



**Tri Counties Bank**

**Annual Report  
Nineteen Seventy Eight**



**To Our Shareholders:**

1978 was a highly successful and productive year for Tri Counties Bank.

The rapid success and completion of our stock sale, which raised \$1,750,000 in capital, was certainly a positive way for the year to begin. A large portion of the proceeds have been used to purchase the bank's main office building in Chico, and the remainder has gone into the bank's commercial banking business, primarily additional loans, investments in securities, and the development of new banking facilities.

After the completion of the stock sale and the issuance of the stock dividend in December 1978, total shares of Tri Counties Bank outstanding December 31, 1978 were 293,052.

Profits and deposits grew as management had hoped. The bank's assets as of the end of the year were \$25,822,992 — a healthy increase over the 1977 figure of \$18,081,688. Deposits at year end were \$22,609,147 as compared with \$15,995,548 in 1977, and profits for 1978 were

\$175,034 as compared with \$152,030 for 1977. A detailed summary of the financial information pertinent to the bank in 1978 follows in this report.

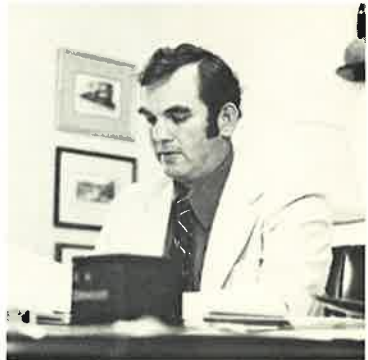
In March 1978 the third branch of Tri Counties Bank opened in Durham. George Rawson has joined the bank as Durham manager, and with his addition our expectations for that branch are very high. Applications for two additional branches were approved by the state superintendent of banks. Our new Orland office should open in midsummer 1979, and the second Chico branch in late 1979 or early 1980.

The decision to add our own computer system was a great step forward. The computer has been delivered, and our staff has converted the savings function over to the new system. We are excited about the prospects of our own locally controlled data processing system. It will save costs, and it will improve customer service dramatically.

The success of Tri Counties Bank comes from the work of everyone on our team —

shareholders, directors, officers, and staff. Our sincere thanks to you for doing your part to ensure the steady growth of our organization.

*Robert H. Steveson*  
Robert H. Steveson  
President



## Management

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Any bank can claim that it's setting out to serve local needs better than they've ever been served. Saying the words is easy. But figuring out ways to make the claim a reality is another, harder matter altogether.

Finding those ways is the principal responsibility of Tri Counties Bank's board of directors. The task of the board's fifteen members is to translate the bank's commitment to serving local needs into banking programs and practices. Most of the bank's founding Board members continue to serve on the board.

At its monthly meetings the board sets bank policy. It decides on growth and new services programs, looks out for stockholders' interests, and ensures adherence to state and federal banking regulations.

In addition, the board members share the work of four committees. The executive committee examines in detail all matters coming before the board in advance of the monthly meeting and makes recommendations to the full board. The investment committee decides where to

invest the bank's own funds. The loan committee supervises the bank's loan policies and decides the merits of all large loan requests. And the audit committee reviews the bank's accounting and its reports to the California Department of Banking and the Federal Deposit Insurance Corporation.

Robert Steveson, President and Member of the Board, implements board decisions and seeks out new ways for Tri Counties Bank to grow. In addition, the President works with D.V. Carter, Vice-President and Cashier, and the administrative staff to oversee bank operations. Working under the President's direction, the bank's managers understand Tri Counties' commitment to local needs. They know their communities; they have the right skills to serve them. Carroll Tarresh, the Willows manager, meets regularly with an advisory committee of seven local businessmen to discuss ways for the bank to better help the West Side. Keith Orme, who manages the Chico branch, is widely experienced in agriculture and rural business and specializes in farm loans.

George Rawson puts his background in all aspects of banking to developing the services of Durham's only bank. Charles Vogel, vice-president and loan administrator, knows every detail of the banking business; he has been in it for 47 years.





## Staff

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The staff of Tri Counties Bank's branches come from the communities they serve; they truly are the friends and neighbors of their customers. To see that their service continuously improves, the bank runs Principles in Banking, its own ongoing training program. This past year the bank also sponsored the Dave Grant Seminar, a course in motivation and achievement open to all employees and their spouses.

Tri Counties' commitment to better service led to the purchase of a minicomputer. When installation of the system is complete, the bank will be able to handle all its own operations

locally, with greater speed and without depending on data processing in San Francisco. In addition, the computer will allow single-entry access to all of a customer's transactions at the bank — savings, checking, and loans — a service not provided by any statewide bank.

