

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C. 20429

FORM 10-Q

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

For the quarterly period ended June 30, 2007

FDIC Certificate No.32203

Summit State Bank

(exact name of registrant as specified in its charter)

94-2878925

(I.R.S Employer Identification No.)

California

(State or other jurisdiction of incorporation or organization)

500 Bicentennial Way, Santa Rosa, CA 95403 Telephone: 707-568-6000

(Address of principal executive offices) (Zip Code) (Registrant's telephone number,
including area code)

N/A

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [] Accelerated filer [] Non-accelerated filer [X]

Indicate by check mark whether the registrant is a shell company, in Rule 12b(2) of the Exchange Act. Yes [] No [x]

As of August 10, 2007 there were 4,844,720 shares of common stock outstanding.

Summit State Bank

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PART I FINANCIAL INFORMATION
Item 1 Financial Statements

SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(In thousands)

	<u>June 30,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
	<u>(Unaudited)</u>	
ASSETS		
Cash and due from banks	\$ 5,932	\$ 10,606
Federal funds sold	690	
Total cash and cash equivalents	<u>6,622</u>	<u>10,606</u>
Time deposits in banks	160	457
Available-for-sale investment securities - amortized cost of \$35,317 in 2007 and \$26,104 in 2006	34,502	25,829
Held-to-maturity investment securities - market value of \$4,820 in 2007 and \$4,868 in 2006	5,000	5,000
Loans, less allowance for loan losses of \$3,175 in 2007 and \$3,736 in 2006	263,044	252,860
Bank premises and equipment, net	8,482	8,175
Investment in Federal Home Loan Bank stock, at cost	3,305	1,699
Other real estate owned	921	
Goodwill	4,119	4,119
Accrued interest receivable and other assets	<u>4,577</u>	<u>4,205</u>
Total assets	<u>\$ 330,732</u>	<u>\$ 312,950</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Demand - non interest-bearing	\$ 11,701	\$ 11,188
Demand - interest-bearing	11,724	12,623
Savings	12,296	19,331
Money market	37,624	47,335
Time deposits, \$100,000 and over	85,396	80,160
Other time deposits	<u>86,529</u>	<u>62,337</u>
Total deposits	245,270	232,974
Securities sold under repurchase agreements	101	257
Federal Home Loan Bank (FHLB) advances	36,620	31,460
Accrued interest payable and other liabilities	<u>873</u>	<u>447</u>
Total liabilities	<u>282,864</u>	<u>265,138</u>
Shareholders' equity		
Preferred stock, no par value; 20,000 shares authorized; none issued		
Common stock, no par value; shares authorized - 30,000; shares issued and outstanding - 4,845 at June 30, 2007 and 4,795 at December 31, 2006	36,956	36,698
Retained earnings	11,376	11,256
Accumulated other comprehensive loss, net of taxes	<u>(464)</u>	<u>(142)</u>
Total shareholders' equity	<u>47,868</u>	<u>47,812</u>
Total liabilities and shareholders' equity	<u>\$ 330,732</u>	<u>\$ 312,950</u>

