1986 TriCo Bancshares Annual Report

TriCo Bancshares

TriCo Bancshares (the "Company") is a bank holding company incorporated at the direction of the Board of Directors of Tri Counties Bank (the "Bank") on October 13, 1981. Pursuant to a corporate reorganization on September 7, 1982, the shareholders of the Bank became shareholders of the Company, and the Bank became the wholly-owned subsidiary of the Company. The Bank currently is the only subsidiary of the Company and the Company has not yet commenced any business operations independent of the Bank.

The Bank engages in the general commercial banking business in the California counties of Butte, Glenn and Shasta, as well as in portions of Tehama and Lassen counties. It opened its first banking office in Chico, California in 1975, followed by branch offices in Willows, Durham and Orland, California and a second branch office in Chico which opened in 1980. In 1981, the Bank acquired the assets of Shasta County Bank through a merger of that bank with and into the Bank and thereby acquired six additional branch offices located in the communities of Bieber, Burney, Cottonwood, Fall River Mills, Palo Cedro and Redding, California.

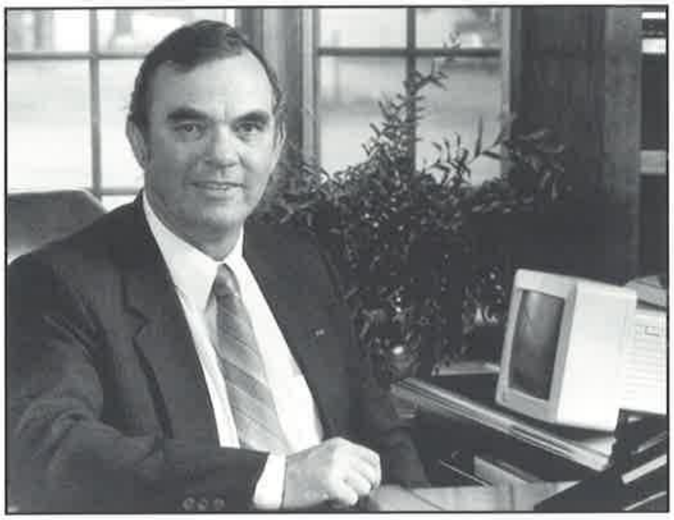
The Bank's operating policy since its inception has emphasized retail banking. Most of the Bank's customers are retail customers and small to medium sized businesses. The business of the Bank emphasizes serving the needs of local businesses, farmers and ranchers, retired individuals and wage earners. The majority of the Bank's loans are direct loans made to individuals and businesses in the area, and most of the Bank's deposits are attracted from individuals and business-related sources. The Bank relies substantially on local promotional activity, personal contacts by its officers, directors, employees and shareholders, extended hours, personalized service and its reputation in the communities it serves to compete with other financial institutions.

Financial Highlights

(in thousands, except net income per share)

	Years ended December 31,				
	1986	1985	1984	1983	1982
Assets	**$222,664**	$173,684	$152,508	$122,165	$106,116
Securities investments	**41,430**	29,422	22,310	18,412	9,798
Loans, net	**140,361**	108,352	90,985	79,130	71,163
Deposits	**200,314**	152,260	132,800	108,588	93,074
Shareholders' equity	**12,900**	11,756	8,177	7,586	6,937
Interest income	**19,072**	17,051	15,675	13,444	12,434
Interest expense	**9,939**	9,559	9,047	7,039	6,775
Net income	**1,440**	1,127	476	544	218
Earnings per common share	**$ 1.20**	$ 1.05	$ .54	$ .63	$ .26
Stock dividend per common share	**5.00%**	5.00%	5.00%	—	—
Return on average assets	**0.76%**	0.71%	0.36%	0.44%	0.22%

President's Message
Quality • Earnings • Growth



Robert H. Steveson
President & Chief Executive Officer

Dear Shareholder:

TriCo Bancshares had a very good year in 1986.

Your Bank continues its dynamic growth and improvement in earnings and quality of assets. Deposits increased $48,054,000 and were $200,314,000 at December 31, 1986. Loans also reflect a dramatic increase. Present loans outstanding are $141,711,000 and reflect a $32,238,000 increase during 1986. Pre-tax profits reflect a spectacular gain: $2,190,000 compared to $1,398,000 for the previous year.

Since the 1986 tax laws were being introduced, many of the tax advantages previously available no longer benefit your Company. Therefore, Management shifted its strategies in 1986 and concentrated on maximum earnings and a high provision to taxes. After-tax earnings, while not nearly as spectacular as the increase in pre-tax earnings, increased by $313,000 or 28%. After-tax earnings for the year ending December 31, 1986 were $1,440,000.

All of the above was accomplished while TriCo Bancshares improved the quality of its assets significantly through sale of real estate, better collection of delinquent loans and continued recoveries of loans previously considered uncollectible.

The Directors, Management and Staff of your Company are doubly proud of our performance when you consider that one of our major competitors — Crocker Bank — decided to sell out to Wells Fargo Bank and another is recording the second largest loss sustained in banking history. These two events reflect the tremendous changes brought upon the California banking industry from interest rate deregulation and an economic downturn. Additionally, agriculture — which is a leader in economic contributions in our trade area — continues its agonizing transition from government-supported pricing to free world trade.

One last comment — 1986 performance was achieved with minimum addition to staff. Oh, yes! Your Directors felt it was time to recognize the common shareholders of the Company. Toward that goal, a cash dividend of $.25 per share was declared on October 14, 1986 and paid on December 10, 1986.

I am indeed proud to report to you, our shareholders, a strong Company — well staffed, with an excellent future and ready to take on opportunities as they come.

Sincerely,

Robert H. Steveson

Robert H. Steveson
President & Chief
Executive Officer

Achieving the goals we set for ourselves in 1986 took Tri Counties Bank in several new directions. From a long-range perspective, these directions are the result of an evolutionary process that started when the Bank was organized in 1975:

A bank, like any other business, cannot succeed by standing still. From day one, Tri Counties Bank has been moving steadily and, we think you'll agree, in the right directions:

Moving Up:

Ranked 60th out of 450 banks in the state, Tri Counties Bank currently maintains a 25 percent growth rate in assets.

Given the fact that 80 percent of all banking in California is controlled by four major banks, reaching 60th place is quite an accomplishment.

Tri Counties Bank has become a highly visible regional bank with the second largest customer base in an area with an estimated deposit base of $2 billion.

Moving In:

Our new Administrative Headquarters at 15 Independence Circle occupies part of a 25-acre business park, Philadelphia Square, owned by TCB Real Estate, a subsidiary of Tri Counties Bank.

To date, 11 lots have been sold and 8 buildings have been completed or are under construction following strict architectural guidelines set by TCB Real Estate.

As both an investment and an architectural statement, Philadelphia Square reflects the Bank's strong ties to the community. Real growth is never unilateral; we've continued to grow while larger banks are shrinking. We're always striving to convert growth into high returns for the community.

Moving Forward:

Believing from the start that responsiveness to the community's needs is essential in achieving meaningful growth, we are now able to demonstrate our responsiveness through new products and services designed to help our customers adjust to the current economy and new tax laws:

- TriCo Line, the Home Equity Access Account, provides a line of credit based on the customer's home equity — up to 75 percent of the appraised value less the first mortgage. Second, it provides a substantial tax deduction by consolidating all consumer borrowing under a home loan.
- INVEST, a personal investment services program, provides advice and information on investments through the independent brokerage services of ISFA Corporation. With this service, Bank customers can get the help they need determining and fulfilling their investment needs while saving on broker's commissions.

While adding new services, we have continued to build up existing services, particularly in the area of loans. With $20 million in SBA loans, $50 million in FREDIMAC loans, and a total of $142 million in loans, Tri Counties Bank is the largest provider of small-business loans north of Sacramento.

Moving Together:

We have doubled our assets from $106 million to $223 million in 5 years with the same staff by increasing productivity. Centralized proof and check filing, handled exclusively at our data processing facility near the Chico airport, allows our tellers and Bank personnel to spend more time working directly with customers. Careful training, staffing as needed, and incentive programs produce a dedicated, efficient staff in every branch.

Though geographically diverse, the 11 branches of Tri Counties Bank share a common goal: to foster our image as a strong, independent, locally-owned bank by providing the best possible service to the communities we serve and by adapting to their changing needs.

Board of Directors

Back row standing, left to right:

Donald E. Murphy
Vice President & General Manager, J. H. McKnight Ranch, Nelson

Wendell J. Lundberg
Owner, Wehah Farms, rice and grain operations, Richvale

Robert H. Steveson
President and Chief Executive Officer,
Tri Counties Bank and TriCo Bancshares, Chico

Robert J. Stern
Retired President, R. J. Stern Co., Inc., Oroville

Middle row seated, left to right:

Everett B. Beich
Vice Chairman of the Board, Owner, Beich Company, real estate development, Chico

Sankey M. Hall, Jr.
Retired Businessman, Chico

Wayne Meeks
Owner, Wayne Meeks Red Bluff Ford-Mercury, Red Bluff

Alex A. Vereschagin, Jr.
Chairman of the Board, Secretary-Treasurer, Vereschagin Oil Company, petroleum distribution company, Orland

Front row seated, left to right:

DeWayne E. Caviness, M.D.
Physician and Surgeon, Chico

Fred W. Hignell III
Secretary of the Board, Principal Partner, Hignell & Hignell, Inc., investment and development company, Chico

Donald J. Casey, M.D.
Retired Physician, Chico

Administration Tri Counties Bank

Top row from left to right:

Kathleen Pisani
Executive Secretary

Larry Hall
Vice President &
Data Processing Manager

Lawrence Sparks
Vice President &
Loan Supervisor

Daniel Herbert
Vice President &
Cashier

James Mabry
Senior Vice President
& Loan Administrator

Bottom row from left to right:

David Raven
Regional Vice President

Janet K. Hannis
Assistant Vice President &
Sales Administrator

Carroll Taresh
Regional Vice President

Joan Jones
Executive Vice President &
Chief Administrative Officer

Ruth Irvine
Assistant Vice President
& Personnel Manager

Accountants' Report

Board of Directors and Shareholders
TriCo Bancshares and Subsidiaries
Chico, California

We have examined the consolidated balance sheets of TriCo Bancshares and subsidiaries at December 31, 1986 and 1985, and the related consolidated statements of income, changes in shareholders' equity and changes in financial position for each of the three years in the period ended December 31, 1986. 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 consolidated financial position of TriCo Bancshares and subsidiaries at December 31, 1986 and 1985, and the consolidated results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1986, in conformity with generally accepted accounting principles applied on a consistent basis.