Tri Counties Bank has become an integral part of the communities it serves. The bank now has 60 employees, making it one of the significant employers in the area. Tri Counties Bank is a local lender; the money it puts into the community circulates there, adding to growth and prosperity. And the bank is investing in local youth with its scholarship

program for outstanding seniors from middle-income families at the two Chico high schools and at Durham and Willows high schools.

Tri Counties Bank — a commitment to service, and the people to make it happen.



**To the Board of Directors  
and Shareholders  
Tri Counties Bank  
Chico, California**

We have examined the balance sheets of Tri Counties Bank as of December 31, 1978 and 1977, and the related statements of income, changes in stockholders' equity, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Tri Counties Bank as of December 31, 1978 and 1977, and the results of its operations and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

*Coopers & Lybrand*

Sacramento, California  
January 26, 1979

**Tri Counties Bank  
Balance Sheets  
December 31, 1978  
and 1979**

**Assets**

	1978	1977
Cash and due from banks	\$ 1,160,201	\$ 751,921
Federal funds sold	1,800,000	0
Investment securities:		
U.S. Treasury	1,558,031	1,537,719
Other U.S. government agencies	2,354,785	1,605,629
State and local agencies	784,857	784,840
Tax-exempt municipal obligations	648,853	0
Total investment securities	5,346,526	3,928,188
Loans:		
Consumer installment	4,966,103	6,267,186
Commercial	5,365,512	4,211,759
Real estate	6,636,703	3,274,910
	16,968,318	13,753,855
Unearned discount	(860,621)	(1,088,033)
Allowance for loan losses	(40,165)	(40,496)
Net loans	16,067,532	12,625,326
Premises and equipment, net	990,241	490,671
Accrued interest receivable and other assets	458,492	285,582
Total Assets	\$25,822,992	\$18,081,688

**Liabilities and  
Stockholders' Equity**

	<u>1978</u>	<u>1977</u>
Deposits:		
Demand	<b>\$ 8,063,532</b>	\$ 6,326,541
Savings and time	<b>12,203,494</b>	7,544,007
Public time	<b>2,342,121</b>	2,125,000
Total deposits	<b>22,609,147</b>	15,995,548
Federal funds purchased	<b>0</b>	500,000
Accrued interest payable and other liabilities	<b>93,608</b>	67,056
Accrued income taxes, including deferred amounts of \$107,920 in 1978 and \$24,109 in 1977	<b>123,221</b>	26,640
Total liabilities	<b>22,825,976</b>	16,589,244
Commitments (Note 6)		
Stockholders' equity:		
Common stock, \$5 par value, authorized - 1,000,000 shares; issued and outstanding, 1978 - 293,152 shares; 1977 - 176,798 shares	<b>1,465,760</b>	883,990
Capital surplus	<b>1,377,750</b>	555,974
Undivided profits	<b>153,506</b>	52,480
Total stockholders' equity	<b>2,997,016</b>	1,492,444
	<b><u>\$25,822,992</u></b>	<b><u>\$18,081,688</u></b>

The accompanying notes are an integral part of the financial statements.



**Tri Counties Bank  
Statements of Income  
for the years ended  
December 31, 1978  
and 1977**

	1978	1977
Interest Income:		
Interest, fees, and profits from loans	<b>\$ 1,732,887</b>	\$ 1,085,035
Interest on investment securities:		
U.S. Treasury	<b>107,743</b>	110,840
U.S. government agencies	<b>128,571</b>	86,750
State and local agencies	<b>62,814</b>	62,524
Tax-exempt municipal obligations	<b>15,548</b>	0
Interest on time deposits and federal funds sold	<b>87,438</b>	12,666
Total interest income	<b>2,135,001</b>	1,357,815
Interest Expense:		
Interest on deposits:		
Interest on savings deposits	<b>428,684</b>	288,191
Interest on time certificates of deposit	<b>115,006</b>	58,771
Interest on public time deposits	<b>169,134</b>	98,588
	<b>712,824</b>	445,550
Interest on short-term borrowings	<b>13,077</b>	11,010
Total interest expense	<b>725,901</b>	456,560
Net interest income	<b>1,409,100</b>	901,255
Provision for loan losses	<b>44,000</b>	11,000
Net interest income after provision for loan losses	<b>1,365,100</b>	890,255
Other income - service charges and other	<b>140,634</b>	86,434
Other expenses:		
Salaries and employee benefits	<b>594,656</b>	419,264
Occupancy expense	<b>83,917</b>	60,820
Equipment and data processing expense	<b>150,651</b>	96,860
Other operating expenses	<b>323,338</b>	212,715
	<b>1,152,562</b>	789,659
Income before provision for income taxes, securities transactions and extraordinary item	<b>353,172</b>	187,030
Provision for income taxes	<b>145,795</b>	49,334
Income before securities transactions	<b>207,377</b>	137,696
Investment securities transactions less applicable income taxes of \$38,795 and \$4,800 in 1978 and 1977, respectively	<b>(32,343)</b>	5,200
Income before extraordinary item	<b>175,034</b>	142,896
Extraordinary item - tax effect of net operating loss	<b>0</b>	9,134
Net income	<b>\$ 175,034</b>	\$ 152,030
Income per share:		
Primary earnings per share:		
Income before securities transactions and extraordinary item	<b>\$ .74</b>	\$ .86
Securities transactions, less related income taxes	<b>(.11)</b>	.03
Extraordinary item	<b>0</b>	.06
Net income	<b>\$ .63</b>	\$ .95