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

**SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME**
(In thousands, except for earnings per share data)

	Three Months Ended		Six Months Ended	
	June 30, 2007 (Unaudited)	June 30, 2006 (Unaudited)	June 30, 2007 (Unaudited)	June 30, 2006 (Unaudited)
Interest income:				
Interest and fees on loans	\$ 4,986	\$ 4,554	\$ 9,948	\$ 8,824
Interest on Federal funds sold	2	4	2	244
Interest on investment securities and deposits in banks	589	337	1,132	677
Dividends on FHLB stock	30	25	58	46
	<u>5,607</u>	<u>4,920</u>	<u>11,140</u>	<u>9,791</u>
Total interest income				
Interest expense:				
Deposits	2,426	1,759	4,771	3,625
Securities sold under repurchase agreements	1	6	2	6
FHLB Advances	545	463	968	666
	<u>2,972</u>	<u>2,228</u>	<u>5,741</u>	<u>4,297</u>
Total interest expense				
Net interest income before provision for loan losses	2,635	2,692	5,399	5,494
Provision for loan losses	260	111	331	222
	<u>2,375</u>	<u>2,581</u>	<u>5,068</u>	<u>5,272</u>
Net interest income after provision for loan losses				
Non-interest income:				
Service charges	95	78	181	162
Office leases	166	167	332	318
Gains on sales of loans	27	5	41	22
Real estate exchange fees	2	7	7	23
Loan servicing, net	19	13	29	31
Other income	4	64	17	100
	<u>313</u>	<u>334</u>	<u>607</u>	<u>656</u>
Total non-interest income				
Non-interest expense:				
Salaries and employee benefits	957	890	1,956	1,767
Occupancy and equipment	390	339	757	661
Other expenses	655	496	1,269	1,030
	<u>2,002</u>	<u>1,725</u>	<u>3,982</u>	<u>3,458</u>
Total non-interest expense				
Income before provision for income taxes	686	1,190	1,693	2,470
Provision for Income taxes	286	507	701	1,037
	<u>\$ 400</u>	<u>\$ 683</u>	<u>\$ 992</u>	<u>\$ 1,433</u>
Net income				
Basic earnings per share	<u>\$ 0.08</u>	<u>\$ 0.20</u>	<u>\$ 0.21</u>	<u>\$ 0.43</u>
Diluted earnings per share	<u>\$ 0.08</u>	<u>\$ 0.20</u>	<u>\$ 0.20</u>	<u>\$ 0.42</u>
Basic weighted average shares of common stock outstanding	<u>4,845</u>	<u>3,362</u>	<u>4,837</u>	<u>3,362</u>
Diluted weighted average shares of common stock outstanding	<u>4,857</u>	<u>3,394</u>	<u>4,849</u>	<u>3,378</u>

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

SUMMIT STATE BANK AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Six Months Ended June 30, 2007 (Unaudited) and the Year Ended December 31, 2006
(In thousands, except dividends per share)

	<u>Common Stock</u>		<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss) (Net of Taxes)</u>	<u>Total Shareholders' Equity</u>	<u>Total Comprehensive Income</u>
	<u>Shares</u>	<u>Amount</u>				
Balance, January 1, 2006	3,361	\$ 17,395	\$ 9,914	\$ (266)	\$ 27,043	
Comprehensive income:						
Net income			2,808		2,808	\$ 2,808
Other comprehensive loss, net of tax:						
Net change in unrealized losses on available-for-sale investment securities				124	124	<u>124</u>
Total comprehensive income						<u>\$ 2,932</u>
Stock issued	1,434	19,303			19,303	
Cash dividends - \$.36 per share			<u>(1,466)</u>		<u>(1,466)</u>	
Balance, December 31, 2006	4,795	\$ 36,698	\$ 11,256	\$ (142)	\$ 47,812	
Comprehensive income:						
Net income			992		992	\$ 992
Other comprehensive loss, net of tax:						
Net change in unrealized losses on available-for-sale investment securities				(322)	(322)	<u>(322)</u>
Total comprehensive income						<u>\$ 670</u>
Stock issued	50	258			258	
Cash dividends - \$.18 per share			<u>(872)</u>		<u>(872)</u>	
Balance, June 30, 2007	<u>4,845</u>	<u>\$ 36,956</u>	<u>\$ 11,376</u>	<u>\$ (464)</u>	<u>\$ 47,868</u>	