Touche Ross & Co.

Certified Public Accountants
San Francisco, California
January 29, 1987

Consolidated Balance Sheets

December 31, 1986 and 1985
(in thousands, except share amounts)

Assets	1986	1985
Cash and due from banks	$ 13,745	$ 10,961
Federal funds sold	5,200	—
Investment securities (approximate market value $41,432 and $29,695)	41,430	29,422
Loans held for sale	2,134	2,000
Loans:		
Commercial	63,861	48,040
Consumer installment	33,053	32,500
Real estate mortgages	34,773	19,259
Real estate construction	8,462	7,378
Lease financing	1,562	2,296
	141,711	109,473
Less: Allowance for loan losses	1,350	1,121
Net loans	140,361	108,352
Premises and equipment, net	6,600	6,974
Investment in real estate	7,177	10,144
Other real estate owned	1,851	1,659
Accrued interest receivable	1,724	1,691
Other assets	2,442	2,481
Total assets	$222,664	$173,684

Liabilities and shareholders' equity	1986	1985
Deposits:		
Noninterest bearing demand	$ 45,398	$ 33,409
Interest bearing demand	67,534	47,336
Savings	16,788	12,505
Time certificates, $100,000 and over	3,557	8,924
Other time certificates	67,037	50,086
Total deposits	200,314	152,260
Federal funds purchased	—	1,600
Accrued interest and other liabilities	3,517	3,091
Deferred income taxes	663	310
Long-term debt	5,270	4,667
Total liabilities	209,764	161,928
Commitments and contingencies (Note M)		
Shareholders' equity:		
Preferred stock, no par value; shares authorized 1,000,000; shares issued and outstanding 26,724 shares	2,544	2,544
Common stock, no par value; shares authorized 20,000,000; shares issued and outstanding 893,660 and 833,773 shares	7,812	7,155
Retained earnings	2,544	2,057
Total shareholders' equity	12,900	11,756
Total liabilities and shareholders' equity	$222,664	$173,684

See Notes to Consolidated Financial Statements

Consolidated Statements Of Income

Years ended December 31, 1986, 1985 and 1984
(in thousands, except earnings per share)

	1986	1985	1984
Interest income:			
Interest and fees on loans	**$16,781**	$14,868	$13,505
Interest on federal funds sold	**331**	183	187
Interest on investment securities — taxable	**1,155**	1,172	1,920
Interest on investment securities — tax exempt	**805**	828	63
Total interest income	**19,072**	17,051	15,675
Interest expense:			
Interest on money market, savings and time certificates of deposit	**8,928**	7,901	7,026
Interest on time certificates of deposit $100,000 and over	**424**	949	1,309
Interest on short-term borrowing	**6**	45	56
Interest on long-term debt	**581**	664	656
Total interest expense	**9,939**	9,559	9,047
Net interest income	**9,133**	7,492	6,628
Provision for loan losses	**878**	698	750
Net interest income after provision for loan losses	**8,255**	6,794	5,878
Other income:			
Service charges and other income	**1,924**	1,537	1,529
Investment securities gains	**1,013**	515	70
Total other income	**2,937**	2,052	1,599
Other expenses:			
Salaries and related expenses	**3,989**	3,720	3,449
Other	**5,013**	3,728	3,731
Total other expenses	**9,002**	7,448	7,180
Net income before income taxes	**2,190**	1,398	297
Income taxes (credit)	**750**	271	(179)
Net income	**$ 1,440**	$ 1,127	$ 476
Net income applicable to common stock	**$ 1,145**	$ 1,003	$ 476
Earnings per common share	**$ 1.20**	$ 1.05	$ .54

See Notes to Consolidated Financial Statements

Consolidated Statements Of Changes In Shareholders' Equity

Years ended December 31, 1986, 1985 and 1984
(in thousands, except share amounts)

	Preferred Stock		Common Stock			
	Number of Shares	Amount	Number of Shares	Amount	Retained Earnings	Total
Balance, January 1, 1984	—	—	745,730	$6,037	$1,549	$ 7,586
Capital notes converted to common stock	—	—	9,602	126	—	126
5% stock dividend, less cash paid for fractional shares	—	—	36,515	511	(522)	(11)
Net Income	—	—	—	—	476	476
Balance, December 31, 1984	—	—	791,847	6,674	1,503	8,177
Capital notes converted to common stock	—	—	3,082	40	—	40
5% stock dividend, less cash paid for fractional shares	—	—	38,844	441	(449)	(8)
Preferred stock issue	26,724	$2,544	—	—	—	2,544
Preferred stock dividends	—	—	—	—	(124)	(124)
Net Income	—	—	—	—	1,127	1,127
Balance, December 31, 1985	26,724	2,544	833,773	7,155	2,057	11,756
5% stock dividend, less cash paid for fractional shares	—	—	41,003	431	(438)	(7)
Common stock issue	—	—	18,884	226	—	226
Preferred stock dividends	—	—	—	—	(295)	(295)
Common stock dividends	—	—	—	—	(220)	(220)
Net Income	—	—	—	—	1,440	1,440
Balance, December 31, 1986	26,724	$2,544	893,660	$7,812	$2,544	$12,900

See Notes to Consolidated Financial Statements

Consolidated Statements Of Changes In Financial Position

Years ended December 31, 1986, 1985 and 1984
(in thousands)

	1986	1985	1984
Financial resources were provided by (applied to):			
Operations			
Net income	**$ 1,440**	$ 1,127	$ 476
Noncash items:			
Depreciation and amortization	**831**	780	676
Provision for loan losses	**878**	698	750
Provision for deferred income taxes	**353**	264	(257)
Financial resources provided by operations	**3,502**	2,869	1,645
Preferred stock, cash dividend	**(295)**	(123)	—
Common stock, cash dividend	**(220)**	—	—
Net financial resources provided by operations	**2,987**	2,746	1,645
Deposits and other financing activities:			
Deposits:			
Interest bearing	**36,065**	13,575	20,753
Noninterest bearing	**11,989**	5,885	3,459
	48,054	19,460	24,212
Other financing activities:			
Issuance of common stock	**226**	—	—
Issuance of preferred stock	—	2,544	—
Subordinated debt issued	—	1,257	—
Long-term debt borrowings	**1,000**	—	2,500
Long-term debt retired	**(154)**	(2,096)	(59)
Subordinated debt retired	**(243)**	(260)	(282)
Net effect of stock dividend	**(7)**	(8)	(11)
	822	1,437	2,148
Other activities:			
Cash and due from banks	**(2,784)**	(246)	(1,109)
Premises and equipment, net	**(214)**	(899)	(846)
Other real estate owned, net	**(192)**	2,042	309
Other, net	**(1,411)**	(663)	3,588
	(4,601)	234	1,942
Increase in financial resources invested in earning assets	**$47,262**	$23,877	$29,947
Increase (decrease) in earning assets:			
Federal funds sold	**$ 5,200**	$ (1,000)	$ 1,000
Investment securities	**12,008**	7,112	3,898
Loans held for sale	**134**	(2,407)	4,407
Loans, net	**32,887**	18,065	12,605
Investment in real estate	**(2,967)**	2,107	8,037
Increase in earning assets	**$47,262**	$23,877	$29,947

See Notes to Consolidated Financial Statements

Notes To Consolidated Financial Statements
Years ended December 31, 1986, 1985 and 1984

Note A — General Summary of Significant Accounting Policies:

The accounting and reporting policies of TriCo Bancshares (the "Company") conform to generally accepted accounting principles and prevailing practices within the banking industry. The Company carries its assets and liabilities principally on the historical cost basis and follows the accrual method of accounting.

Basis of Presentation

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary, Tri Counties Bank (the "Bank") and the wholly-owned subsidiaries of the Bank. All material intercompany accounts and transactions have been eliminated.

Investment Securities

Investment securities are carried at cost, adjusted for the accretion of discounts and amortization of premiums using the straight-line method which is not materially different from the interest method. Amortization is recognized as an adjustment to interest income. Gains and losses (determined on a specific identification basis) on sales of investment securities are presented separately in the statements of income.

Loans

Loans are reported at the principal amount outstanding, net of unearned income and the allowance for loan losses. Unearned discount on installment loans is recognized as income over the terms of the loans by using principal amounts outstanding. Interest on other loans is calculated by using the simple interest method on the daily balance of the principal amount outstanding.

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Accrual of interest on loans is generally discontinued either when reasonable doubt exists as to the full, timely collection of interest or principal or when a loan becomes contractually past due by ninety days or more with respect to interest or principal. When a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed against the allowance for loan losses. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of Management, the loans are estimated to be fully collectible as to both principal and interest.

Renegotiated loans are those loans on which concessions in terms have been granted because of a borrower's financial difficulty. Interest is generally accrued on such loans in accordance with the new terms.