**Statement of Income  
Continued**

	<u>1978</u>	1977
Earnings per share, assuming full dilution:		
Income before securities transactions and extraordinary item	\$ .71	\$ .86
Securities transactions, less related income taxes	(.11)	.03
Extraordinary item	0	.06
Net income	<u>\$ .60</u>	<u>\$ .95</u>

The accompanying notes are an integral part of the financial statements.

**Tri Counties Bank  
Statements of Changes  
in Stockholders' Equity  
for the years ended  
December 31, 1978  
and 1977**

	<u>Common Stock</u>		<u>Capital Surplus</u>	<u>Undivided Profits</u>	<u>Total</u>
	<u>Number of Shares</u>	<u>Amount</u>			
Balance, January 1, 1977	100,000	\$ 500,000	\$ 418,231	\$ 62,739	\$ 980,970
Net income for the year				152,030	152,030
45% stock dividend, less cash paid for fractional shares	44,905	224,525	(63,851)	(162,289)	(1,615)
Sale of common stock	31,893	159,465	255,144		414,609
Costs associated with the sale of common stock			(53,550)		(53,550)
Balance, December 31, 1977	176,798	883,990	555,974	52,480	1,492,444
Net income for the year				175,034	175,034
Sale of common stock	102,722	513,610	821,776		1,335,386
5% stock dividend, less cash paid for fractional shares	13,632	68,160		(74,008)	(5,848)
Balance, December 31, 1978	<u>293,152</u>	<u>\$1,465,760</u>	<u>\$1,377,750</u>	<u>\$153,506</u>	<u>\$2,997,016</u>

The accompanying notes are an integral part of the financial statements.

**Tri Counties Bank**  
**Statement of changes in**  
**Financial Position for the**  
**years ended December**  
**31, 1978 and 1977**

	<u>1978</u>	<u>1977</u>
Resources provided:		
Operations:		
Income before extraordinary item	\$ 175,034	\$ 142,896
Noncash items:		
Depreciation and amortization	41,162	21,865
Provision for loan losses and deferred income taxes	124,195	35,109
Provided by operations, exclusive of extraordinary item	<u>340,391</u>	199,870
Resources provided by extraordinary item	0	9,134
Increase in liabilities:		
Deposits	6,613,599	5,127,685
Federal funds purchased	0	500,000
Proceeds from sale of common stock	1,335,386	414,609
Accrued interest payable and other liabilities	42,938	24,701
Decrease in assets:		
Cash and due from banks	0	852,218
Federal funds sold	0	350,000
	<u>\$8,332,314</u>	<u>\$7,478,217</u>
Resources used:		
Costs associated with sale of common stock and issuance of stock dividend	\$ 5,848	\$ 55,165
Increase in assets:		
Cash and due from banks	408,280	0
Federal funds sold	1,800,000	0
Investment securities	1,418,338	1,542,449
Loans, net	3,486,206	5,458,755
Premises and equipment	540,732	300,002
Accrued interest receivable and other assets	172,910	121,846
Decrease in liabilities:		
Federal funds purchased	500,000	0
	<u>\$8,332,314</u>	<u>\$7,478,217</u>

The accompanying notes are an integral part of the financial statements.