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

SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Six Months Ended	
	June 30,	June 30,
	2007	2006
	(Unaudited)	(Unaudited)
Cash flows from operating activities:		
Net income	\$ 992	\$ 1,433
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	318	352
Loss on disposal of bank premises and equipment	27	-
Net (decrease) increase in deferred loan fees	18	4
Provision for loan losses	331	222
Gains on sales of loans	(41)	(22)
Loans originated for sale	(661)	(150)
Proceeds from sales of loans held for sale	702	172
Dividends on Federal Home Loan Bank stock	(48)	(41)
Net change in accrued interest receivable and other assets	(154)	(506)
Net change in accrued interest payable and other liabilities	426	(999)
Stock-based compensation expense	-	6
	<u>1,910</u>	<u>471</u>
Net cash provided by operating activities		
Cash flows from investing activities:		
Decrease in time deposits in banks	297	983
Purchases of available-for-sale investment securities	(10,000)	(3,000)
Proceeds from calls and maturities of available-for-sale investment securities	787	500
Purchase of Federal Home Loan Bank stock	(1,558)	(1,836)
Proceeds from the redemption of Federal Home Loan Bank stock	-	719
Net change in loans	(11,454)	(10,662)
Purchases of bank premises and equipment	(652)	(106)
	<u>(22,580)</u>	<u>(13,402)</u>
Net cash used in investing activities		

(Continued)

SUMMIT STATE BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	<u>Six Months Ended</u>	
	<u>June 30,</u> <u>2007</u> <u>(Unaudited)</u>	<u>June 30,</u> <u>2006</u> <u>(Unaudited)</u>
Cash flows from financing activities:		
Net (decrease) increase in demand, NOW, savings and money market deposits	(17,132)	(87,624)
Net change in certificates of deposit	29,428	22,264
Net change in securities sold under repurchase agreements	(156)	735
Net change in short term FHLB advances	(3,840)	8,555
Proceeds from long term FHLB advances	9,000	10,000
Issuance of common stock	258	
Dividends paid on common stock	(872)	(605)
	<u>16,686</u>	<u>(46,675)</u>
Net cash (used in) provided by financing activities		
	(3,984)	(59,606)
(Decrease) increase in cash and cash equivalents		
Cash and cash equivalents at beginning of year	<u>10,606</u>	<u>65,556</u>
Cash and cash equivalents at end of period	<u>\$ 6,622</u>	<u>\$ 5,950</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest expense	\$ 5,503	\$ 5,049
Income taxes, net of refunds	\$ 575	\$ 793
Noncash investing activities:		
Transfer from loans to other real estate owned	\$ 921	\$ -

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

SUMMIT STATE BANK AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

On January 15, 1999, Summit State Bank (the “Bank” or “the Bank”) received authority to transact business as a California state-chartered commercial bank and is subject to regulation, supervision and examination by the California Department of Financial Institutions and the Federal Deposit Insurance Corporation. The Bank was organized under a charter granted by the Department of Savings and Loan of the State of California under the name Summit Savings. The Bank was incorporated on December 20, 1982. The Bank converted to a federal savings bank under a charter granted by the Office of Thrift Supervision on May 24, 1990. The Bank provides a variety of banking services to individuals and businesses in its primary service area of Sonoma County, California. The Bank's branch locations include Santa Rosa, Rohnert Park and Windsor. The Bank offers depository and lending services primarily to meet the needs of its business and individual clientele. These services include a variety of transaction, money market, savings and time deposit account alternatives. The Bank's lending activities are directed primarily towards commercial real estate, construction and business loans. The Bank utilizes its subsidiary Alto Service Corporation for its deed of trust services.

The consolidated financial statements as of June 30, 2007 and for the three and six months ended June 30, 2007 and 2006 are unaudited. In the opinion of management, these unaudited consolidated financial statements contain all adjustments, consisting only of normal recurring accruals necessary to present fairly the consolidated financial position of the Bank at June 30, 2007, the changes in shareholders' equity for six months ended June 30, 2007, the consolidated results of operations for the three and six months ended June 30, 2007 and 2006, and cash flows for the six months ended June 30, 2007 and 2006.

The unaudited consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and Article 10 of Regulation S-X of the Securities and Exchange Commission. Operating results for the three and six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. These unaudited consolidated financial statements do not include all disclosures associated with the Bank's consolidated annual financial statements and notes thereto and accordingly, should be read in conjunction with financial statements and notes thereto included in the Bank's Annual report on Form 10-K on file with the FDIC.

