value**
Financial assets:		
Cash and cash equivalents	$ 68,936,916	$ 68,936,916

Securities available for sale	53,267,982	53,267,982
Loans, net	395,206,208	400,399,726
Interest receivable	1,641,862	1,641,862
Financial liabilities:		
Deposits	(476,738,850)	(477,261,566)
FHLB advance	(8,000,000)	(8,028,835)
Interest payable	(167,277)	(167,277)

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

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

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

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

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstance that caused the transfer, which generally corresponds with the Company s quarterly valuation process.

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

		Fair Value Measurements at September 30, 2011		
	September 30, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities:				
U.S. agencies	$ 53,896,581	$ 0	$ 53,896,581	$ 0
Collateralized mortgage obligations	12,369,303	0	12,369,303	0
Municipalities	14,575,004	0	14,575,004	0
SBA Pools	1,243,716	0	1,243,716	0
Corporate Debt	1,967,801	0	1,967,801	0
Mutual Fund	2,747,269	2,747,269	0	0
Assets and liabilities measured on a non-recurring basis:				
Impaired loans	$ 4,991,192	$ 0	$ 0	$ 4,991,192
Other real estate owned	$ 244,375	$ 0	$ 0	$ 244,375

		Fair Value Measurements at December 31, 2010		
	December 31, 2010	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs (Level 3)

		(Level 1)	(Level 2)	
Assets and liabilities measured on a recurring basis:				
Available-for-sale securities				
U.S. agencies	$ 30,190,388	$ 0	$ 30,190,388	$ 0
Collateralized mortgage obligations	8,136,780	0	8,136,780	0
Municipalities	10,799,499	0	10,799,499	0
SBA Pools	1,506,096	0	1,506,096	0
Mutual Fund	2,635,219	2,635,219	0	0
Assets and liabilities measured on a non-recurring basis:				
Impaired loans	$ 3,947,203	$ 0	$ 0	$ 3,947,203
Other real estate owned	$ 778,174	$ 0	$ 0	$ 778,174

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Losses recognized from non-recurring fair value adjustments for the three and nine month periods ended September 30, 2011 and 2010 are presented on the following table:

	THREE MONTHS ENDED SEPTEMBER 30, 2011	THREE MONTHS ENDED SEPTEMBER 30, 2010	NINE MONTHS ENDED SEPTEMBER 30, 2011	NINE MONTHS ENDED SEPTEMBER 30, 2010
Impaired loans	$ 0	$ 809,233	$ 444,860	$ 1,890,991
Other real estate owned	0	32,312	72,339	127,474
Total loss from non-recurring fair value adjustments	$ 0	$ 841,545	$ 517,199	$ 2,018,465

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. Changes in fair market value are recorded in other comprehensive income net of tax.

The fair value measurement applies to impaired loans, which includes impaired loans measured at an observable market price (if available), or at the fair value of the loan s collateral (if the loan is collateral dependent). Fair value of the loan s collateral, when the loan is dependent on collateral, is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the collateral. At September 30, 2011, impaired loans that were charged down to the fair value of the collateral or that had a specific loan loss reserve had a principal balance of $6,045,985 with a valuation allowance of $1,054,793. Upon being classified as impaired, either a charge off or a specific reserve or both may be taken to reduce the balance of each loan to an estimate of the collateral fair market value less cost to dispose. This estimate was a level 3 valuation.

Fair value of other real estate owned is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the property. Total fair market value at September 30, 2011 was $244,375 which was a level 3 valuation. Any market value write downs are charged directly to operating expenses. The Company is required by internal bank policies to order real estate appraisals on OREO properties every six months. In addition, management evaluates the book values on a quarterly basis for reasonableness and makes fair value adjustments as necessary.

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NOTE 9 EARNINGS PER SHARE

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

In thousands (except share and per share amounts)	THREE MONTHS ENDED SEPTEMBER 30, 2011		2010	
BASIC EARNINGS PER SHARE				
Net income available to common shareholders	$	1,177,461	$	930,511
Weighted average shares outstanding		7,705,164		7,692,900
Net income per common share	$	0.15	$	0.12
DILUTED EARNINGS PER SHARE				
Net income available to common shareholders	$	1,177,461	$	930,511
Weighted average shares outstanding		7,705,164		7,692,900
Effect of dilutive stock options		15,636		36,275
Effect of dilutive non-vested restricted shares		10,663		0
Effect of dilutive warrants		0		0
Weighted average shares of common stock and common stock equivalents		7,731,463		7,729,175
Net income per diluted common share	$	0.15	$	0.12

In thousands (except share and per share amounts)	NINE MONTHS ENDED SEPTEMBER 30, 2011		2010	
BASIC EARNINGS PER SHARE				
Net income available to common shareholders	$	3,371,375	$	2,496,112
Weighted average shares outstanding		7,710,097		7,685,592
Net income per common share	$	0.44	$	0.32
DILUTED EARNINGS PER SHARE				
Net income available to common shareholders	$	3,371,375	$	2,496,112
Weighted average shares outstanding		7,710,097		7,685,592
Effect of dilutive stock options		12,301		34,024
Effect of dilutive non-vested restricted shares		9,252		0
Effect of dilutive warrants		7,939		0
Weighted average shares of common stock and common stock equivalents		7,739,589		7,719,616
Net income per diluted common share	$	0.44	$	0.32

During the three and nine month periods ended September 30, 2011, anti-dilutive weighted average options to purchase 221,741 and 219,625 shares of common stock, respectively, were outstanding with prices ranging from $5.74 to $15.67. Anti-dilutive weighted average stock options of 223,386 and 234,517 were outstanding during the same three and nine month periods of 2010, respectively, with prices ranging from $5.20 to $15.67. These options were not included in the computation of diluted EPS because the options exercise price was greater than the average market price of the common shares. These options begin to expire in 2013. Weighted average warrants of 350,346 issued to the U.S. Treasury

Capital Purchase Program were anti-dilutive for the three month period ended September 30, 2011, as the exercise price of $5.78 was more than the average market price of common shares. These warrants were dilutive for the nine month period ended September 30, 2011, as well as the three and nine month periods ended September 30, 2011, as the exercise price was more than the average market price of common shares.