Direct finance leases are carried net of unearned income. Income from these leases is recognized on a basis which generally produces a level yield on the outstanding balances receivable.

Loan Fees

Loan fees are recognized as income to the extent they represent reimbursements of loan origination costs.

Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses charged to expenses. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely or, with respect to consumer installment loans, according to an established delinquency schedule. The allowance is an amount that Management believes will be adequate to absorb losses inherent in existing loans, leases and commitments to extend credit, based on evaluations of the collectibility and prior loss experience of loans, leases and commitments to extend credit. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, loan concentrations, specific problem loans, commitments, and current and anticipated economic conditions that may affect the borrower's ability to pay.

Intangible Assets

Intangible assets (included in other assets) represent the purchased deposit account base (core, deposits) acquired in connection with the acquisition of Shasta County Bank. Core deposits represent the present value of the expected future benefits to be realized from the acquired bank's deposit base, comprised principally of demand and savings deposits. Core deposits are amortized over 10 years using the straight-line method.

Premises and Equipment

Premises (including those acquired under capital lease) and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization expenses are computed using the straight-line method over the shorter of the estimated useful life of the asset or lease term.

Investment in Real Estate

Investment in real estate is stated at the lower of cost or market and consists of properties either acquired or transferred from other real estate owned for the purpose of development or to be held as income earning assets.

Subsequent to acquisition or transfer, properties included in the investment in real estate account are periodically appraised. Any decline in value below the carrying amount of a property is charged to other noninterest expense. Income and expenses on the investment in real estate is included in other operating expenses.

Other Real Estate Owned

Real estate acquired by foreclosure is carried at the lower of the recorded investment in the property or its fair value. Prior to foreclosure, the value of the underlying loan is written down to the fair market value of the real estate to be acquired by a charge to the allowance for loan losses, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other expenses.

Income Taxes

Deferred income taxes are provided for timing differences between items of income or expense reported in the consolidated financial statements and those reported for income tax purposes. Investment tax credits related to premises and equipment are accounted for under the flow-through method as a reduction of income tax expense in the period the assets are placed in service.

Earnings per Common Share

Earnings per common share are computed based on the weighted average number of shares of common stock and common stock equivalents assumed outstanding during each year. The assumed conversion of the convertible capital notes results in elimination of the related interest expense, net of income tax effect, in the computation of earnings per common share in 1986 and 1985. In 1984, the conversion of the capital notes was not assumed for computation purposes because the effect of such conversion would have been antidilutive. The weighted average number of shares used in the computation of earnings per common share were 1,021,591, 1,042,194 and 872,226 for 1986, 1985 and 1984. Fully diluted earnings per common share are not presented because such amounts would not differ materially from the reported earnings per common share amounts in any of the years presented.

Note B — Restricted Cash Balances:

Reserves (in the form of deposits with the Federal Reserve Bank) of $1,250,000 were maintained to satisfy Federal regulatory requirements at December 31, 1986.

Note C — Investment Securities:

The carrying amount and estimated market values of investment securities are summarized as follows:

	December 31, 1986		December 31, 1985	
	Carrying Amount	**Market Value**	Carrying Amount	Market Value
		(in thousands)		
U.S. Treasury and other U.S. Government agencies and corporations	**$29,757**	**$29,734**	$15,044	$15,267
State and political subdivisions	**11,673**	**11,698**	14,378	14,428
	$41,430	**$41,432**	$29,422	$29,695

Investment securities with an aggregate carrying amount of $3,774,000 and $4,600,000 at December 31, 1986 and 1985, were pledged as collateral for public deposits as required by law.

The Bank generally intends to hold investment securities to maturity, and therefore, a valuation allowance is not provided for the excess of carrying amount over market value.

Note D — Allowance for Loan Losses:

Transactions in the allowance for loan losses were as follows:

	Years ended December 31,	
	1986	1985
	(in thousands)	
Balance, beginning of year	**$1,121**	$ 945
Provision charged to operations	**878**	698
Loans charged off	**(855)**	(628)
Recoveries of loans previously charged off	**206**	106
Balance, end of year	**$1,350**	$1,121

Loans classified as nonaccrual amounted to approximately $1,689,000 and $2,086,000 at December 31, 1986 and 1985. If interest on those loans had been accrued, such income would have approximated $131,000 and $320,000 in 1986 and 1985.

Note E — Premises and Equipment:

Premises and equipment are comprised of:

	December 31,	
	1986	1985
	(in thousands)	
Premises (including $831,000 acquired under capital lease)	**$5,587**	$5,898
Furniture and equipment	**2,662**	2,148
	8,249	8,046
Less accumulated:		
Depreciation	**(2,555)**	(2,040)
Amortization of capital lease	**(190)**	(155)
	5,504	5,851
Land	**1,096**	1,123
	$6,600	$6,974

Depreciation and amortization of premises and equipment amounted to $582,000, $555,000 and $451,000 in 1986, 1985 and 1984.

Note F — Income Taxes:

The provision (credit) for income taxes is comprised of:	1986	1985	1984
	Years ended December 31,		
Tax expense (credit) applicable to income, net of tax credits:		(in thousands)	
Federal	**$515**	$ 122	$(199)
State	**235**	149	20
	$750	$271	$(179)
Current:			
Federal	**$118**	$ 10	$ —
State	**279**	179	78
	397	189	78
Deferred:			
Federal	**397**	72	(199)
State	**(44)**	10	(58)
	353	82	(257)
	$750	$ 271	$(179)

The components of deferred income tax expense are as follows:

Items applied to increase (reduce) deferred income taxes:			
Tax credits	**$515**	$ 38	$(172)
Accrual income deferred for tax purposes, net	**(145)**	102	(237)
Provision for loan losses	**3**	(22)	(19)
Provision for loss on other real estate	**134**	(77)	(68)
Amortization of core deposits	**(168)**	(112)	14
Use of accelerated depreciation methods for tax purposes	**113**	39	37
Capitalized leases	**(20)**	(11)	(9)
Direct financing leases	**(35)**	31	73
Restoration of deferred taxes, applicable to utilization of prior year's net operating loss carryovers	**—**	58	109
Other differences	**(44)**	36	15
	$353	$ 82	$(257)

A reconciliation of the federal statutory income tax rate to the Company's consolidated effective tax rate is as follows:

Federal statutory income tax rate	**46.0%**	46.0%	46.0%
Reduction of taxes previously provided, no longer required	**—**	(5.3)	(33.8)
State income taxes, net of federal tax benefit	**5.9**	5.8	5.9
Investment tax credits	**—**	(1.3)	(57.9)
Tax-exempt interest on municipal obligations	**(15.4)**	(24.5)	(10.7)
Tax bracket rate differential	**—**	(1.5)	(6.8)
Other	**(2.3)**	.1	(2.9)
Effective tax rate	**34.2%**	19.3%	(60.2)%

Investment tax credits of $18,000 and $172,000 reduced the provision for federal income taxes for the years ended December 31, 1985 and 1984.

The Company has tax credit carryforwards of $50,000 available to offset federal income taxes payable in 1987. The tax credit carryforward will be reduced to $41,000 thereafter and expires in the year 2000.

Note G — Long-term Debt:

Long-term debt at December 31, 1986 and 1985 consisted of:

	1986	1985
	(in thousands)	
9½% convertible subordinated capital notes payable in annual installments of $400,000, including interest; balance due March 27, 1988. Notes are convertible into common stock of the Company originally at $15.20 per share (subject to certain adjustments as defined in the Note agreement). The adjusted price at December 31, 1986 was $11.93. Notes may be prepaid in whole or in part at par value any time prior to maturity, subject to the holder's prior right of conversion.	**$1,641**	$1,884
14¼% subordinated capital notes due on July 1, 1988 and July 1, 1992, in the amounts of $393,000 and $864,600, with interest payable monthly. Notes may be prepaid in whole or in part anytime after July 1, 1988.	**1,257**	1,257
9% subordinated capital notes due April 1, 1989, with interest payable semiannually. Notes may be prepaid in whole or in part at any time.	**150**	150
Term loan agreements, interest at prime plus 1 to 2 percent, (9.5% at December 31, 1986) collateralized by 100% of the Bank stock, require the Bank to maintain a primary capital to total assets ratio of at least .07 to 1 and restrict payments of cash dividends or distribution of the Company's assets to its shareholders:		
Quarterly principal payments $15,650 through June 15, 1992	**344**	407
Quarterly principal payments $20,833 through June 15, 1993	**458**	—
Quarterly principal payments $20,833 through June 15, 1993	**458**	—
10% mortgage payable in monthly installments of $4,000, including interest, through December 1, 2003, collateralized by a first deed of trust on certain Bank premises.	**376**	383
Capital lease obligation on premises, effective interest rate of 12%, payable monthly in varying amounts through December 1, 2009.	**586**	586
	$5,270	$4,667

The aggregate maturities of long-term debt, excluding the capital lease obligation, are as follows:

	(in thousands)
1987	$ 477
1988	2,030
1989	386
1990	236
1991	236
1992 and after	1,319

Future minimum annual lease payments under the capital lease obligation are as follows:

	(in thousands)
1987	$ 75
1988	75
1989	76
1990	77
1991	78
1992 and after	1,567
Net minimum lease payments	1,948
Less amount representing interest	1,362
Present value of net minimum lease payments	$ 586

Note H — Other Operating Expenses:

The components of other operating expenses are as follows:

	Years ended December 31,		
	1986	1985	1984
	(in thousands)		
Equipment and data processing	**$ 826**	$ 861	$ 804
Occupancy	**777**	556	494
Advertising	**241**	139	82
Net other real estate expense	**440**	307	448
Losses and expenses net of income on investment in real estate	**534**	—	—
Legal	**231**	168	290
Other	**1,964**	1,697	1,613
	$5,013	$3,728	$3,731

Note I — Retirement Plans:

During 1984 the Company created a discretionary employee stock ownership plan and a discretionary profit-sharing plan. Substantially all the employees with at least one year's service as of the end of the calendar year participate in both the discretionary employee stock ownership plan and the discretionary profit-sharing plan. Contributions are made to each plan at the discretion of the Board of Directors. A contribution to the discretionary employee stock ownership plan of $192,000 and $132,000 was approved by the Board of Directors in 1986 and 1985. No contributions were approved to the discretionary profit-sharing plan in 1986 or 1985.