The accounting and reporting policies of the Bank and subsidiary conform to the accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Principles of Consolidation

The consolidated financial statements include the accounts of the Bank and its wholly-owned subsidiary, Alto Service Corporation. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Earnings Per Share

Basic earnings per common share (EPS), which excludes dilution, is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings of the Bank. Earnings and dividends per share are restated for all stock splits and stock dividends through the date of issuance of the financial statements. Accordingly, all share and per share information reflects the two-for-one stock split paid on June 14, 2006.

The factors used in the earnings per share computation follow:

(in thousands except earnings per share)	Three Months Ended		Six Months Ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
Basic				
Net income	\$ 400	\$ 683	\$ 992	\$ 1,433
Weighted average common shares outstanding	4,845	3,362	4,837	3,362
Basic earnings per common share	\$ 0.08	\$ 0.20	\$ 0.21	\$ 0.43
Diluted				
Net income	\$ 400	\$ 683	\$ 992	\$ 1,433
Weighted average common shares outstanding for basic earnings per common share	4,845	3,362	4,837	3,362
Add: Dilutive effects of assumed exercises of stock options	12	32	12	16
Average shares and dilutive potential common shares	4,857	3,394	4,849	3,378
Diluted earnings per common share	\$ 0.08	\$ 0.20	\$ 0.20	\$ 0.42

Adoption of New Accounting Standards

FASB Interpretation 48

The Bank adopted FASB Interpretation 48, Accounting for Uncertainty in Income Taxes ("FIN 48"), as of January 1, 2007. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The adoption had no affect on the Bank's consolidated financial statements.

The Bank and its subsidiaries are subject to U.S. federal income tax as well as income tax of the state of California. The Bank is no longer subject to examination by federal taxing authorities for years before 2003 and by state taxing authorities for years before 2002. The Bank does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

The Bank recognizes interest and/or penalties related to income tax matters in income tax expense. The Bank did not have any amounts accrued for interest and penalties at June 30, 2007.

SFAS No. 156

The Bank adopted Statement of Financial Accounting Standard No. 156 “Accounting for Servicing of Financial Assets” (“SFAS No. 156”), as of January 1, 2007. SFAS No. 156 requires separately recognized servicing assets and servicing liabilities to be initially measured at fair value and permits the Bank to elect to measure servicing assets and servicing liabilities at fair value at each reporting date and report changes in fair value in earnings in the period in which the changes occur or to continue to amortize the servicing assets over the loan service period with periodic impairment assessment. The Bank has elected to continue to amortize its servicing assets. There was no cumulative effect upon the adoption of SFAS No. 156 and the effect on net income for the three and six months ended June 30, 2007 was not significant and the Bank’s servicing assets at June 30, 2007 and December 31, 2006 were not considered significant.

2. COMPREHENSIVE INCOME

Comprehensive income is made up of net income plus other comprehensive income or loss. Other comprehensive income or loss, net of taxes, includes unrealized gains (losses) on available-for-sale investment securities of \$(335,000) and \$(150,000) for the three months ended June 30, 2007 and 2006 and \$(322,000) and \$(208,000) for the six months ended June 30, 2007 and 2006. Total comprehensive income was \$65,000 and \$533,000 for the three months ended June 30, 2007 and 2006, and \$670,000 and \$1,225,000 for the six months ended June 30, 2007 and 2006.

3. REGULATORY CAPITAL

The Bank’s actual and required capital amounts and ratios consisted of the following:

	<u>June 30, 2007</u>	
	<u>Amount</u>	<u>Ratio</u>
<u>Tier 1 Leverage Ratio</u>		
Summit State Bank.....	\$ 44,146,000	13.7%
Minimum requirement for “Well-Capitalized” institution	\$ 16,153,000	5.0%
Minimum regulatory requirement	\$ 12,923,000	4.0%
<u>Tier 1 Risk-Based Capital Ratio</u>		
Summit State Bank.....	\$ 44,146,000	15.5%
Minimum requirement for “Well-Capitalized” institution	\$ 17,075,000	6.0%
Minimum regulatory requirement	\$ 11,384,000	4.0%
<u>Total Risk-Based Capital Ratio</u>		
Summit State Bank.....	\$ 47,373,000	16.7%
Minimum requirement for “Well-Capitalized” institution	\$ 28,459,000	10.0%
Minimum regulatory requirement	\$ 22,767,000	8.0%