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

The following discussion explains the significant factors affecting our operations and financial position for the periods presented. The discussion should be read in conjunction with our financial statements and the notes related thereto which appear or that are referenced to elsewhere in this report, and with the audited consolidated financial statements and accompanying notes included in our 2010 Annual Report on Form 10-K, as amended. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

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

Forward-Looking Statements

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

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

Critical Accounting Estimates

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

Asset Impairment Judgments

Certain of our assets are carried in our statements of financial condition at fair value or at the lower of cost or fair value. Valuation allowances are established when necessary to recognize impairment of such assets. We periodically perform analyses to test for impairment of various assets. In addition to our impairment analyses related to loans, another significant impairment analysis relates to other than temporary declines in the value of our securities.

Our available for sale portfolio is carried at estimated fair value, with any unrealized gains and losses, net of taxes, reported as accumulated other comprehensive income in shareholders equity. We conduct a periodic review and evaluation of the securities portfolio to determine if the value of any security has declined below its carrying value and whether such decline is other than temporary. If such decline is deemed other than temporary, we would adjust the carrying amount of the security by writing down the security to fair market value through a charge to current period income. The market values of our securities are significantly affected by changes in interest rates.

In general, as interest rates rise, the market value of fixed-rate securities will decrease; as interest rates fall, the market value of fixed-rate securities will increase. With significant changes in interest rates, we evaluate our intent and ability to hold the security for a sufficient time to recover the recorded principal balance. Estimated fair values for securities are based on published or securities dealers market values. Market volatility is unpredictable and may impact such values.

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Allowance for Loan Losses

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

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

• the specific review of individual loans,

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

• our judgmental estimate based on various subjective factors.

The first phase of our methodology involves the specific review of individual loans to identify and measure impairment. We evaluate each loan by use of a risk rating system, except for homogeneous loans, such as automobile loans and home mortgages. Specific risk rated loans are deemed impaired if all amounts, including principal and interest, will likely not be collected in accordance with the contractual terms of the related loan agreement. Impairment for commercial and real estate loans is measured either based on the present value of the loan s expected future cash flows or, if collection on the loan is collateral dependent, the estimated fair value of the collateral, less selling and holding costs.

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

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

• concentration of credits,

• nature and volume of the loan portfolio,

• delinquency trends,

• non-accrual loan trend,

• problem loan trend,

• loss and recovery trend,

• quality of loan review,

• lending and management staff,

• lending policies and procedures,

• economic and business conditions, and

• other external factors including regulatory review.

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

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

Non-Accrual Loan Policy

Interest on loans is credited to income as earned and is accrued only if deemed collectible. Accrual of interest is discontinued when a loan is over 90 days delinquent or if management believes that collection is highly uncertain. Generally, payments received on nonaccrual loans are recorded as principal reductions. Interest income is recognized after all principal has been repaid or an improvement in the condition of the loan has occurred that would warrant resumption of interest accruals. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due.

Stock-Based Compensation

The Company recognizes in the statement of income the grant-date fair value of stock options and other equity-based forms of compensation issued to employees over the employees requisite service period (generally the vesting period). The Company uses the straight-line recognition of expenses for awards with graded vesting. The Company utilizes a binomial pricing model for all grants. Expected volatility is based on the historical volatility of the price of the Company s stock for the period equal to the contractual stock option term. The Company uses historical data to estimate option exercise and stock option forfeiture rates within the valuation model. The expected term of options granted for the binomial model is derived from applying a historical suboptimal exercise factor to the contractual term of the grant. For binomial pricing, the risk-free rate for periods is equal to the U.S. Treasury yield at the time of grant and commensurate with the contractual term of the grant.

Other Real Estate Owned

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

Introduction

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

The Company offers a complement of business checking and savings accounts for its business customers. The Company also offers commercial and real estate loans, as well as lines of credit. Real estate loans are generally of a short-term nature for both residential and commercial purposes. Longer-term real estate loans are generally made with adjustable interest rates and contain normal provisions for acceleration. In addition, the Company offers traditional residential mortgages through a third party.

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

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

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Overview of Results of Operations and Financial Condition

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

Management believes the following were important factors in the Company s performance during the three and nine month periods ended September 30, 2011:

- Thanks to our deep roots in the communities that we serve, our focus on customer care and our selectivity in lending, during the first nine months of 2011, our performance has been better than most institutions of our size that compete in our market. Despite the stagnant economy affecting our primary market areas, we have been able to increase our core deposits to $467.3 million and have posted net income available to common shareholders of $0.15 and $0.44 per diluted share for the three and nine month periods ended September 30, 2011, respectively. While recently published economic data indicate that the current downturn may be easing, it is not clear when or at what speed the recession will end. To the extent that the recession continues, it will affect the market areas that we serve and our results accordingly.

- The Company recognized net income available to common shareholders of $1,177,000 and $3,371,000 for the three and nine month periods ended September 30, 2011, respectively, as compared to $931,000 and $2,496,000 for the same periods in 2010. The Company recognized net income before preferred stock dividends and accretion of $1,749,000 and $4,364,000 for the third quarter and nine month period ended September 30, 2011, respectively. The factors contributing to these results will be discussed below.

- The Company recognized $571,000 and $992,000, respectively, in the third quarter and nine month period ended September 30, 2011 associated with the accrual for preferred stock dividends and accretion of the preferred stock discount in connection with the 13,500 shares of Series A Preferred Stock that the U.S. Treasury purchased from the Company in December 2008 under the TARP Program. The Company converted out of the TARP program and into the Small Business Lending Funding (SBLF) program in August 2011, which resulted in preferred stock discount accretion of $389,000, the full remaining balance of the discount. So long as such preferred stock remains outstanding under SBLF, it will pay quarterly cumulative dividends at a variable rate between 1% and 5% per year for the first 2.5 years depending on growth of our small business loan portfolio. If there is no loan growth after 2.5 years, the dividend rate could increase to 7% and if the preferred stock remains outstanding after 4.5 years, the rate increases to 9%, regardless of loan growth.