Note J — Preferred Stock:

On July 31, 1985, the Company issued 26,724 shares of Series A Preferred Stock.

The Company may redeem the preferred stock in whole or in part at its option on or after July 1, 1988 at $100 per share plus accrued and unpaid dividends. The preferred stock is nonvoting, has a dividend preference and has a liquidation preference of $100 per share plus accrued and unpaid dividends.

Note K — Dividend Restrictions:

Banking regulations limit the amount of dividends that may be paid without prior approval of the Bank's regulatory agencies. Retained earnings from which dividends may be paid without prior approval of the State Superintendent of Banks amounted to $1,727,000 at December 31, 1986. The amount of dividends that may be paid is subject to the minimum capital ratio requirements of the Bank's regulatory agencies and the term loan agreements.

Note L — Related Party Transactions:

Certain directors and officers and companies with which they are associated were customers of, and had banking transactions with, the Bank in the ordinary course of business. It is the Bank's policy that all loans and commitments to lend to officers and directors be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other borrowers. Such loans are summarized as follows:

	December 31,	
	1986	1985
	(in thousands)	
Loans outstanding	**$4,784**	$3,247

Note M — Commitments and Contingencies:

In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities that are not presented in the accompanying financial statements. The commitments and contingent liabilities include various guarantees, commitments to extend credit, and standby letters of credit. At December 31, 1986, undisbursed commercial and real estate loans amounted to $16,308,000 and $2,730,000. Standby letters of credit and guarantees totaled $1,087,000 at December 31, 1986. The Bank does not anticipate any material losses as a result of the commitments and contingent liabilities.

The Bank has available unused lines of credit totaling $9,000,000 for federal funds transactions.

The Bank is a defendant in legal actions arising from normal business activities. Management believes that these actions are without merit or that the ultimate liability, if any, resulting from them will not materially affect the Bank's financial position.

At December 31, 1986, minimum commitments under noncancellable operating leases with initial or remaining terms of one year or more are as follows:

	(in thousands)
1987	$150
1988	142
1989	137
1990	133
1991	94
1992 and later	641

Rent expense under operating leases was $228,000 $259,000 and $253,000 in 1986, 1985 and 1984.

Loans Held for Sale

At December 31, 1986, the Company was committed to sell approximately $2,134,000 in conventional mortgage loans to the Federal Home Loan Mortgage Corporation.

Note N — Earnings per Common Share:

Earnings per common share for 1985 were previously reported at $1.30 per common share. The earnings per common share for 1985 should have been $1.10 per common share after the effect of deducting preferred stock dividends but before the retroactive effect of the 5% stock dividend in 1986. Earnings per common share for 1985 after the retroactive effect of the 5% stock dividend in 1986 are $1.05 per common share.

Earnings per common share for the first three quarters of 1986, as restated (unaudited), are $.38, $.22 and $.39.

Note O — TriCo Bancshares Financial Statements: TriCo Bancshares (Parent Only) Balance Sheets

Assets	December 31, 1986	1985
	(in thousands)	
Cash	**$ 279**	$ 1
Loans	**350**	—
Investment in Tri Counties Bank	**14,279**	13,078
Other assets	**104**	66
Income tax benefit	**451**	316
Total Assets	**$15,463**	$13,461
Liabilities and Shareholders' Equity		
Liabilities:		
Long-term debt	**$ 2,518**	$ 1,665
Other liabilities	**45**	40
Shareholders' equity:		
Preferred stock, no par value; shares authorized 1,000,000; shares issued and outstanding 26,724 shares	**2,544**	2,544
Common stock, no par value; shares authorized 20,000,000; shares issued and outstanding 893,660 and 833,773 shares	**7,812**	7,155
Retained earnings	**2,544**	2,057
Total shareholders' equity	**12,900**	11,756
Total Liabilities and Shareholders' Equity	**$15,463**	$13,461

Statements of Income

	Years ended December 31, 1986	1985	1984
	(in thousands)		
Interest income	**$ 13**	$ 8	$ —
Interest expense on long-term debt	**256**	258	297
Administration expense	**17**	7	63
Total expense	**273**	265	360
Loss before equity in net income of Tri Counties Bank	**260**	257	360
Equity in net income of Tri Counties Bank	**1,565**	1,250	642
Income tax credits	**(135)**	(134)	(194)
Net income	**$1,440**	$1,127	$476

Statements of Changes in Financial Position

	Years ended December 31, 1986	1985	1984
	(in thousands)		
Financial resources were provided by (applied to):			
Operations:			
Net income	**$1,440**	$1,127	$ 476
Noncash items:			
Equity in net income of Tri Counties Bank	**(1,565)**	(1,251)	(642)
Amortization	**13**	6	6
Provision for deferred income taxes	**(135)**	(134)	(182)
Financial resources provided by operations	**(247)**	(252)	(342)
Preferred stock, cash dividend	**(295)**	(123)	—
Common stock, cash dividend	**(220)**	—	—
Net financial resources provided by operations	**(762)**	(375)	(342)
Deposits and other financing activities:			
Financing activities and shareholders' equity transactions:			
Issuance of common stock	**226**	—	—
Issuance of preferred stock	**—**	2,544	—
Subordinated debt issued	**—**	1,257	—
Long-term debt incurred	**1,000**	—	2,500
Long-term debt retired	**(147)**	(1,906)	—
Contributed capital to Tri Counties Bank	**(600)**	(1,800)	(2,500)
Dividend from Tri Counties Bank	**925**	503	303
Net effect of stock dividend	**(7)**	(8)	(11)
Other activities:			
Cash and due from banks	**(278)**	—	38
Other	**(7)**	(215)	12
Increase in financial resources invested in earning assets	**$ 350**	$ —	$ —
Increase in earning assets:			
Loans, net	**$ 350**	$ —	$ —
Increase in earning assets	**$ 350**	$ —	$ —

Common Stock Information

Market Information. The Common Stock of the Company is not listed on any exchange nor is it listed with NASDAQ. There is only a limited trading market in the Company's Common Stock. Since August 15, 1986, Sutro & Company has been a market-maker in the Common Stock of the Company. The following table summarizes those trades of which the Company has knowledge, setting forth the approximate high ask and low bid prices for the periods indicated. The prices indicated below may not necessarily represent actual transactions.

	Prices of the Company's Common Stock[1,2]		Approximate Trading Volume
Quarter Ended:	**High**	**Low**	**(in shares)**
March 31, 1985	$10.48	$ 9.52	3,678
June 30, 1985	$10.00	$ 9.52	2,675
September 30, 1985	$10.00	$ 9.52	3,717
December 31, 1985	$10.00	$ 9.52	5,204
March 31, 1986	$10.50	$10.00	13,478
June 30, 1986	$10.50	$10.00	38,161
September 30, 1986	$11.63	$10.50	43,755
December 31, 1986	$12.75	$11.00	57,050

[1]As estimated by the Company, based upon trades of which the Company was aware. The Company is not aware of the price of some of the trades included in the Approximate Trading Volume.

[2]Figures adjusted to reflect the 5% stock dividend paid in 1986.

Holders. As of December 31, 1986, there were approximately 1,535 holders of record of the Company's Common Stock.

Dividends. On December 10, 1986, the Company paid a cash dividend of $.25 per share of Common Stock. The Company has paid no other cash dividends during the last two fiscal years, but on June 16, 1986 and February 28, 1985, the Company paid 5% stock dividends to its shareholders. The holders of Common Stock of the Company are entitled to receive cash dividends when and as declared by the Board of Directors, out of funds legally available therefor, subject to the restrictions set forth in the California General Corporation Law (the "Corporation Law"), certain loan agreements of the Company and the dividend rights of the holders of the Series A Preferred Stock.

Pursuant to the terms of loan agreements between the Company and First Interstate Bank of California in the aggregate amount of $1,260,000, the Company is restricted in its ability to pay cash dividends to its Common Stock shareholders. See Note K to Notes to Consolidated Financial Statements. The Certificate of Determination of Preferences of the Series A Preferred Stock prohibits the payment of dividends to the holders of Common Stock if the Company is not current in its payments of dividends to the Preferred Stock shareholders.

The Corporation Law provides that a corporation may make a distribution to its shareholders if the corporation's retained earnings equal at least the amount of the proposed distribution. The Corporation Law further provides that, if sufficient retained earnings are not available for the proposed distribution, a corporation may nevertheless make a distribution to its shareholders if immediately after giving effect to such dividend the corporation meets the following two conditions: (i) the corporation's assets equal at least 1¼ times its liabilities, and (ii) either the corporation's current assets equal at least its current liabilities or, if the average of the corporation's earnings before taxes on income and before interest expense for the two preceding fiscal years was less than the average of the corporation's interest expense for such fiscal years, the corporation's current assets equal at least 1¼ times its current liabilities.