4. STOCK OPTIONS

The shareholders approved the 2007 stock option plan (“Plan”) on May 21, 2007. The Plan reserved 150,000 shares of common stock for issuance to directors and employees. The Plan requires that the option exercise price may not be less than the fair market value of the stock at the date the option is granted. The option expiration dates are determined by the Board of Directors, but may not be later than ten years from the date of grant. In June 2007, 20,000 shares were granted at an exercise price of \$10.92 and a term of ten years.

5. COMMITMENTS AND CONTINGENCIES

The Bank is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the financial position or results of operations of the Bank.

The Bank's business activity is primarily with clients located within Northern California. Although the Bank has a diversified loan portfolio, a significant portion of its clients' ability to repay loans is dependent upon the real estate market and various economic factors within Sonoma County. Generally, loans are secured by various forms of collateral. The Bank's loan policy requires sufficient collateral to be obtained as necessary to meet the Bank's relative risk criteria for each borrower. The Bank's collateral for the lending portfolio consists primarily of real estate, accounts receivable, inventory and other financial instruments.

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its clients and to reduce its own exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the consolidated balance sheets. The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and standby letters of credit as it does for loans included on the consolidated balance sheet.

Commitments to extend credit, which totaled \$45,037,000 and \$35,471,000 at June 30, 2007 and December 31, 2006, respectively, are agreements to lend to a client as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each client's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of the credit, is based on management's credit evaluation of the borrower. Collateral held relating to these commitments varies, but may include securities, equipment, accounts receivable, inventory and deeds of trust on residential real estate and income-producing commercial properties.

Standby letters of credit, which totaled \$655,000 and \$2,019,000 at June 30, 2007 and December 31, 2006, respectively, are conditional commitments issued by the Bank to guarantee the performance of a client to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to clients. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at June 30, 2007 and December 31, 2006. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

6. EFFECT OF NEWLY ISSUED BUT NOT YET EFFECTIVE ACCOUNTING STANDARDS

New accounting standards have been issued that the Bank does not expect will have a material effect on the consolidated financial statements when adopted in future years or for which the Bank has not yet completed its evaluation of the potential effect upon adoption. In general, these standards establish a hierarchy about the assumptions used to measure fair value and provides the option to measure certain financial assets and liabilities at fair value for 2008, and revise the accrual of post-retirement benefits associated with providing life insurance for 2008.

7. SUBSEQUENT EVENT

Cash Dividend

On July 30, 2007, the Board of Directors declared a \$.09 per share cash dividend to shareholders of record at the close of business on August 10, 2007, to be paid on August 21, 2007.

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

The following discussion provides additional information about the financial condition of the Bank at June 30, 2007 and December 31, 2006, and results of operations for the three and six months ended June 30, 2007 and 2006. The following analysis should be read in conjunction with the financial statements of the Bank and the notes thereto appearing elsewhere in the report, which were prepared in accordance with accounting principles generally accepted in the United States. The interim financial information provided as of and for the

three and six months ended June 30, 2007 and 2006 is unaudited. In the opinion of management of the Bank, the interim financial information presented reflects all adjustments (consisting solely of normal recurring accruals) considered necessary for a fair representation of the results of such periods.

All references to common shares and per share information have been adjusted for a 2-for-1 stock split. The record date for the stock split was June 1, 2006 and was payable on June 14, 2006. All shares and per share amounts in this discussion reflect the impact of the stock split.

Forward Looking Statements. This discussion includes forward-looking statements within the meaning of the “safe harbor” provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that are based on the current beliefs of the Bank management as well as assumptions made by and information currently available to the Bank’s management. When used in this discussion, the words “anticipate,” “believe,” “estimate,” “expect,” “should,” “intend,” “project,” “may,” “will,” “would,” variations of such words and words or phrases of similar meaning constitute forward-looking statements. Although the Bank believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct.