- The Company has taken significant steps to reduce the risk of loan losses. In the three and nine month periods ended September 30, 2011, the provision for loan loss was $300,000 and $1,200,000, respectively, which was a decrease of $705,000 and $1,815,000 compared to the same periods in 2010. The decrease was mainly due to management s assessment of the appropriate level for the allowance for loan losses and a decrease in the level of non-accrual loans. The Company continues to monitor its loan portfolio with the objective of avoiding defaults or write-downs. Despite these actions, the possibility of additional losses cannot be eliminated, but the Board of Directors and all employees continue to work hard to make the best of these continuing challenging conditions.

- Net interest income decreased $19,000 or 0.3% for the three month period ended September 30, 2011 and increased $181,000 or 1.0% for the nine month period ended September 30, 2011, compared to the same periods in 2010. The decrease for the quarter was primarily due to a decrease in average loan balances of $19.7 million, and the year-to-date increase was primarily due to the increase in average earning assets of $43.4 million for the nine month period ended September 30, 2011, as compared to the same periods of 2010.

- Non-interest income increased by $87,000 or 12.9% and $60,000 or 2.9% for the third quarter and nine month periods ended September 30, 2011, respectively, as compared to the same periods in 2010. The increase was primarily due to gains in service charges on deposits as described below.

- Non-interest expense increased by $20,000 or 0.5% and $185,000 or 1.4% for the three and nine month periods ended September 30, 2011, respectively, as compared to the same periods in 2010. The primary reason for the increase was an increase in salaries and benefits and occupancy associated with new branch openings, which was offset in part by the reduction in the write downs of OREO property values as described below.

- Total assets increased $31.6 million or 5.7% from December 31, 2010. Total net loans decreased by $13.4 million or 3.4% and investment securities increased by $33.5 million or 62.9% from December 31, 2010 to September 30, 2011, while deposits increased by $28.8 million or 6.2% for the same period.

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Income Summary

For the three and nine month periods ended September 30, 2011, the Company recorded net income available to common shareholders of $1,177,000 and $3,371,000, respectively, representing increases of $246,000 and $875,000 as compared to the same periods in 2010. Return on average assets (annualized) was 1.21% and 1.03% for the third quarter and nine month periods ended September 30, respectively, as compared with 0.86% and 0.81% for the same periods in 2010. Annualized return on average common equity was 8.44% and 8.43% for the third quarter and nine month period ended September 30, 2011, respectively, as compared to 7.38% and 6.83% for the same periods of 2010.

Net income before provisions for income taxes and preferred stock dividends and accretion was up $753,000 and $1,871,000 for the third quarter and nine month periods ended September 30, 2011 from the comparable 2010 periods. The income statement components of these variances are as follows:

Pre-Tax Income Variance Summary:

(In thousands)	Effect on Pre-Tax Income Increase (Decrease) Three Months Ended September 30, 2011	Effect on Pre-Tax Income Increase (Decrease) Nine Months Ended September 30, 2011
Change from 2010 to 2011 in:		
Net interest income	$ (19)	$ 181
Provision for loan losses	705	1,815
Non-interest income	87	60
Non-interest expense	(20)	(185)
Change in income before income taxes	$ 753	$ 1,871

These variances will be explained in the discussion below.

Net Interest Income

Net interest income is the largest source of the Company s operating income. For the three and nine month periods ended September 30, 2011, net interest income was $6.34 million and $18.85 million, respectively, which represented a decrease of $20,000 or 0.3% for the third quarter and an increase of $181,000 or 1.0% for the nine month period ended September 30, 2011, from the comparable periods in 2010.

The net interest margin (net interest income as a percentage of average interest earning assets) was 4.85% and 4.88% for the three and nine month periods ended September 30, 2011, respectively, a decrease of 38 and 39 basis points, as compared to the same periods in 2010. The decrease in the net interest margin in the first nine months of 2011 was primarily attributable to the increased average cash and cash equivalent balances of $39.2 million which are earning 0.24% and thus driving down the overall yield on earning assets.

The current low market interest rate environment has had a positive impact on net interest income in previous years because the Company s balance sheet is liability sensitive which typically results in our average cost of funds decreasing faster than the average yield on interest earning assets in a declining rate environment. In 2011, we have not recognized this benefit to the same degree, as deposit interest rates are at historic lows and have essentially reached a threshold in which they cannot reasonably be further reduced. However, the total cost of funds did decrease 30 and 40 basis points in the third quarter and nine month period ended September 30, 2011, respectively, compared to 2010 due to a shift from high cost CDs and FHLB borrowed funds into demand deposit and money market accounts. In addition, average non-interest-bearing demand deposit balances increased by $25.1 million for the nine month period ended September 30, 2011, as compared to the same period of 2010. Compared to cost of funds, the decrease in earning asset yield was more significant at 62 and 72 basis points for the three and nine month periods ended September 30, 2011, respectively, compared to the same periods of 2010. The investment securities portfolio recognized the most significant decrease of 78 basis points for the 2011 year-to-date period as compared to 2010, mainly because of the Company deploying cash into investment security purchases, which have historically low yields. The yield on loans has remained more stable, with a reduction of 20 basis points for the 2011 year-to-date period as compared to 2010, partly as a result of the significant portion of our loans that are at their contractual rate floors.