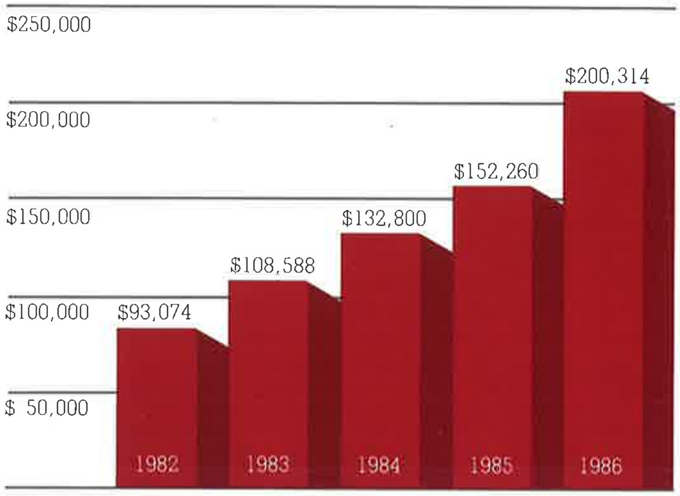
The Company, as sole shareholder of the Bank, is entitled to dividends when and as declared by the Bank's Board of Directors, out of funds legally available therefor, subject to the powers of the Federal Deposit Insurance Corporation (the "FDIC") and the restrictions set forth in the California Financial Code (the "Financial Code") and the loan agreements. The Financial Code provides that a bank may not make any distributions to its shareholders in excess of the lesser of: (i) the bank's retained earnings, or (ii) the bank's net income for its last three fiscal years, less the amount of any distributions made by the bank to its shareholders during such period. However, a bank may, with the prior approval of the California Superintendent of Banks (the "Superintendent"), make a distribution to its shareholders of up to the amount of its net income for its last fiscal year. If the Superintendent determines that the shareholders' equity of a bank is inadequate or that a distribution by the bank to its shareholders would be unsafe or unsound, the Superintendent may order a bank to refrain from making a proposed distribution. The FDIC may also order a bank to refrain from making a proposed distribution when, in its opinion, the payment of such would be an unsafe or unsound practice. The Bank paid cash dividends in the aggregate amount of $925,000 in 1986. The loan agreements with First Interstate Bank of California restrict the dividends that the Bank may pay to the Company.

The Federal Reserve Act limits the loans and advances that the Bank may make to its affiliates. For purposes of such Act, the Company is an affiliate of the Bank. The Bank may not make any loans, extensions of credit or advances to the Company if the aggregate amount of such loans, extensions of credit, advances and any repurchase agreements and investments exceeds 10% of the capital stock and surplus of the Bank. Any such permitted loan or advance by the Bank must be secured by collateral of a type and value set forth in the Federal Reserve Act.

Financial Highlights

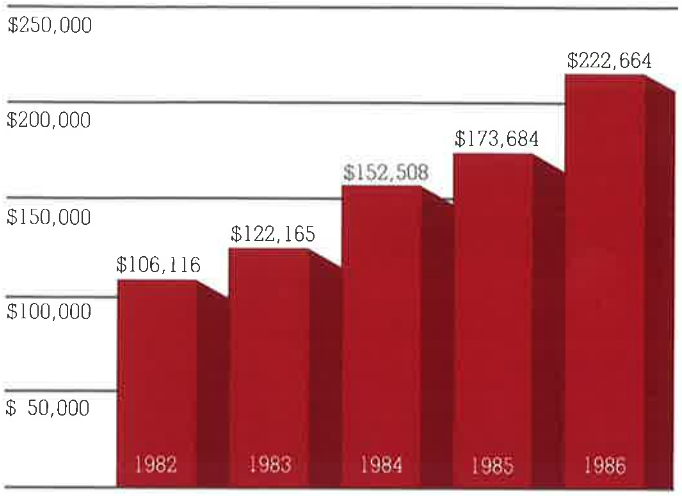
Deposits

(in thousands)
December 31,



Total Assets

(in thousands)
December 31,



Management's Discussion and Analysis of Financial Condition and Results of Operations

As the Company has not commenced any business operations independent of the Bank, its only subsidiary, the following discussion pertains primarily to the activities of the Bank.

(A) Results of Operations.

The following is a summary of operations for the five years ended December 31, 1986 and Management's discussion and analysis of the significant changes in income and expense accounts presented therein for the most recent two years — each as compared with its respective prior period. This information should be read in conjunction with the financial statements and notes related thereto appearing elsewhere in this Annual Report.

	Years ended December 31,				
	1986	1985[1]	1984[1]	1983[1]	1982[1]
	(in thousands, except earnings per share amounts)				
Interest income:					
Interest and fees on loans	**$16,781**	$14,868	$13,505	$11,945	$11,349
Interest on investment securities (taxable)	**1,155**	1,172	1,920	1,288	1,032
Interest on investment securities (tax free)[2]	**1,489**	1,538	126	—	—
Interest on time deposits and federal funds sold	**331**	183	187	211	53
Total interest income	**19,756**	17,761	15,738	13,444	12,434
Interest expense:					
Interest on deposits	**9,352**	8,850	8,335	6,673	6,269
Interest on short-term borrowing	**6**	45	56	15	87
Interest on long-term debt	**581**	664	656	351	419
Total interest expense	**9,939**	9,559	9,047	7,039	6,775
Net interest income	**9,817**	8,202	6,691	6,405	5,659
Less provision for loan losses	**878**	698	750	983	860
Net interest income after provision for loan losses	**8,939**	7,504	5,941	5,422	4,799
Other income:					
Gain on security transactions	**1,013**	515	70	143	268
Service charges and other	**1,924**	1,537	1,529	1,465	1,120
Total other income	**2,937**	2,052	1,599	1,608	1,388
Other expenses:					
Salaries and employee benefits	**3,989**	3,720	3,449	3,246	3,133
Other operating expenses	**5,013**	3,728	3,731	3,088	2,756
Total other expenses	**9,002**	7,448	7,180	6,334	5,889
Income before provision for income taxes	**2,874**	2,108	360	696	298
Provision (credit) for income taxes-actual	**750**	271	(179)	152	80
Tax equivalent adjustment	**684**	710	63	—	—
Net income	**$ 1,440**	$ 1,127	$ 476	$ 544	$ 218
Earnings per common share	**$ 1.20**	$ 1.05	$ .54	$ .63	$ .26
Selected Balance Sheet Information					
Total assets	**$222,664**	$173,684	$152,508	$122,165	$106,116
Long-term obligations	**$ 5,270**	$ 4,667	$ 5,772	$ 3,613	$ 4,014
Preferred Stock	**$ 2,544**	$ 2,544	—	—	—

[1] Certain reclassifications have been made in the 1985, 1984, 1983 and 1982 summary of operations to conform to classifications in 1986.
[2] Interest on tax-free securities is reported on a tax equivalent basis of 1.85.

Management's Discussion and Analysis of Financial Condition and Results of Operations

(A) Results of Operations. (continued)

This seems right?

Net Interest Income

The major component of income, net interest income, continued to increase in 1986. Net interest income increased to $9,817,000 in 1986 from $8,202,000 in 1985. This 20% increase is due to an increase in the volume of interest earning assets, partly offset by an increase in interest bearing liabilities and a decrease in the net yield on earning assets. Net income in 1985 increased compared to 1984 as a result of an increase in net yield on earning assets and an increase in the volume of interest earning assets.

Net interest income is the most significant contributor to the Bank's earnings. Net interest income represents the excess of interest and fees earned on interest earning assets (loans, investment securities and federal funds sold) over the interest paid on deposits and borrowed funds.

Table One: Analysis of Change in Net Yield on Earning Assets

	1986			1985			1984		
Assets	**Average Balance[1]**	**Income/ Expense**	**Yield/ Rate**	Average Balance[1]	Income/ Expense	Yield/ Rate	Average Balance[1]	Income/ Expense	Yield/ Rate
				(amounts in thousands)					
Earning Assets:									
Loans[2,3]	**$125,527**	**$16,781**	**13.37%**	$102,709	$14,868	14.48%	$ 85,285	$13,505	15.84%
Investment Securities[4]	**26,212**	**2,644**	**10.09%**	22,284	2,710	12.16%	19,975	2,046	10.24%
Federal funds sold	**5,165**	**331**	**6.41%**	2,211	183	8.28%	1,665	187	11.23%
Total earning assets	**156,904**	**19,756**	**12.59%**	127,204	17,761	13.96%	106,925	15,738	14.72%
Cash and due from banks	**8,435**			8,909			8,209		
Premises and equipment	**7,230**			7,027			6,481		
Other assets	**18,193**			16,891			12,608		
Less: Allowance for loan losses	**(1,228)**			(1,015)			(795)		
Total	**$189,534**			$159,016			$133,428		
Liabilities and shareholders' equity									
Interest bearing liabilities:									
Demand deposits (interest bearing)	**$ 54,207**	**3,286**	**6.06%**	$ 44,872	3,103	6.92%	$ 36,511	3,039	8.32%
Savings deposits	**13,755**	**751**	**5.46%**	11,443	631	5.51%	11,351	637	5.61%
Time deposits	**66,283**	**5,315**	**8.02%**	54,913	5,116	9.32%	43,964	4,659	10.60%
Federal funds purchased	**88**	**6**	**6.82%**	540	45	8.33%	487	56	11.50%
Long-term debt and mortgages	**4,769**	**581**	**12.18%**	5,160	664	12.87%	5,695	656	11.52%
Total interest bearing liabilities	**139,102**	**9,939**	**7.15%**	116,928	9,559	8.18%	98,008	9,047	9.23%
Demand deposits	**34,596**			28,919			25,550		
Other liabilities	**3,473**			3,202			1,887		
Shareholders' equity	**12,363**			9,967			7,882		
Total	**$189,534**			$159,016			$133,327		
Net interest income		**$ 9,817**			$ 8,202			$ 6,691	
Net yield on earning assets[5]		**6.26%**			6.45%			6.26%	

[1] Average balances are computed principally on the basis of daily balances.
[2] Nonaccrual loans are included.
[3] Interest income on loans includes fees on loans of $1,352,000 in 1986, $1,224,000 in 1985 and $994,000 in 1984.
[4] Interest income is stated on a tax equivalent basis of 1.85.
[5] Net yield on interest earning assets is computed by dividing net interest earnings by total interest earning assets. Net interest income is the difference between the total interest earned and the total interest paid.