## Tri Counties Bank Notes to Financial Statements

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### Summary of Significant Accounting Policies:

The accounting policies of Tri Counties Bank (the Bank) conform to generally accepted accounting principles and to general practices of the banking industry. The following is a summary of the more significant policies:

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### Investment Securities

Investment securities are carried at cost increased by accretion of discounts and decreased by amortization of premiums. Gains and losses (determined on a specific identification basis) on sales and exchanges of investment securities are presented, net of applicable income taxes, separately in the statements of income.

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### Loans

Loans are stated net of undisbursed funds. Interest on commercial and real estate loans is accrued principally on a simple-interest basis. Interest on installment loans made prior to July 1978 is recognized principally using the sum-of-the-months-digits method ("rule of 78's"). Interest on installment loans made commencing in July 1978 is accrued on a simple-interest basis. The effect of this change in 1978 was not material to the Bank's income.

Interest on certain loans is not accrued if, in management's judgment, amounts are considered doubtful of collection. Loans placed in nonaccrual status amounted to approximately \$21,000 at December 31, 1978. There were no loans classified as nonaccrual as of December 31, 1977.

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### Allowance for Loan Losses

The allowance for loan losses represents management's recognition of the assumed risks of extending credit and the overall quality of the loan portfolio. Although it is not possible to anticipate loan losses with complete accuracy, the evaluation of the quality of the loan portfolio considers such factors as the borrower's financial condition and repayment history, the value of any existing collateral, and third-party guarantees.

In addition, other factors such as past loan loss experience and external business and economic conditions beyond the borrower's control are considered which, in management's judgment, deserve current recognition.

The allowance for loan losses is increased by provisions for loan losses charged to operating expense and recoveries of previously charged-off loans. The allowance is reduced for net loan losses.

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### Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Land is carried at cost. Depreciation expense is computed using the straight-line method over the following estimated useful lives:

Bank premises	40 years
Furniture and equipment	3 to 10 years
Land improvements	10 years

Improvements and major renewals are capitalized, and maintenance and repairs are charged to operating expenses. Gains and losses from disposal of Bank premises and equipment are included in current operations.



**Tri Counties Bank  
Notes to Financial  
Statements, Continued**

**Income Taxes**

The provision for income taxes includes amounts attributable to all significant timing differences between revenues and expenses reported for financial statement purposes and for income tax purposes, after excluding nontaxable revenues and nondeductible expenses. The principal timing differences result from the use of the cash method of accounting for tax purposes, realization of investment and new jobs tax credits in different reporting periods, and differences in the method of calculating the provision for loan losses.

Investment and new jobs tax credits are applied to reduce the provision for federal income taxes in the year the credits arise.

**Earnings Per Share**

Earnings per share computations for 1978 and 1977 are based on the weighted average number of shares and common equivalent shares outstanding during the year (after retroactive adjustment for stock dividends), which includes the effect of outstanding stock options (see Note 7) utilizing the treasury-stock method. Primary earnings per share are based on the average market prices (computed quarterly) for the Bank's stock. Earnings per share, assuming full dilution, are based on the greater of the ending or average market prices. Shares used in the computations of primary and fully dilutive earnings per share for 1978 were 281,969 and 290,774, respectively. Shares used in the computations for 1977 were 159,511.

**Reclassifications**

In September 1978, the Securities and Exchange Commission issued Article 9 of Regulation S-X relating to requirements for the form and content of financial statements of bank holding companies and banks, effective for reporting periods beginning after December 24, 1978. The Bank has elected to adopt early compliance with this pronouncement and has made certain reclassifications in its reporting format for 1978 and 1977 to conform thereto. These reclassifications, which principally relate to the presentation of the statements of income, do not have any effect on amounts previously reported in 1977 for net income, net income per share, or total stockholders' equity.

**Investment Securities:**

A summary of the book and market values of investment securities is as follows:

	1978		1977	
	Book Value	Market Value	Book Value	Market Value
U.S. Treasury	\$1,558,031	\$1,522,152	\$1,537,719	\$1,501,766
Other U.S. government agencies	2,354,785	2,353,880	1,605,629	1,541,000
State and local agencies	784,857	784,857	784,840	785,000
Tax-exempt municipal obligations	648,853	611,224	—	—
	<b>\$5,346,526</b>	<b>\$5,272,113</b>	\$3,928,188	\$3,827,766

At December 31, 1978, securities with face and market values of \$2,750,000 and \$2,585,251, respectively, were pledged as collateral for \$2,142,121 of public deposits as required by law.