These forward-looking statements relate to, among other things, expectations regarding the business environment in which the Bank operates, projections of future performance, potential future performance, potential future credit experience, perceived opportunities in the market, and statements regarding the Bank’s mission and vision. Factors which may cause actual results to vary from forward-looking statements include, but are not limited to, changes in interest rates, general economic and business conditions, changes in business strategy or development plans, changes in credit quality, the availability of capital to fund the expansion of our business, legislative and regulatory changes, government monetary and fiscal policies, real estate valuations, competition in the financial services industry, demographic changes, civil disturbances or terrorist threats or acts, or apprehension about the possible future occurrences of acts of this type, outbreak or escalation of hostilities in which the United States is involved, any declaration of war by the U.S. Congress or any other national or international calamity, crisis or emergency, and other risks referenced in this discussion.

This discussion contains certain forward-looking information about us. All statements other than statements of historical fact are forward-looking statements. Such statements involve inherent risks and uncertainties, many of which are difficult to predict and are generally beyond our control. We caution readers that a number of important factors could cause actual results to differ materially from those expressed in, implied or projected by, such forward-looking statements. Risks and uncertainties include, but are not limited to:

- lower revenues than expected;
- credit quality deterioration which could cause an increase in the provision for credit losses;
- competitive pressure among depository institutions increases significantly;
- the cost of additional capital is more than expected;
- a change in the interest rate environment reduces interest margins;
- asset/liability repricing risks and liquidity risks;
- legislative or regulatory requirements or changes adversely affecting our business;
- changes in the securities markets;
- general economic conditions, either nationally or in the market areas in which we do or anticipate doing business, are less favorable than expected;
- the economic and regulatory effects of the continuing war on terrorism and other events of war, including the war in Iraq;
- our ability to complete any future acquisitions, to successfully integrate acquired entities, or to achieve expected synergies and operating efficiencies within expected time-frames or at all;
- the integration of any future acquired businesses costs more, takes longer or is less successful than expected; and

- regulatory approvals for announced or future acquisitions cannot be obtained on the terms expected or on the anticipated schedule.

Also, other important factors that could cause actual results to differ materially from the Bank's expectations are disclosed under Item 1A. "RISK FACTORS," in our Registration Statement on Form 10, as amended (the "Form 10"), and in our Annual Report on Form 10-K on file with the Federal Deposit Insurance Corporation ("FDIC") and below under this "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS – *Critical Accounting Policies*" and elsewhere in this report.

If any of these risks or uncertainties materializes, or if any of the assumptions underlying such forward-looking statements proves to be incorrect, our results could differ materially from those expressed in, implied or projected by, such forward-looking statements. We assume no obligation to update such forward-looking statements.

We caution that these statements are further qualified by important factors, in addition to those under "Risk Factors" in our Form 10 and in our Annual Report on Form 10-K and elsewhere in this report, which could cause actual results to differ significantly from those in the forward-looking statements, including, among other things, economic conditions and other risks.

Forward-looking statements are not guarantees of performance. By their nature, they involve risks, uncertainties and assumptions. Our future results and shareholder values may differ significantly from those expressed in these forward-looking statements. You are cautioned not to put undue reliance on any forward-looking statement. Any such statement speaks only as of the date of this discussion, regardless of the time of delivery of this document. We do not undertake any obligation to update or release any revisions to any forward-looking statements, to report any new information, future event or other circumstances after the date of this filing or to reflect the occurrence of unanticipated events, except as required by law. However, your attention is directed to any further disclosures made on related subjects in any subsequent reports we may file with the FDIC, including on Forms 10-K, 10-Q and 8-K.

Critical Accounting Policies. The discussion and analysis of the Bank's results of operations and financial condition are based upon financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Bank's management to make estimates and judgments that affect the reported amounts of assets and liabilities, income and expense, and the related disclosures of contingent assets and liabilities at the date of these financial statements.

The Bank believes these estimates and assumptions to be reasonably accurate; however, actual results may differ from these estimates under different assumptions or circumstances. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses.