Management's Discussion and Analysis of Financial Condition and Results of Operations

(A) Results of Operations. (continued)

The accompanying tables analyze the changes in net interest income for 1986, 1985 and 1984. The first table provides an analysis of change in net yield on earning assets setting forth average assets, liabilities and shareholders' equity; interest income earned and interest expense paid and average rates earned and paid; and the net yield on earning assets. The second table presents an analysis of volume and rate changes on net interest income and expense.

Table Two: Analysis of Volume and Rate Changes on Net Interest Income and Expense

	1986 over 1985			1985 over 1984			1984 over 1983		
	Volume	**Yield/ Rate**	**Total**	Volume	Yield/ Rate	Total	Volume	Yield/ Rate	Total
				(in thousands)					
Increase (decrease) in interest income:									
Loans[1,2]	**$3,051**	**$(1,138)**	**$1,913**	$2,523	$(1,160)	$1,363	$1,028	$ 532	$1,560
Investment securities[3]	**396**	**(462)**	**(66)**	81	583	664	700	58	758
Federal funds sold	**189**	**(41)**	**148**	45	(49)	(4)	(85)	61	(24)
Total	**3,636**	**(1,641)**	**1,995**	2,649	(626)	2,023	1,643	651	2,294
Increase (decrease) in interest expense:									
Demand deposits (interest bearing)	**566**	**(383)**	**183**	579	(515)	64	36	66	102
Savings deposits	**126**	**(6)**	**120**	5	(11)	(6)	(128)	21	(107)
Time deposits	**912**	**(713)**	**199**	1,020	(563)	457	1,104	563	1,667
Federal funds purchased	**(31)**	**(8)**	**(39)**	4	(15)	(11)	37	4	41
Long-term borrowings	**(48)**	**(35)**	**(83)**	(69)	77	8	208	97	305
Total	**1,525**	**(1,145)**	**380**	1,539	(1,027)	512	1,257	751	2,008
Increase (decrease) in net interest income	**$2,111**	**$ (496)**	**$1,615**	$1,110	$ 401	$1,511	$ 386	$(100)	$ 286

[1] Nonaccrual loans are included.
[2] Interest income on loans includes fees on loans of $1,352,000 in 1986 and $1,224,000 in 1985 and $994,000 in 1984.
[3] Interest income is stated on a tax equivalent basis of 1.85.

Interest Income

Interest income increased 11% to $19,756,000 in 1986 from $17,761,000 in 1985 due to continued growth in the amount of earning assets. Average earning assets increased 23% in 1986 compared to 19% in 1985. Average rates earned on earning assets decreased to 12.59% in 1986 from 13.96% in 1985.

The Bank experienced continued growth in its loan portfolio, an increase of 22% in 1986, 20% in 1985. The interest income increase due to this increased volume of loans was offset by a rate reduction resulting in a total of increased interest income on loans of 13%. The increased interest income on loans in 1985 was similarly reduced by an interest rate reduction.

The Bank continued to increase its holding of investment securities in 1986. The interest income from the increased volume of securities was offset by reduced interest rates resulting in a 2% decrease of interest income from securities. Income from tax-free securities is restated to reflect the tax benefit. This benefit was $684,000 in 1986 and $710,000 in 1985. Income from securities increased $664,000 in 1985 due to both an increase in volume of securities and an increase in the rate of interest on tax-free securities.

Fees on loans increased 11% and 23% in 1986 and 1985. The increased volume of real estate loans provided the major portion of this increase.

Interest Expense

Interest expense in 1986 increased to $9,939,000 from $9,559,000 in 1985. This resulted from the continued increase in the volume of interest bearing demand, savings and time deposits under $100,000, offset by the decreased interest rates and a continued decrease in deposits over $100,000. In 1985, interest expense increased due to the increase in volume of time deposits partly offset by a decreased rate of interest.

Interest on federal funds purchased decreased in 1986 due primarily to a reduced average amount of federal funds purchased. The interest on federal funds purchased decreased in 1985 primarily due to a lower interest rate.

Interest on long-term debt decreased due to the decrease in average volume of long-term debt and lower interest rates.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Net Yield on Earning Assets

The net yield on earning assets declined to 6.26% in 1986 from 6.45% in 1985. This change resulted primarily from increased rate differential; that is, interest rates on interest earning assets decreased more than interest rates on interest bearing liabilities. In 1985, the net yield on earning assets increased to 6.45% from 6.26% in 1984. This increase was due to increased rate differential and a shift of time deposits to money market accounts.

Other Income

Income from service charges and fees totaled $1,575,000, $1,251,000 and $1,242,000 in 1986, 1985 and 1984. This increase is due primarily to the increased number of checking and savings accounts and to the increased fees generated from analysis of the monthly activity of commercial accounts.

Securities Transactions

Net gains from security transactions were $1,013,000, $515,000 and $70,000 in 1986, 1985 and 1984. The Bank does not actively trade in the securities market but does elect, for liquidity purposes, to sell certain securities when it is to its advantage during periods of declining interest rates.

Other Expenses

Salaries and benefits increased 7% in 1986 and 8% in 1985, primarily due to annual salary adjustments and increased insurance costs.

Other operating expenses increased primarily due to general and administrative expenses resulting from the growth of the Bank, increased expense in the sale of Other Real Estate Owned and losses in the sale of investment properties.

Provision (credit) for Income Taxes

The effective tax rate on income was 34% in 1986. The effective tax rate was less than the statutory rate due to tax-free interest of $805,000. Similarly, the effective tax rate in 1985 was 19% due to the tax-free interest of $828,000.

Return on Assets and Equity

The following sets forth certain ratios for the Company for the last three years (using average balance sheet data):

	1986	1985	1984
Return on assets	**.76%**	.71%	.36%
Return on shareholders' equity	**11.65%**	11.31%	6.04%
Return on common shareholders' equity	**11.66%**	11.54%	6.04%
Shareholders' equity to assets	**6.52%**	6.27%	5.91%
Common shareholders' equity to assets	**5.18%**	5.47%	5.91%
Common shareholders' dividend payout ratio	**20.83%**	—	—

In 1986, the return on assets increased primarily due to income of $1,440,000 offset by a $30,518,000 increase in average assets. Similarly, the return on assets in 1985 increased due to increased income offset by a $25,588,000 increase in average assets.

The return on shareholders' equity and common shareholders' equity to assets increased in 1986 and 1985 primarily due to the increase in income.

The ratio of shareholders' equity to assets increased in 1986 and 1985 due to increase in income and increase in average preferred stock issued in 1985, offset by an increase in average assets.

The ratio of common shareholders' equity to assets decreased in 1986 and 1985 primarily due to the increase in average assets of $30,518,000 in 1986 and $25,588,000 in 1985.

In 1986, the Company paid its first cash dividend of $.25 per share at a dividend payout ratio of 20.83%.

Management's Discussion and Analysis of Financial Condition and Results of Operations

(B) Balance Sheet Analysis.

Loans

Total loans increased 29% in 1986 following an increase of 19% in 1985. The mix of loans changed. Commercial loans remained 46% of the loan portfolio, consumer loans decreased to 23% in 1986, compared to 30% in 1985 and real estate loans increased to 25% in 1986 compared to 18% in 1985. Real estate loans totaling $17,623,000 were sold to FHLMC in 1986. The increase in real estate loans was due primarily to increased volume and refinancing of single family residences.

Loan Portfolio Composite

	December 31,				
	1986	1985	1984	1983	1982
	(in thousands)				
Commercial, financial and agricultural	**$ 63,861**	$ 48,040	$36,003	$34,386	$33,805
Consumer installment	**33,053**	32,500	29,178	21,974	19,021
Real estate mortgage	**34,773**	19,259	20,007	17,141	15,215
Real estate construction	**8,462**	7,378	3,753	4,618	4,214
Lease financing	**1,562**	2,296	2,989	1,812	—
Total loans	**$141,711**	$109,473	$91,930	$79,931	$72,255

Nonaccrual, Past Due and Restructured Loans

The table below sets forth the nonaccrual loans and loans carried on an accrual basis but past due more than 90 days, for the years indicated. There were no loans, the terms of which had been restructured, prior to 1986.

	December 31,				
	1986	1985	1984	1983	1982
	(in thousands)				
Nonaccrual loans	**$ 1,689**	$ 2,086	$ 1,515	$ 2,625	$ 746
Past due loans (90 days or more)	**1,598**	1,812	1,475	1,625	3,838
Restructured debt	**415**				
Total	**$ 3,702**	$ 3,898	$ 2,990	$ 4,250	$ 4,584

Nonperforming loans decreased to 2.6% of total loans in 1986 compared to 3.6% in 1985. Commercial, real estate (other than 1-4 single family dwellings), and consumer loans are reviewed on an individual basis for reclassification to nonaccrual status when any one of the following occurs: the loan becomes 90 days past due as to interest or principal, the full and timely collection of additional interest or principal becomes uncertain, the loan is classified doubtful by internal auditors or bank regulatory agencies, or a portion of the principal balance has been charged off. Approximately $131,000 of additional interest income would have been recorded if loans classified as nonaccrual had been current in 1986. The reclassification of loans as nonperforming does not necessarily reflect Management's judgment as to collectibility.