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The following tables shows the relative impact of changes in average balances of interest earning assets and interest bearing liabilities, and interest rates earned and paid by the Company on those assets and liabilities for the three and nine month periods ended September 30, 2011 and 2010:

Net Interest Analysis

	Three Months Ended September 30, 2011			Three Months Ended September 30, 2010		
(Dollars in thousands)	**Average Balance**	**Interest Income / Expense**	**Avg Rate/ Yield**	**Average Balance**	**Interest Income / Expense**	**Avg Rate/ Yield**
Assets:						
Earning assets:						
Gross loans (1) (2)	$ 390,329	$ 5,889	5.99%	$ 409,992	$ 6,408	6.20%
Investment securities (2)	81,806	886	4.30%	49,626	652	5.21%
Federal funds sold	6,978	4	0.23%	5,792	3	0.21%
Interest-earning deposits	45,655	28	0.24%	21,452	13	0.24%
Total interest-earning assets	524,768	6,807	5.15%	486,862	7,076	5.77%
Total noninterest earning assets	50,172			38,028		
Total Assets	574,940			524,890		
Liabilities and Shareholders Equity:						
Interest-bearing liabilities:						
Money market deposits	247,621	181	0.29%	207,921	311	0.59%
NOW deposits	66,296	32	0.19%	60,583	48	0.31%
Savings deposits	17,739	14	0.31%	14,880	15	0.40%
Time certificates of deposit $100,000 or more	39,202	96	0.97%	40,528	98	0.96%
Other time deposits	22,611	53	0.93%	35,637	98	1.09%
Other borrowings	6,019	15	0.99%	18,500	85	1.82%
Total interest-bearing liabilities	399,488	391	0.39%	378,049	655	0.69%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	103,958			80,196		
Other liabilities	2,656			3,101		
Total noninterest-bearing liabilities	106,614			83,297		
Shareholders equity	68,838			63,544		
Total liabilities and shareholders equity	$ 574,940			$ 524,890		
Net interest income		$ 6,416			$ 6,421	
Net interest spread (3)			4.76%			5.08%
Net interest margin (4)			4.85%			5.23%

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

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

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

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

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(Dollars in thousands)	Nine months ended September 30, 2011 Average Balance	Interest Income / Expense	Avg Rate/ Yield	Nine months ended September 30, 2010 Average Balance	Interest Income / Expense	Avg Rate/ Yield
Assets:						
Earning assets:						
Gross loans (1) (2)	$ 394,011	$ 17,758	6.03%	$ 413,504	$ 19,262	6.23%
Investment securities (2)	72,354	2,486	4.59%	48,696	1,956	5.37%
Federal funds sold	17,729	31	0.23%	4,248	7	0.22%
Interest-earning deposits	38,321	69	0.24%	12,608	21	0.22%
Total interest-earning assets	522,415	20,344	5.21%	479,056	21,246	5.93%
Total noninterest earning assets	42,968			38,613		
Total Assets	565,383			517,669		
Liabilities and Shareholders Equity:						
Interest-bearing liabilities:						
Money market deposits	241,497	594	0.33%	208,576	1,133	0.73%
NOW deposits	65,520	100	0.20%	59,301	145	0.33%
Savings deposits	18,487	52	0.38%	14,629	47	0.43%
Time certificates of deposit $100,000 or more	41,058	305	0.99%	39,778	401	1.35%
Other time deposits	23,952	172	0.96%	36,519	372	1.36%
Other borrowings	7,025	56	1.07%	20,719	269	1.74%
Total interest-bearing liabilities	397,539	1,279	0.43%	379,522	2,367	0.83%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	98,015			72,947		
Other liabilities	2,863			2,811		
Total noninterest-bearing liabilities	100,878			75,758		
Shareholders equity	66,966			62,389		
Total liabilities and shareholders equity	$ 565,383			$ 517,669		
Net interest income		$ 19,065			$ 18,879	
Net interest spread (3)			4.78%			5.10%
Net interest margin (4)			4.88%			5.27%

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

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

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

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

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Shown in the following tables are the relative impacts on net interest income of changes in the average outstanding balances (volume) of earning assets and interest bearing liabilities and the rates earned and paid by the Company on those assets and liabilities for the three and nine month periods ended September 30, 2011 and 2010. Changes in interest income and expense that are not attributable specifically to either rate or volume are allocated to the rate column below.

Rate / Volume Variance Analysis

(In thousands)

	For the Three Months Ended September 30, 2011 vs 2010 Increase (Decrease) in interest income and expense due to changes in:		
	Volume	**Rate**	**Total**
Interest income:			
Gross loans (1)	$ (308)	$ (211)	$ (519)
Investment securities	423	(189)	234
Federal funds sold	0	1	1
Interest-earning deposits	15	0	15
Total interest income	$ **130**	$ **(399)**	$ **(269)**
Interest expense:			
Money market deposits	59	(189)	(130)
NOW deposits	4	(20)	(16)
Savings deposits	3	(4)	(1)
Time CD $100K or more	(3)	1	(2)
Other time deposits	(36)	(9)	(45)
Other borrowings	(56)	(14)	(70)
Total interest expense	$ **(29)**	$ **(235)**	$ **(264)**
Change in net interest income	$ **159**	$ **(164)**	$ **(5)**

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

The table above reflects the current low interest rate environment has impacted assets slightly more than liabilities as indicated by the decrease of $164,000 in net interest income due to the rate change for the third quarter of 2011. This is not typical for the Company, as we have historically been liability sensitive in recent years. However, purchases of investment securities in the past 12 months at market interest rates lower than our overall portfolio reflects a decrease of $189,000 due to the lower yield of the new securities. The decreased loan volume was offset by the increase in investment securities and combined with the overall change in mix of balances resulted in an increase of $159,000 to net interest income over the same period.

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	For the Nine Months Ended September 30 2011 vs 2010 Increase (Decrease) in interest income and expense due to changes in:		
	Volume	Rate	Total
Interest income:			
Gross loans (1)	$ (908)	$ (596)	$ (1,504)
Investment securities	950	(420)	530
Federal funds sold	22	2	24
Interest-earning deposits	43	5	48
Total interest income	$ **107**	$ **(1,009)**	$ **(902)**
Interest expense:			
Money market deposits	179	(718)	(539)
NOW deposits	15	(60)	(45)
Savings deposits	12	(7)	5
Time CD $100K or more	13	(109)	(96)
Other time deposits	(128)	(72)	(200)
Other borrowings	(178)	(35)	(213)
Total interest expense	$ **(87)**	$ **(1,001)**	$ **(1,088)**
Change in net interest income	$ **194**	$ **(8)**	$ **186**

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

The table above reflects the current low interest rate environment has impacted assets more than liabilities as indicated by the decrease of $8,000 in net interest income due to the rate change for the nine month period ended September 30, 2011. The decreased loan volume was offset by the increase in investment securities and combined with the overall change in mix of balances resulted in an increase of $194,000 to net interest income over the same period.