**Tri Counties Bank  
Notes to Financial  
Statements, Continued**

**Premises and Equipment:**

	1978	1977
Premises and equipment are comprised of:		
Bank premises	<b>\$645,617</b>	\$177,584
Furniture, fixtures, and equipment	<b>300,716</b>	197,096
Land improvements	<b>4,497</b>	4,497
	<b>950,830</b>	379,177
Less accumulated depreciation	<b>(78,066)</b>	(36,904)
	<b>872,764</b>	342,273
Land	<b>109,602</b>	109,602
Construction in progress	<b>7,875</b>	38,796
	<b>\$990,241</b>	\$490,671

**Allowance for Loan  
Losses:**

	1978	1977
Transactions in the allowance for loan losses were as follows:		
Balance, beginning of year	<b>\$ 40,496</b>	\$ 64,117
Provisions charged to operations	<b>44,000</b>	11,000
Loans charged off	<b>(47,637)</b>	(46,711)
Recoveries of loans previously charged off	<b>3,306</b>	12,090
	<b>\$ 40,165</b>	\$ 40,496

**Income Taxes:**

	1978	1977
The provisions for income taxes included in the statements are comprised of:		
Taxes applicable to income before securities transactions, net of tax credits:		
Federal	<b>\$100,653</b>	\$22,688
State	<b>45,147</b>	26,646
	<b>145,800</b>	49,334
Taxes applicable to securities transactions	<b>(38,800)</b>	4,800
Extraordinary item:		
Tax effect of federal net operating loss carryforward	<b>0</b>	(9,134)
	<b>\$107,000</b>	\$45,000
Current payable:		
Federal	<b>\$ 0</b>	\$ 0
State	<b>23,189</b>	20,891
	<b>23,189</b>	20,891
Deferred:		
Federal	<b>70,751</b>	16,094
State	<b>13,060</b>	8,015
	<b>83,811</b>	24,109
	<b>\$107,000</b>	\$45,000

**Tri Counties Bank  
Notes to Financial  
Statements, Continued**

**Income Taxes, continued:**

The tax effects of the principal elements of timing differences which give rise to deferred income taxes are as follows:

	<u>1978</u>	<u>1977</u>
Restoration of deferred taxes, applicable to utilization of prior years' tax credits	<b>\$37,600</b>	\$ 0
Gain on sale of participation loans, net	<b>15,800</b>	0
California franchise tax	<b>(13,800)</b>	1,000
Accrual income deferred for tax purposes, net	<b>29,900</b>	12,000
Provision for loan losses	<b>12,200</b>	11,400
Other differences	<b>2,111</b>	(291)
	<b><u>\$83,811</u></b>	<b><u>\$24,109</u></b>

A reconciliation of the federal statutory tax rate to the effective tax rate applicable to income before securities transactions and extraordinary item is as follows:

Federal statutory income tax rate	<b>48.0%</b>	48.0%
State income taxes, net of federal tax benefit	<b>6.5</b>	6.6
New jobs and investment tax credits	<b>(7.5)</b>	(21.6)
Surtax exemption and other	<b>(5.7)</b>	(6.6)
Effective tax rate	<b><u>41.3%</u></b>	<b><u>26.4%</u></b>

Investment tax and new jobs credits utilized to reduce estimated federal income tax expense for the years ended December 31, 1978 and 1977 were \$26,427 and \$39,699 (after giving effect to the nondeductibility of federal unemployment base wages), respectively.

The Bank has approximately \$23,600 of tax credits available to offset any future federal income tax liability, which credits expire in 1985.

**Tri Counties Bank  
Notes to Financial  
Statements Continued**

**Commitments:**

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**Operating Leases**

In 1977 and the early part of 1978, the Bank leased its main office building from a partnership comprised of certain directors of the Bank. This lease contained an option for the Bank to purchase the building at its current fair market value subject to the approval of the California Superintendent of Banks. In connection with the sale of additional common stock completed in March 1978, the Bank obtained the Superintendent's approval to exercise its option and acquired the building for a purchase price of \$317,000. In connection with this acquisition, the Bank converted the building to a branch office and moved its administrative offices to a temporary location under a short-term lease agreement which expires in July 1979.

Total rental expense for 1978 and 1977 under the above-mentioned leases was \$27,507 and \$30,816, respectively.

In September 1978, the Bank entered into a new lease with a developer of a shopping center to relocate its main office premises to that location upon completion of construction of the new bank building. Under the terms of this agreement, the Bank is responsible for the costs of construction of all leasehold improvements on this property for which the lessor has agreed to reimburse the Bank for an amount equal to the lower of the actual costs of construction or \$400,000. As of the date of this report, the Bank had not yet obtained any proposals nor entered into any contracts for construction of the improvements.