Allowance for Loan Losses Activity

In determining the adequacy of the loan loss allowance, Management relies primarily on its ongoing review of the loan portfolio, both to ascertain whether there are probable losses to be written off and to assess the loan portfolio in the aggregate. Problem loans are examined on an individual basis to determine estimated probable loss. In addition, Management considers current and projected loan mix and loan volumes, historical net loan loss experience for each loan category, and current and anticipated economic conditions affecting each loan category.

The Bank's total net charge-offs increased by 24% to $649,000 in 1986 from $522,000 in 1985.

The provision for loan losses increased $180,000 in 1986 primarily due to the increased volume of loans. This followed a decrease of $52,000 in 1985. The ratio of net charge-offs to average loans during 1986 increased slightly following a decrease in 1985 and 1984.

Management's Discussion and Analysis of Financial Condition and Results of Operations

(B) Balance Sheet Analysis. (continued)

Allowance for Loan Losses (continued)

The following table summarizes, for the years indicated, the activity in the allowance for loan losses:

	December 31,				
	1986	1985	1984	1983	1982
	(amounts in thousands)				
Balance, beginning of year	**$ 1,121**	$ 945	$ 801	$ 1,092	$ 626
Provision charged to operations	**878**	698	750	983	860
Loans charged off:					
Commercial, financial and agricultural	**(590)**	(332)	(517)	(1,012)	(254)
Consumer installment	**(241)**	(292)	(379)	(237)	(162)
Real estate mortgage	**(24)**	(4)	(20)	(105)	(22)
Real estate construction	**—**	—	—	—	(113)
Total loans charged off	**(855)**	(628)	(916)	(1,354)	(551)
Recoveries:					
Commercial, financial and agricultural	**108**	65	265	35	127
Consumer installment	**98**	34	45	18	29
Real estate mortgage	**—**	7	—	27	1
Real estate construction	**—**	—	—	—	—
Total recoveries	**206**	106	310	80	157
Net loans charged off	**(649)**	(522)	(606)	(1,274)	(394)
Balance, year end	**1,350**	1,121	945	801	1,092
Average total loans	**$125,527**	$102,709	$85,285	$78,797	$67,924
Ratios:					
Net charge-offs during period to average loans outstanding during period	**.52%**	.51%	.71%	1.62%	.58%
Provision for loan losses to average loans outstanding	**.70%**	.68%	.88%	1.25%	1.27%
Allowance to loans at year end	**.95%**	1.02%	1.03%	1.00%	1.51%

Loans Held for Sale

At December 31, 1986, the Bank was committed to sell approximately $2,134,000 in conventional real estate mortgage loans to the Federal Home Loan Mortgage Corporation to provide increased liquidity. The sale was completed in 1987.

Investment in Real Estate

At December 31, 1986, $7,177,000 of property was held by a subsidiary of the Bank for the purposes of development or to be held as income earning assets. $10,144,000 was held at December 31, 1985. This reduction resulted primarily from the sale of $5,100,000 of investment property, offset by the addition of $460,000 in property purchased from the Bank and $1,240,000 development costs.

Deposits

Deposit accounts increased 32% in 1986, from $152,260,000 to $200,314,000. The mix of deposits changed slightly for 1986. Noninterest bearing demand deposits, savings deposits, and other time deposits remained unchanged. Certificates of deposits over $100,000 decreased from 6% of deposits to 2% of deposits and interest bearing demand deposits increased from 31% to 34% of deposits.

Long-Term Debt

Total long-term debt increased by $603,000 in 1986. The Company executed two $500,000 term loan agreements with First Interstate Bank. The Company contributed $600,000 of the proceeds to the Bank as a capital contribution, loaned $350,000 to officers and retained $50,000 for general corporate purposes. During 1986, the Company retired $147,000 of long-term debt and the Bank retired $250,000 of long-term debt.

Equity

The primary capital ratio of the Bank is 7.0%. The primary capital ratio includes the Bank's stockholders' equity and the allowance for loan losses divided by the total assets and the allowance for loan losses at December 31, 1986. Management has determined this ratio is adequate to support the anticipated growth of the Bank.

Liquidity

Liquidity relates to the ability of the Company and the Bank to generate adequate cash to meet their respective needs. The principal cash requirements of the Bank are to cover downward fluctuations in its deposit accounts and unexpected loan demand.

Another indication of potential demand on the Bank's liquidity is the maturity distribution of certificates of deposit in denominations of $100,000 or more which is set forth in the following table. These deposits are generally more rate sensitive than other deposits and therefore more likely to be withdrawn to obtain higher yields elsewhere if available.

Management's Discussion and Analysis of Financial Condition and Results of Operations

(B) Balance Sheet Analysis. (continued)

Certificates of Deposit in Denominations of $100,000 or More —

	Amount as of December 31, 1986	1985
	(in thousands)	
Time remaining until maturity:		
Less than three months	**$2,843**	$6,070
3 months to 6 months	**205**	2,654
6 months to 12 months	**409**	100
More than 12 months	**100**	100
Total	**$3,557**	$8,924

Management believes that the Bank's investment portfolio, together with the Bank's lines of credit with other institutions and the surplus funds due to increased deposits, is sufficiently liquid to cover potential fluctuations in deposit accounts and loan demand. The Bank has maintained a quality portfolio and has selected maturities to provide a proper balance of liquidity and attractive yields. The maturity distribution of the portfolio is presented in the following table:

Investment Securities Maturities — December 31, 1986

	Within One Year	After One but within 5 Years	After 5 but within 10 Years	After 10 Years	Total
	(amounts in thousands)				
U.S. Treasury and other U.S. Government agencies and corporations	$1,752	$17,129	$2,528	$8,348	$29,757
State and political subdivisions	1,510	930	7,134[1]	2,099	11,673
Total book value	$3,262	$18,059	$9,662	$10,447	$41,430
Average yield[2]	9.15%	6.86%	9.81%	8.67%	8.81%

[1] Includes tax-free security, Adams County, Colorado, book value $2,027,288, market value $2,025,000, sold January 28, 1987.
[2] Yields are computed on a tax equivalent basis.

Loan demands also affect the Bank's liquidity position. The following table presents the maturities and sensitivity to changes in interest rates of commercial and real estate construction loans at December 31, 1986.

Loan Maturities — December 31, 1986

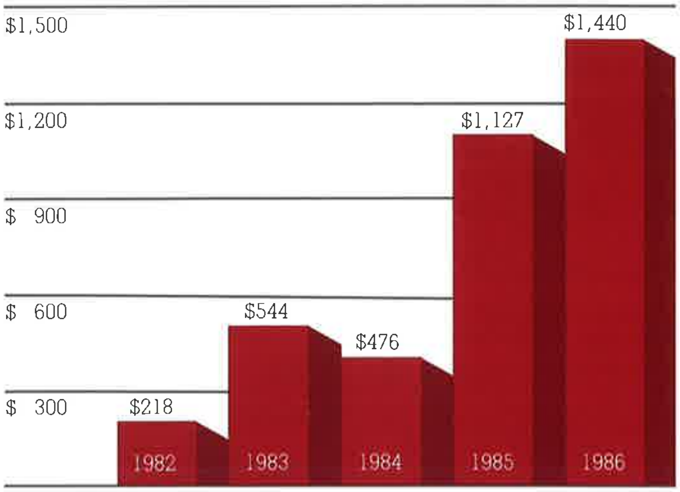
	Within One Year	After One but within 5 Years	After 5 Years	Total
	(in thousands)			
Commercial loans	$20,170	$14,959	$28,732	$63,861
Real estate construction loans	7,929	533	—	8,462
Total	$28,099	$15,492	$28,732	$72,323
Loans with predetermined interest rates		$ 6,655	$ 3,778	
Loans tied to Bank's base commercial loan rate		8,837	24,954	
Total		$15,492	$28,732	

The principal cash requirements of the Company are servicing the term loan agreements of $1,260,000, paying interest on 14¼% Subordinated Capital Notes and dividends on preferred stock. The Company is dependent upon the payment of cash dividends by the Bank to service its commitments. The Company expects that the cash dividends paid by the Bank to the Company will be sufficient to meet this repayment schedule.