Non-Interest Income

Non-interest income represents service charges on deposit accounts and other non-interest related charges and fees, including fees from mortgage commissions and investment service fee income. For the three and nine month periods ended September 30, 2011, non-interest income was $763,000 and $2,115,000, respectively, an increase of $87,000 or 12.9% and $60,000 or 2.9%, compared to the same periods in 2010.

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

	For the Three Months Ended September 30,			
	2011	2010	$ change	% change
Service charges on deposits	$ 306,081	$ 272,136	$ 33,945	12.5%
Earnings on cash surrender value of life insurance	109,710	103,986	5,724	5.5%
Mortgage commissions	37,080	30,849	6,231	20.2%
Other income	310,499	269,078	41,421	15.4%
Total non-interest income	$ 763,370	$ 676,049	$ 87,321	12.9%

	For the Nine Months Ended September 30,			
	2011	2010	$ change	% change
Service charges on deposits	$ 846,217	$ 787,142	$ 59,075	7.5%
Earnings on cash surrender value of life insurance	324,668	308,671	15,997	5.2%
Mortgage commissions	63,900	74,984	(11,084)	(14.8)%
Other income	879,771	884,047	(4,276)	(0.5)%
Total non-interest income	$ 2,114,556	$ 2,054,844	$ 59,712	2.9%

The increase to total non-interest income for the third quarter and nine month period ending September 30, 2011 is due primarily to a increase in service charges on deposits of $34,000 and $59,000 for the three and nine month periods ended September 30, 2011, respectively, as compared to the same periods of 2010. In addition, investment service fee income recognized a significant increase of $29,000 in the third quarter of 2011 as compared to the third quarter of 2010. Investment service fee income is included in the other income line item in the above table. Mortgage commissions increased by $6,000 for the third quarter 2011, but still reflected a decrease of $11,000 for the year-to-date period of 2011, as compared to the same periods of 2010.

Non-Interest Expense

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

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

	For the Three Months Ended September 30,			
	2011	2010	$ change	% change
Salaries and employee benefits	$ 2,356,589	$ 2,143,094	$ 213,495	10.0%
Occupancy	731,512	690,209	41,303	6.0%
Data processing fees	253,438	233,694	19,744	8.4%
OREO expenses	8,497	35,051	(26,554)	(75.8)%
Regulatory assessments (FDIC & DFI)	135,000	258,000	(123,000)	(47.7)%
Other	723,095	828,155	(105,060)	(12.7)%

Total non-interest income	$	4,208,131	$	4,188,203	$	19,928	0.5%

	For the Nine Months Ended September 30,						
		2011		2010		$ change	% change
Salaries and employee benefits	$	7,069,980	$	6,483,605	$	586,375	9.0%
Occupancy		2,063,759		2,031,127		32,632	1.6%
Data processing fees		751,965		706,889		45,076	6.4%
OREO expenses		358,776		598,894		(240,118)	(40.1)%
Regulatory assessments (FDIC & DFI)		531,000		774,000		(243,000)	(31.4)%
Other		2,359,473		2,355,381		4,092	0.2%
Total non-interest income	$	13,134,953	$	12,949,896	$	185,057	1.4%

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Non-interest expenses increased by $20,000 or 0.5% and $185,000 or 1.4% for the three and nine months ended September 30, 2011, respectively, as compared to the same periods of 2010. Salaries and employee benefits increased $213,000 and $586,000 for the three and nine months ended September 30, 2011, respectively, as compared to the same periods of 2010, primarily as a result of hiring new employees for new branch openings and additional bonus accruals corresponding to the Company s performance metrics. The new branch openings also resulted in an increase in occupancy expenses of $41,000 and $33,000, respectively, for the third quarter and nine month period ended September 30, 2011, as compared to the prior year. Data processing fees increased by $20,000 and $45,000 for the three and nine month periods ended September 30, 2011, respectively, as a result of an increased number of transaction accounts.

Other operating expenses decreased by $105,000 for the three months ended September 30, 2011, but reflected a slight increase of $4,000 on a year-to-date basis, as compared to the same periods of 2010. The decrease for the third quarter was primarily a result of less impaired loan expenses and cost savings on a new telephone line system. The impaired loan expenses were incurred as a result of an agreement with a borrower to fund overhead costs on an impaired residential development loan.

OREO expenses were $8,000 and $359,000 in the third quarter and nine month period ended September 30, 2011, respectively, compared to $35,000 and $598,000 for the comparable periods of 2010. Included within these totals are OREO write downs, of which there were none for the three month period ended September 30, 2011 and $291,000 for the nine month period ended September 30, 2011, as compared to $23,000 and $413,000 for the same periods of 2010. The remaining expense included in OREO expenses is attributed to general overhead such as property taxes and utilities associated with the properties classified as other real estate owned. There have been multiple sales of the OREO properties which has reduced our OREO inventory from four properties as of September 30, 2010 to two properties as of September 30, 2011. There have been no sales of OREO property in the third quarter of 2011 and one sale of an OREO property recorded year-to-date in 2011.

FDIC and DFI (California Department of Financial Institutions) regulatory assessments were $135,000 and $531,000 for the three and nine months ended September 30, 2011, respectively, a decrease of $123,000 and $243,000 as compared to the comparable periods of 2010. The initial base assessment rate for financial institutions varies based on the overall risk profile of the institution as defined by the FDIC. The decrease in the third quarter and first nine months of 2011is due to a lower base assessment rate as the Company has improved its overall risk ratings. The decrease in expense was in spite of a higher deposit base in 2011 as compared to 2010, as the FDIC assessment rates are applied to average quarterly deposits.

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

Income Taxes

We reported a provision for income taxes of $846,000, and $2,261,000 for the three and nine month periods ended September 30, 2011, respectively, an increase of $145,000 and $635,000 as compared to the provision of $701,000 and $1,626,000 reported in the comparable periods of 2010. The effective income tax rate on income from continuing operations was 32.6% and 34.1% for the third quarter and nine month period ended September 30, 2011, respectively, compared to 38.0% and 34.2% for the comparable periods of 2010. These provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income, and adjusted for the effects of all permanent differences between income for tax and financial reporting purposes (such as earnings on qualified municipal securities, BOLI and certain tax-exempt loans). The disparity between the effective tax rates in 2011 as compared to 2010 for the quarter is primarily due to tax credits from California Enterprise Zones and low income housing projects as well as tax free-income on loans within these enterprise zones and municipal securities and loans that comprise a larger proportion of pre-tax income in 2010 as compared to 2011.