The lease contains various provisions allowing for cancellation by either party in the event certain conditions, among others, with respect to commencement of construction and obtaining government permits and approvals, are not met. The obligation of the Bank to pay rentals under the lease is to commence upon the earlier of the actual date of opening for business at the new premises or October 1, 1979. The term of the lease from that date is 30 years with the Bank having options to renew for two additional five-year periods. The total rental obligation is \$2,384,400 (excluding the renewal option periods), payable at \$73,600 for the first five years and in annual increments which increase by \$500 per year for the next five years and \$1,000 per year for the remaining 20 years.

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**Bonus Plan**

The Bank has a bonus plan with its president which provides for incentive payments based on certain percentages of net income levels (before calculation of the bonus) achieved. These percentages are 5% on the first \$250,000, 3% on the next \$250,000, and 2% on net income exceeding \$500,000 per year. This plan is scheduled to terminate on December 31, 1979.

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**Loans**

At December 31, 1978, the Bank had outstanding loan commitments of approximately \$1,120,000.



**Tri Counties Bank  
Notes to Financial  
Statements, Continued**

**Commitments**

**Stock Options**

The Bank has a stock option plan covering 30,450 shares (after retroactive adjustment for stock dividends) of its capital stock. The plan, which terminates in 1985, provides for the granting of options to key employees of the Bank, entitling them to purchase shares of common stock at fair market value on the date the option is granted. Optionees, option prices, and dates of grant and exercise are determined by the Board of Directors of the Bank. The options are exercisable no later than five years from the date of grant and are not transferable by the holder, other than by will or the laws of descent and distribution. The options lapse immediately upon the earlier of the termination of employment, one year after the optionee's death, or the termination date of the option.

Transactions in 1978 and 1977 related to stock options were as follows:

	Shares Available for Grant	Options Outstanding		
		Shares	Price Per Share	Total
Balance, January 1, 1977	17,509	12,941	\$ 6.57-\$9.85	\$ 97,500
Options granted	(10,500)	10,500	\$12.38	130,000
Balance, December 31, 1977	7,009	23,441	\$6.57-\$12.38	227,500
Options terminated	2,284	(2,284)	\$ 6.57-\$9.85	(17,500)
Balance, December 31, 1978	9,293	21,157	\$6.57-\$12.38	\$210,000
Options exercisable at December 31, 1978		9,095		

No charges to income are made in connection with transactions under this plan.

**Related Party  
Transactions:**

Certain directors and officers of the Bank and the companies with which they are associated were customers of, and had banking transactions with, the Bank in the ordinary course of the Bank's business. All loans and commitments to lend included in such transactions were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons, and in the opinion of the management, did not involve more than the normal risk of collectibility or present other unfavorable features. As of December 31, 1978, the total amount of outstanding loans to these parties aggregated approximately \$578,000.

In May 1978, the Bank exercised an option to purchase its Chico office from a partnership comprised of certain directors of the Bank as more fully explained in Note 6.

The following is a summary of the statements of income (loss) and management's discussion and analysis of the significant changes in income and expense accounts presented in the Statements of Income (Loss) appearing on page 8, each as compared with its respective prior period, and should be read in conjunction with the Statements of Income (Loss) and with the financial statements and notes relating thereto appearing elsewhere herein.

	<b>(Stated in Thousands)</b>				
	<b>Dec. 31, 1978</b>	<b>% of Change</b>	<b>Dec. 31, 1977</b>	<b>% of Change</b>	<b>Dec. 31, 1976</b>
Operating income:					
Interest and fees on loans	1733	60%	1085	72%	630
Interest on securities, federal funds sold and time deposits	402	47%	273	51%	181
Service charges on deposit accounts	111	82%	61	60%	38
Other operating income	30	20%	25	108%	12
Total operating income	2276	58%	1444	68%	861
Operating expenses:					
Salaries and related benefits	595	42%	419	74%	241
Interest on deposits	726	59%	456	77%	258
Provision for loan losses	44	300%	11	(325%)	47
Other operating expenses	558	50%	371	60%	232
Total operating expenses	1923	53%	1257	62%	778
Income before income taxes, securities transactions and extraordinary item	353	89%	187	125%	83
Income taxes	146	198%	49	48%	33
Income before securities transactions and extraordinary item	207	51%	138	(176%)	50
Securities transactions, less related income taxes	(32)	(560)	5	- 740	42
Income before extraordinary item	175	22%	143	55%	92
Extraordinary item:					
Reduction of federal income taxes arising from carryforward of net operating losses	0	(1000%)	9	(555%)	59
Net income	175	15%	152	0	151

## **Management's Discussion and Analysis of Operations Continued:**

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### **General**

The changes in income and expense accounts reflect the steady growth of the Bank and improvement in its operations. In 1978 total operating income rose 58% to \$2,135,001, primarily as a result of a 60% growth of interest and fees on loans and a 23% expansion of loans outstanding. In 1977 operating income rose approximately 68% to \$1,357,815 primarily as a result of a 72% growth of interest and fees on loans on a 59% expansion in loans outstanding.