Financial Highlights

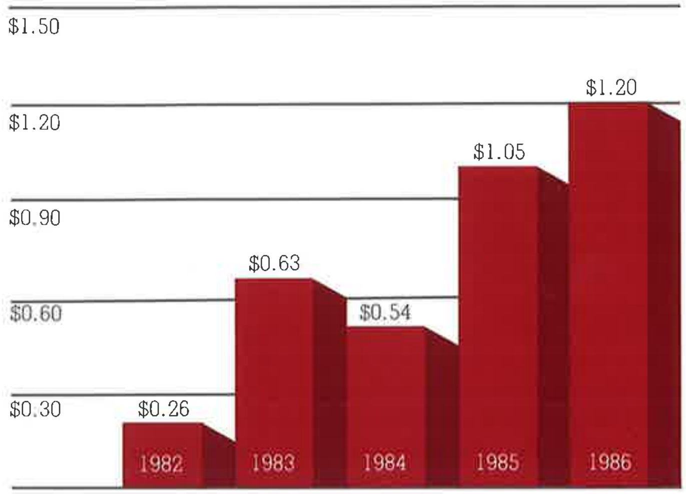
Net Income

(in thousands)
December 31,



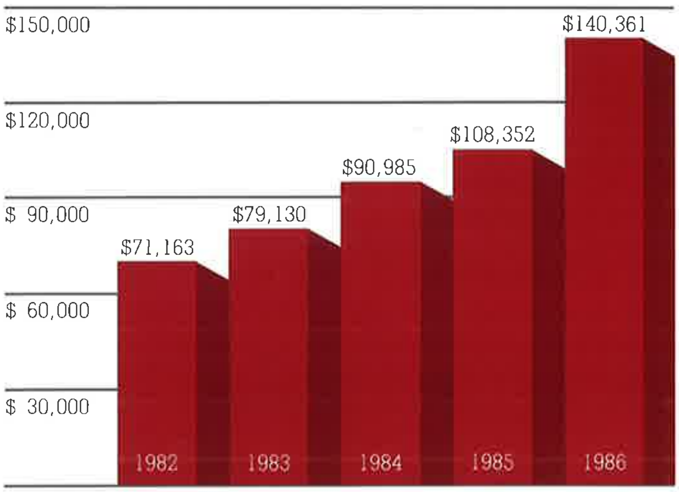
Earnings Per Share

December 31,



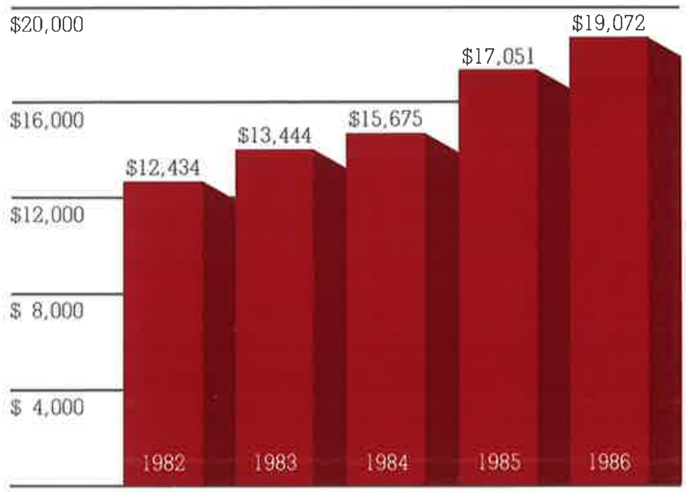
Loans, Net

(in thousands)
December 31,



Interest Income

(in thousands)
December 31,



TriCo Bancshares Executive Officers

Robert H. Steveson
President & Chief Executive Officer

Joan Jones
Vice President & Chief Financial Officer

Fred W. Hignell III
Secretary

Administration Tri Counties Bank

Robert H. Steveson
President & Chief Executive Officer

Joan Jones
Executive Vice President & Chief Administrative Officer

James Mabry
Senior Vice President & Loan Administrator

Daniel Herbert
Vice President & Cashier

Lawrence Sparks
Vice President & Loan Supervisor

David Raven
Regional Vice President

Carroll Taresh
Regional Vice President

Ruth Irvine
Assistant Vice President & Personnel Manager

Kathleen Pisani
Executive Secretary

Janet K. Hannis
Assistant Vice President & Sales Administrator

Larry Hall
Vice President & Data Processing Manager

Fred Bryant
Compliance Officer & Credit Supervisor

Gary Geraets
Auditor

Managers

Park Plaza Branch/Chico
Ty Thresher
Vice President & Manager

Palo Cedro Branch
Julie Jones
Facility Manager

Pillsbury Branch/Chico
Jim Burnell
Vice President & Manager

Redding Branch
Larry Lewis
Vice President & Manager

Durham Branch
Walter Bender
Manager

Burney Branch
Vi Nelson
Manager

Orland Branch
Erika Bender
Manager

Fall River Mills Branch
Suzanne Shoemaker
Facility Manager

Bieber Branch
Stella Griner
Facility Manager

Cottonwood Branch
Bonnie Coleman
Manager

Willows Branch
Ed Richter
Manager

Department Managers

Data Processing/Chico
Larry Hall
Vice President & Manager

Real Estate Department/Chico
Wayne Francis
Manager

SBA Department/Redding
Debbie Gibson
Manager

INVEST/Chico
Ron Bee
Manager

Computerized Loan Documentation Center/Chico
Kathy Allan
Manager

Purchasing Department/Chico
Beverly London
Manager

Locations

Park Plaza Branch
780 Mangrove Avenue
P.O. Box 2207
Chico, California 95927
(916) 345-5151

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

Durham Branch
9411 Midway
P.O. Box 190
Durham, California 95938
(916) 343-3735

Orland Branch
100 East Walker Street
P.O. Box 188
Orland, California 95963
(916) 865-5524

Willows Branch
210 North Tehama Street
P.O. Box 1158
Willows, California 95988
(916) 934-2191

Cottonwood Branch
3349 Main Street
P.O. Box 410
Cottonwood, California 96022
(916) 347-3751

Palo Cedro Branch
3751 Deschutes Road
P.O. Box 144
Palo Cedro, California 96073
(916) 547-4494

Redding Branch
1810 Market Street
P.O. Box 4738
Redding, California 96099
(916) 244-4700

Burney Branch
1275 Main Street
P.O. Box 2590
Burney, California 96013
(916) 335-2215

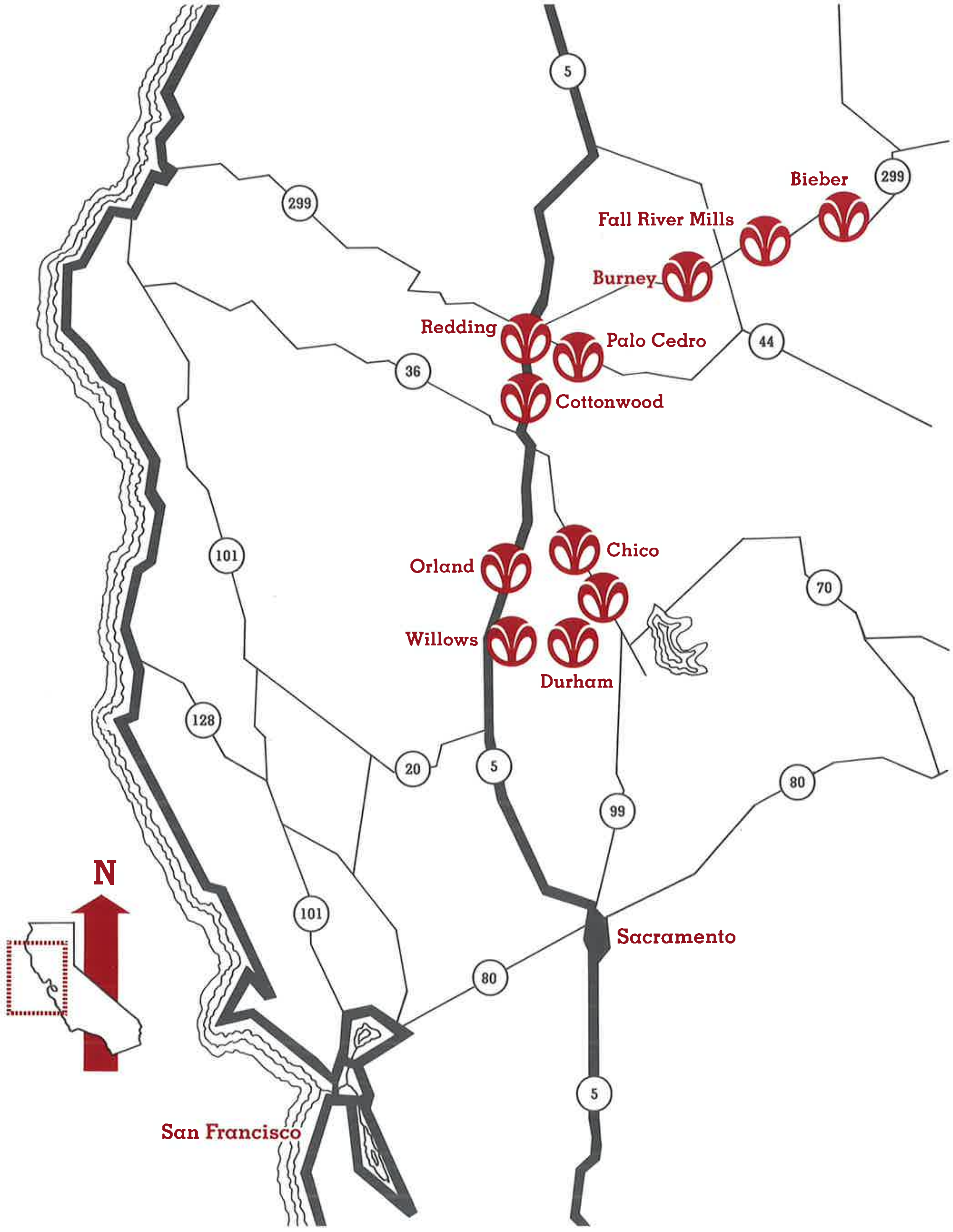
Fall River Mills Branch
Highway 299 East
P.O. Box 758
Fall River Mills, California 96028
(916) 336-6291

Bieber Branch
Bridge & Market Streets
P.O. Box 217
Bieber, California 96009
(916) 294-5211

Administration Offices
15 Independence Circle
Chico, California 95926
(916) 893-8222

Form 10-K

The Company will provide to any interested party, without charge, a copy of the Company's Annual Report on Form 10-K for the year ended December 31, 1986, as filed with the Securities and Exchange Commission, including the financial statements and schedules thereto. The report may be obtained by written request to: **Corporate Secretary, TriCo Bancshares, 15 Independence Circle, Chico, CA 95926.**


Bieber
299
Fall River Mills
Burney
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Redding
Palo Cedro
44
36
Cottonwood
5
Chico
Orland
70
101
Willows
Durham
128
20
5
80
99
N
101
Sacramento
80
5
San Francisco

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