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Asset Quality

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

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

Non-accrual loans totaled $8.5 million at September 30, 2011, as compared to $11.5 million at December 31, 2010. The non-accrual loans as of September 30, 2011 are loans made to seven borrowers primarily for purposes of real estate construction and commercial real estate. As of September 30, 2011, we had seven loans considered troubled debt restructurings totaling $4.9 million, six of which are included in nonaccrual loans and the other was placed back on accrual status in the first quarter of 2011.

OREO totaled $244,000 as of September 30, 2011 and consists of two properties that were acquired through foreclosure including residential land lots and a commercial real estate property.

The following table presents information about the Company s non-performing loans, including asset quality ratios as of September 30, 2011 and December 31, 2010:

Non-Performing Assets

(in thousands)		**September 30, 2011**		**December 31, 2010**
Loans in non-accrual status	$	8,504	$	11,475
Loans past due 90 days or more and accruing		0		0
Total non-performing loans		8,504		11,475
Other real estate owned		244		778
Total non-performing assets	$	8,748	$	12,253
Allowance for loan losses	$	8,857	$	8,255
Asset quality ratios:				
Non-performing assets to total assets		1.50%		2.22%
Non-performing loans to total loans		2.17%		2.84%
Allowance for loan losses to total loans		2.26%		2.04%

Allowance for loan losses to total non-performing loans	104.15%	71.94%

Non-performing assets decreased by $3.5 million as of September 30, 2011 as compared to December 31, 2010, primarily as a result of the $3.0 million reduction in non-accrual loans. The reduction of our non-accrual loans during the nine month period ended September 30, 2011 is due to principal payments of $1.9 million, charge-offs of $600,000 and a reclassification of one loan of $604,000 that was placed back on accrual status. Additionally, OREO balances decreased by $534,000 during the nine month period ended September 30, 2011.

Allowance for Loan and Lease Losses (ALLL)

In anticipation of credit risk inherent in our lending business, we routinely set aside allowances through charges to earnings. Such charges are not only made for the outstanding loan portfolio, but also for off-balance sheet items, such as commitments to extend credits or letters of credit. Charges made for the outstanding loan portfolio have been credited to the allowance for loan losses, whereas charges for off-balance sheet items have been credited to the reserve for off-balance sheet items, which is presented as a component of other liabilities. The Company recorded loan loss provisions of $300,000 and $1,200,000 for the three and nine month periods in 2011, respectively, which represented a $705,000 and $1,815,000 decrease, as compared to the provisions recorded in the same periods of 2010.

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The allowance for loan losses increased by $602,000 or 7.3%, to $8.9 million at September 30, 2011, as compared with $8.3 million at December 31, 2010. The Company recognized the increase in the allowance for loan losses during the first nine months of the year due to the loan loss provision of $1,200,000 which was partially offset by net loan charge-offs of $598,000. The weak business climate has continued to adversely impact the financial conditions of certain Bank clients in addition to decrease collateral values. The increase to the allowance for loan losses combined with the decrease in our loan portfolio resulted in an increase in the allowance for loan losses as a percentage of total loans to 2.26% at September 30, 2011, as compared to 2.04% at December 31, 2010.

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

The Company makes provisions for loan losses when required to bring the total allowance for loan and lease losses to a level deemed appropriate for the level of risk in the loan portfolio. At least quarterly, management conducts an assessment of the overall quality of the loan portfolio and general economic trends in the local market. The determination of the appropriate level for the allowance is based on that review, considering such factors as historical experience, the volume and type of lending conducted, the amount of and identified potential loss associated with specific nonperforming loans, regulatory policies, general economic conditions, and other factors related to the collectibility of loans in the portfolio.

Although management believes the allowance at September 30, 2011 was adequate to absorb probable losses from any known and inherent risks in the portfolio, no assurance can be given that the adverse effect of current and future economic conditions on our service areas, or other variables, will not result in increased losses in the loan portfolio in the future.

Investment Activities

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

Cash Equivalents and Interest-bearing Deposits in other Financial Institutions

The Company holds federal funds sold, unpledged available-for-sale securities and salable government guaranteed loans to help meet liquidity requirements and provide temporary holdings until the funds can be otherwise deployed or invested. As of September 30, 2011, and December 31, 2010, we had $80.8 million and $68.9 million, respectively, in cash and cash equivalents.

Investment Securities

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

Management has evaluated the investment securities portfolio to determine if the impairment of any security in an unrealized loss position is temporary or other than temporary. We conduct a periodic review and evaluation of the securities portfolio to determine if the value of any security has declined below its carrying value. If such decline is deemed other than temporary, we would adjust the carrying amount of the security by writing down the security to fair value through a charge to current period income or a charge to accumulated other comprehensive income depending on the nature of the impairment and managements intent or requirement to sell the security. Management has determined that no investment security is other than temporarily impaired. The unrealized losses are due solely to interest rate changes.

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Deposits

Total deposits at September 30, 2011 were $505.5 million, a $28.8 million or 6.0% increase from the deposit total of $476.7 million at December 31, 2010. Average deposits increased $56.8 million to $488.5 million for the nine month period ended September 30, 2011 as compared to the same period in 2010. We attracted deposits due to the safety and soundness of the Company and our focus on customer service.

(in thousands)	September 30, 2011	December 31, 2010	Nine months change $	Nine months change %
Demand	$ 106,804	$ 102,422	$ 4,382	4.3%
NOW	65,430	60,992	4,438	7.3%
MMDA	253,533	221,814	31,719	14.3%
Savings	17,835	18,306	(471)	(2.6)%
Time < $100K	23,854	28,054	(4,200)	(15.0)%
Time > $100K	38,049	45,151	(7,102)	(15.7)%
	$ 505,505	**$ 476,739**	**$ 28,766**	**6.0%**

Because our client base is comprised primarily of commercial and industrial accounts, individual account balances are generally higher than those of consumer-oriented banks. Six of our clients carry deposit balances of more than 1% of our total deposits, one of which had a deposit balance of more than 3% of total deposits at September 30, 2011.