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### **Interest and Fees on Loans**

Interest and fees on loans increased from \$630,000 in 1976 to \$1,085,000 in 1977 to \$1,733,000 in 1978 primarily because the volume of loans increased. Loans outstanding were approximately \$16,067,000 in 1978, \$12,625,000 in 1977 and \$7,177,571 in 1976.

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### **Interest on Federal Funds Sold**

Interest on Federal Funds sold increased from \$12,666 in 1977 to \$87,438 in 1978. This change was due to an increase in interest rates for Federal funds and an increase in deposits in the later half of 1978 which provided the Bank with excess reserves. Federal funds income decline in 1977 to \$12,666 from \$15,342 in 1976 due to heavy loan demand and the fact that lower interest rates in the Federal funds market made other investments more attractive.

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### **Interest and Dividends on Investment Security**

Total investment securities at December 31, 1978, were \$5,346,525 an increase of 36% from the December 31, 1977 total of \$3,928,188. Investment securities as of December 31, 1976 totaled \$2,385,739. Income from interest on investment securities increased 47% in 1978 to \$402,114, as contrasted with \$273,780 in 1977. The 1977 results represent a 51% increase from 1976 income from interest on investment securities of \$181,470. These increases were reflective of a general over-all increase in interest rates paid on investment securities and the need of the Bank to maintain its liquidity position.

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### **Service Charges and other Income**

Service charges on deposit accounts increased 60% in 1977 over 1976 and 82% in 1978 over 1977, and other operating income increased 108% from 1976 to 1977 and 20% from 1977 to 1978. This was primarily because of increased volume in checking account customers due to the opening of the Willows office in 1977 and the Durham office in 1978.

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### **Salary and Employee Benefits**

Salary and employee benefits increased from \$241,000 in 1976 to \$419,000 in 1977 to \$595,000 in 1978 as a result of staff increases and related inflationary pressure on salary and staff benefits. In 1977, general growth plus the opening of the Willows branch accounted for the increase. In addition the staffing for the new branch in Durham and the staff for the computer operation contributed to the increase in 1978.

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### **Interest on Deposits**

Interest expense on deposits increased in 1978 by 60% over 1977 as year end interest bearing deposits for 1978 were \$14,545,615 compared to \$9,669,007 for 1977. The remainder of the increase in interest expense was attributable to higher interest rate paid by the banking industry over rates paid during 1977. Interest expense increased primarily in 1977 over 1976 because interest bearing deposits increased from \$6,264,852 at year end 1976 to \$9,669,007 at year end 1977.

**Management's Discussion  
and Analysis of  
Operations Continued:**

**Provision for Possible  
Loan Losses**

The provision for possible loan losses in 1978 was \$44,000, in 1977 — \$11,000, in 1976 \$47,000. The reduction in provision for possible loan losses in 1977 was due to a change in the timing of recognition of a portion of the provision. The net charge-off as a percentage of over-all loans was .33% in 1978 compared with .41% in 1977 and .059% in 1976.

**Other Operating  
Expenses**

Other operating expenses increased 52% in 1978 over 1977 and 68% in 1977 over 1976. This reflects the bank's growth as total assets increased 43% in 1978 and 52% in 1977. Operating income for the same period rose 56% and 68% respectively.

**Securities Transactions**

Due to rising interest rates, management elected to sell certain low yielding securities in 1978 and re-invest in higher yielding, high quality securities. This resulted in a —(\$32,000) after tax loss for 1978 as opposed to a \$5,000 gain in 1977 and \$42,000 gain in 1976. The decline in the results of Security Transactions in 1977 from 1976 was due to the market conditions. Additional data on security transactions may be found in the notes to financial statements section.

**Provision for Taxes**

The effective tax rate for Federal and State income taxes was 41.3% in 1978 and 26.4% in 1977. In 1976 the effective tax rate was 40.2%. This tax provision is net of investment tax and new job credits and is largely effected by opening new branches and additions to staff. See notes to financial statements for additional tax information.

**Net Income**

After virtually no increase in net income from 1976 to 1977, 1978 income rose 15% from \$152,000 in 1977 to \$175,000 in 1978. The lack of increase in income from 1976 to 1977 was due to the issuance of a 45% Stock Dividend in 1977 and the opening of a branch in Willows, California. The rather modest gain in 1978 over 1977 (15%) reflects the opening of the Durham office in March, 1978, the establishment of a separate Administrative office and the installation of our own computer.

**Trading Information  
Over-The-Counter-Market**

Tri Counties Bank Common stock is traded in the over-the-counter market. No broker-dealer acts as a market maker in the Common stock of the Bank.

**Stock Prices and  
Dividend Information**

The following table summarizes dividend information and those trades of the Bank's Common stock of which the Bank has knowledge, setting forth the high and low sales prices for the periods indicated. The prices indicated below may not necessarily represent actual transactions. The figures have been ADJUSTED TO REFLECT THE TWO STOCK DIVIDENDS paid in November, 1977 (45%) and December, 1978 (5%).

Quarter Ended:	Sales Price of the Bank's Common Stock		Dividends paid in Common Stock
	High	Low	
March 31, 1977	\$ 9.86	\$ 9.53	
June 30, 1977	9.86	9.86	
September 30, 1977	11.50	9.20	



**Stock Prices and  
Dividend Information  
Continued:**

Quarter Ended:	Sales Price of the Bank's Common Stock		Dividends paid in Common Stock
	High	Low	
December 31, 1977	12.20	12.20	44,905 shares
March 31, 1978	12.38	12.38	
June 30, 1978	16.67	12.28	
September 30, 1978	16.60	16.60	
December 31, 1978	17.14	16.19	13,632 shares

**Board of Directors**



**Robert Stern**  
Chairman of  
the Board  
President Retail  
Store Chain



**Wendell  
Lundberg**  
Vice-  
Chairman of  
the Board  
Owner Rice and  
Grain  
Operations



**Alex  
Vereschagin, Jr.**  
Secretary of  
the Board  
Secretary/-  
Treasurer  
Petroleum  
Distribution  
Company



**Everett Beich**  
Owner Mobile  
Home Sales



**Donald Casey**  
Retired  
Physician



**DeWayne  
Caviness**  
Physician and  
Surgeon



**Gerald  
Compton**  
President  
Agricultural  
Flying Service



**Vernon Fish**  
President  
Development  
Company



**George Hacke**  
Investment  
Account  
Executive



**J. Herod Hall**  
Physician and  
Surgeon



**Sankey M.  
Hall, Jr.**  
Owner  
Petroleum  
Distribution  
Company  
Partner Funeral  
Home



**Fred Hignell  
III**  
Principal  
Partner Real  
Estate  
Investment and  
Development  
Company



**Wayne Meeks**  
Retired Owner  
Automobile  
Dealership



**Donald  
Murphy**  
Vice-President  
and General  
Manager Ranch  
Operation



**Robert  
Steveson**  
President Tri  
Counties  
Bank

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**Administration**

Robert H. Steveson

**President & Chief Executive Officer**  
**Vice President & Cashier**  
**Assistant Vice President**  
**Executive Secretary**  
**Vice President & Loan Administrator**

D.V. Carter  
Joan Jones  
Janet K. Hannis  
Charles C. Vogel

**Chico Office**  
Keith Orme  
Ronald Bee  
Daniel Herbert

**Manager**  
**Installment Loan Officer**  
**Operations Supervisor**

**Willows Office**  
Carroll Taresh  
Martin Johnson

**Manager**  
**Operations Supervisor**

**Durham Office**  
George Rawson

**Manager**

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**Tri Counties Bank**

**Administrative Office**  
585 Manzanita Avenue  
P.O. Box 1130  
Chico, CA. 95927  
(916) 895-1734

2171 Pillsbury Road  
P.O. Box 1130  
Chico, CA. 95927  
(916) 345-5151

The Midway  
P.O. Box 216  
Durham, CA 95938  
(916) 343-3735

154 North Tehama  
P.O. Box 1158  
Willows, CA 95988  
(916) 934-2191

**Member FDIC**

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**Financial Reports**

The Bank will provide to any interested party, without charge, a copy of the Bank's Annual Report for 1978 on Form F-1 filed with the Federal Deposit Insurance Corporation. The report may be obtained by written request to: Corporate Secretary, Tri Counties Bank, 585 Manzanita Avenue, Suite 4, Chico, California 95926.