Since our deposit growth strategy emphasizes core deposit growth we have avoided relying on brokered deposits as a consistent source of funds. The only brokered deposits the Company holds are from CDARS, a certificate of deposit program that exchanges funds with other network banks to offer full FDIC insurance coverage to the customer. The Company had $1.4 million in brokered deposits as of September 30, 2011 as compared to $3.8 million at December 31, 2010.

Borrowings

Although deposits are the primary source of funds for our lending and investment activities and for general business purposes, we may obtain advances from the Federal Home Loan Bank of San Francisco (FHLB) as an alternative to retail deposit funds. Our outstanding FHLB advances decreased by $2.0 million at September 30, 2011 to $6.0 million, as compared to $8.0 million at December 31, 2010 due to elevated liquidity levels from increased deposits and loan payments that allowed us to pay the advances off. The outstanding FHLB advances as of September 30, 2011 are term advances that begin to mature in the fourth quarter of 2011 and will be fully matured in the first quarter of 2012. The outstanding advances have a weighted average interest rate of 1.01% and are all considered short-term as they have remaining maturities of less than one year as of September 30, 2011. See Liquidity Management below for the details on the FHLB borrowings program.

Capital Ratios

We are regulated by the Board of Governors of the Federal Reserve Board (FRB) and are subject to the securities registration and public reporting regulations of the Securities and Exchange Commission. Our banking subsidiary is regulated by the Federal Deposit Insurance Corporation (FDIC) and the California Department of Financial Institutions (DFI). We are not aware of any recommendations of regulatory authorities or otherwise which, if they were to be implemented, would have a material effect on our liquidity, capital resources, or operations.

We must comply with regulatory capital requirements established by the FRB and FDIC. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. These capital standards require us to maintain minimum ratios of Tier 1 capital to total risk-weighted assets and total capital to risk-weighted assets of 4.00% and 8.00%, respectively. Tier 1 capital is comprised of total shareholders equity calculated in accordance with generally accepted accounting principles, excluding accumulated other comprehensive income (loss), less intangible assets, and total capital is comprised of Tier 1 capital plus certain adjustments, the largest of which is our allowance for loan losses. Risk-weighted assets refer to our on- and off-balance sheet exposures, adjusted for their related risk levels using formulas set forth in FRB and FDIC regulations.

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In addition to the risk-based capital requirements described above, we are subject to a leverage capital requirement, which calls for a minimum ratio of Tier 1 capital (as defined above) to quarterly average total assets of 3.00% to 5.00%, depending upon the institution s composite ratings as determined by its regulators. The FRB has not advised us of any requirement specifically applicable to us.

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

The following table shows our capital ratios, as calculated under regulatory guidelines, compared to the regulatory minimum capital ratios and the regulatory minimum capital ratios needed to qualify as a well-capitalized institution at September 30, 2011 and December 31, 2010:

Oak Valley Community Bank Capital Ratios

(dollars in thousands)

				Amount of Capital Required					
	Actual			To Be Well-Capitalized			To Be Adequately Capitalized		
		Amount	Ratio		Amount	Ratio		Amount	Ratio
As of September 30, 2011:									
Total Capital (to Risk-Weighted Assets)	$	72,011	16.2%	$	44,573	10%	$	35,658	8%
Tier 1 Capital (to Risk-Weighted Assets)	$	66,388	14.9%	$	26,744	6%	$	17,829	4%
Tier 1 Capital (to Average Assets)	$	66,388	11.6%	$	28,745	5%	$	22,996	4%
As of December 31, 2010:									
Total Capital (to Risk-Weighted Assets)	$	68,742	14.9%	$	46,090	10%	$	36,872	8%
Tier 1 Capital (to Risk-Weighted Assets)	$	62,946	13.7%	$	27,654	6%	$	18,436	4%
Tier 1 Capital (to Average Assets)	$	62,946	11.5%	$	27,330	5%	$	21,864	4%

Oak Valley Bancorp Capital Ratios

(dollars in thousands)

			Amount of Capital Required			
	Actual		To Be Well-Capitalized		To Be Adequately Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio

As of September 30, 2011 , 2009:								
Total Capital (to Risk-Weighted Assets)	$	72,086	16.2%	N/A	N/A	$	35,661	8%
Tier 1 Capital (to Risk-Weighted Assets)	$	66,463	14.9%	N/A	N/A	$	17,830	4%
Tier 1 Capital (to Average Assets)	$	66,463	11.6%	N/A	N/A	$	22,998	4%
As of December 31, 2010:								
Total Capital (to Risk-Weighted Assets)	$	68,910	15.0%	N/A	N/A	$	36,874	8%
Tier 1 Capital (to Risk-Weighted Assets)	$	63,114	13.7%	N/A	N/A	$	18,437	4%
Tier 1 Capital (to Average Assets)	$	63,114	11.6%	N/A	N/A	$	21,865	4%

Our bank subsidiary is also subject to capital requirements similar to those discussed above. The bank subsidiary s capital ratios do not vary materially from our capital ratios presented above. At September 30, 2011, our bank subsidiary exceeded the minimum ratios established by the FRB and FDIC.

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Liquidity Management

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

Maintenance of adequate liquidity requires that sufficient resources be available at all times to meet our cash flow requirements. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of its customers and to take advantage of investment opportunities as they arise. Liquidity management involves our ability to convert assets into cash or cash equivalents without incurring significant loss, and to raise cash or maintain funds without incurring excessive additional cost. For this purpose, we maintain a portion of our funds in cash and cash equivalents, salable government guaranteed loans and securities available for sale. We obtain funds from the repayment and maturity of loans as well as deposit inflows, investment security maturities and paydowns, Federal funds purchased, FHLB advances, and other borrowings. Our primary uses of funds are the origination of loans, the purchase of investment securities, withdrawals of deposits, maturity of certificate of deposits, repayment of borrowings and dividends to common and preferred stockholders. Our liquid assets at September 30, 2011 were $175.3 million compared to $129.0 million at December 31, 2010. Our liquidity level measured as the percentage of liquid assets to total assets was 30.0% and 23.3% at September 30, 2011 and December 31, 2010, respectively. We anticipate that cash and cash equivalents on hand and other sources of funds will provide adequate liquidity for our operating, investing and financing needs and our regulatory liquidity requirements for the foreseeable future. Management monitors our liquidity position daily, balancing loan funding/payments with changes in deposit activity and overnight investments.

As a secondary source of liquidity, we rely on advances from the FHLB to supplement our supply of lendable funds and to meet deposit withdrawal requirements. Advances from the FHLB are typically secured by a portion of our loan portfolio. The FHLB determines limitations on the amount of advances by assigning a percentage to each eligible loan category that will count towards the borrowing capacity. As of September 30, 2011, our borrowing capacity from the FHLB was approximately $132.0 million and the outstanding balance was $6.0 million, or approximately 4.5% of our borrowing capacity. We also maintain 2 lines of credit with correspondent banks to purchase up to $17.5 million in federal funds, for which there were no advances as of September 30, 2011.

Off-Balance-Sheet Arrangements

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

As of September 30, 2011 and December 31, 2010, we had commitments to extend credit of $50.4 million and $59.9 million, respectively, which includes obligations under letters of credit of $0.6 million and $1.4 million, respectively.

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

Recent Legislation and Other Regulatory Initiatives

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

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

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

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

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

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

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

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4. Controls and Procedures

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

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

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PART II - OTHER INFORMATION

Item 1. **Legal Proceedings**

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

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

On August 11, 2011, the Company issued 13,500 shares of its Series B Preferred Stock to the U.S. Treasury for the aggregate purchase price of $13,500,000 in a transaction exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. The proceeds from the offering were used in their entirety to redeem from the U.S. Treasury 13,500 shares of the Company s Series A Preferred Stock, at the aggregate redemption price of $13,500,000.

On September 28, 2011, the Company repurchased from the U.S. Treasury for the aggregate purchase price of $560,000 a warrant to purchase 350,346 shares of common stock of the Company that the Company had granted to the U.S. Treasury in December 2008 pursuant to the Company s participation in the CPP program.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)
September 1, 2011 to September 30, 2011	350,346	$ 1.60	350,346	350,346
Total	350,346(2)	$ 1.60	350,346	350,346

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(1) All references are to warrants to purchase shares of common stock of the Company that the Company had granted to the U.S. Treasury in December 2008 pursuant to the Company s participation in the CPP program.

(2) The table above does not include shares that were used by option holders to satisfy the exercise price of the call options we issued to our employees and directors pursuant to our stock option plans. There were no such exercises during the nine months ended September 30, 2011.

Except as disclosed in this Item 2, there were no other unregistered sales of our securities during the three months ended September 30, 2011.

Subject to and in accordance with the Certificate of Determination dated August 11, 2011 filed with the California Secretary of State for Senior Non-Cumulative Perpetual Preferred Stock, Series B, so long as any share of Series B Preferred Stock remains outstanding, the Company may declare and pay dividends on the common stock only if (A) after giving effect to such dividend the Company s Tier 1 capital would be at least equal to the Tier 1 Dividend Threshold (as such term is defined in Section 2(rr) of , the aforesaid Certificate of Determination, a copy of which is hereto attached as Exhibit 4.1) and (B) full dividends on all outstanding shares of Series B Preferred Stock for the most recently completed calendar quarter have been or are contemporaneously declared and paid.

Item 3. Defaults Upon Senior Securities

None.

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Item 4. **(Removed and Reserved)**

None.

Item 5. **Other Information**

None.

Item 6. **Exhibits**

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

3.1	Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company s Registration Statement on Form 10-12B filed with the Securities and Exchange Commission on July 31, 2008).
3.2	First Amendment to Articles of Incorporation (incorporated by reference to Exhibit 3.2 to the Company s Registration Statement on Form 10-12B filed with the Securities and Exchange Commission on July 31, 2008).
3.3	Bylaws (incorporated by reference to Exhibit 3.3 to the Company s Registration Statement on Form 10-12B filed with the Securities and Exchange Commission on July 31, 2008).
3.4	Certificate of Amendment of Bylaws (incorporated by reference to Exhibit 3.5 to the Company s Registration Statement on Form 8-A12B filed with the Securities and Exchange Commission on January 14, 2009).
3.5	Certificate of Amendment of Bylaws dated effective as of August 11, 2011.
4.1	Certificate of Determination dated December 2, 2008 filed with the California Secretary of State for Fixed Rate Cumulative Perpetual Preferred Stock, Series A (incorporated by reference to Exhibit 3.4 to the Company s Registration Statement on Form 8-A12B filed with the Securities and Exchange Commission on January 14, 2009).
4.2	Warrant to Purchase Common Stock dated December 5, 2008 (incorporated by reference to Exhibit 10.4 to the Company s Registration Statement on Form 8-A12B filed with the Securities and Exchange Commission on January 14, 2009).
4.3	Certificate of Determination dated August 11, 2011 and filed with the California Secretary of State for Senior Non-Cumulative Perpetual Preferred Stock, Series B.
10.1	Securities Purchase Agreement dated August 11, 2011 between the Company and the Secretary of the U.S. Treasury, with respect to the issuance and sale of Senior Non-Cumulative Perpetual Preferred Stock, Series B.
10.2	Warrant Redemption Letter Agreement dated September 28, 2011 between the Company and the U.S. Treasury, with respect to the redemption of the Warrant to Purchase Common Stock dated December 5, 2008.
31.01	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.01	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document

101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

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

	Oak Valley Bancorp	
Date: November 9, 2011	By:	/s/ RICHARD A. MCCARTY
		Richard A. McCarty
		Executive Vice President and Chief Financial Officer
		(Principal Financial Officer and duly authorized signatory)

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EXHIBIT INDEX

Exhibit	Description
3.5	Certificate of Amendment of Bylaws dated effective as of August 11, 2011.
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101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document