The allowance for loan losses is determined first and foremost by promptly identifying potential credit weaknesses that could jeopardize repayment. The Bank's process for evaluating the adequacy of the allowance for loan losses includes assigning potential loss percentages to each credit based on the Bank's credit grading system and accompanying risk analysis for determining an adequate level of the allowance. The risks are assessed by rating each account based upon paying habits, loan to value ratio, financial condition and level of classifications. The allowance for loan losses was \$3,175,000 at June 30, 2007 and \$3,736,000 at December 31, 2006.

**Earnings Summary
(In Thousands)**

	Three Months Ended		Six Months Ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Statement of Income Data:				
Net interest income	\$ 2,635	\$ 2,692	\$ 5,399	\$ 5,494
Provision for loan losses	260	111	331	222
Noninterest income	313	334	607	656
Noninterest expense	2,002	1,725	3,982	3,458
Provision for income taxes	286	507	701	1,037
Net income	<u>\$ 400</u>	<u>\$ 683</u>	<u>\$ 992</u>	<u>\$ 1,433</u>
Selected per Share Data:				
Basic earnings per share	\$ 0.08	\$ 0.20	\$ 0.21	\$ 0.43
Diluted earnings per share	\$ 0.08	\$ 0.20	\$ 0.20	\$ 0.42
Book value per share (2)	\$ 9.88	\$ 8.23	\$ 9.88	\$ 8.23
Selected Ratios:				
Return on average assets (1)	0.49%	0.94%	0.62%	0.96%
Return on average equity (1)	3.32%	9.93%	4.15%	10.50%
Return on average tangible equity (1)	3.63%	11.67%	4.54%	12.35%
Efficiency ratio	67.91%	57.01%	66.30%	56.23%
Net interest margin (1)	3.43%	3.94%	3.59%	3.92%
Dividend payout ratio	109.25%	44.22%	87.90%	42.22%
Average equity to average assets	14.75%	9.48%	14.93%	9.14%
Nonperforming loans to total loans (2)	0.13%	0.38%	0.13%	0.38%
Nonperforming assets to total assets (2)	0.38%	0.32%	0.38%	0.32%
Allowance for loan losses to total loans (2)	1.19%	1.48%	1.19%	1.48%
Allowance for loan losses to nonperforming loans (2)	931.09%	386.64%	931.09%	386.64%

(1) Annualized.

(2) As of period end

Results of Operations

Three and six months ended June 30, 2007 and June 30, 2006

Net Income

For the three months ended June 30, 2007, net income was \$400,000, or \$0.08 per diluted share, representing an annualized return on average assets of 0.49%. This compares with earnings of \$683,000, or \$0.20 per diluted share, for the three months ended June 30, 2006, representing an annualized return on average assets of 0.94%. Net income for the six months ended June 30, 2007 was \$992,000 or \$0.20 per diluted share compared to \$1,433,000 or \$0.42 per diluted share for the six months ended June 30, 2006. The period-over-period earnings decline of \$283,000, or 41% for the quarter and \$441,000 or 31% for the six months ended June 30, 2007 is attributable to a decline in net interest margin, increased provision for loan losses, a decline in non-interest income and higher operating expenses partially offset by lower provision for income taxes.

On August 16, 2006, the Bank completed an underwritten public offering, of 1,432,700 shares of common stock. Additionally, 50,000 shares of stock were issued in January 2007 for an option exercised. These shares increased the weighted average shares outstanding for the second quarter and six months ended June 30, 2007, over the same periods in 2006 by 44%. The diluted earnings per share decline between the quarters of \$0.12 was comprised of a decline of \$0.08 attributable to the decline in net income and \$0.04 decline attributable to

the increase in weighted average shares outstanding. The \$0.22 decline in diluted earnings per share for the six months ended June 30, 2007 over the same period in 2006 was attributable to \$0.13 decline caused by the decline in net income and \$0.09 caused by the increase in shares outstanding.

Net Interest Income and Net Interest Margin

Net interest income declined \$57,000 or 2% to \$2,635,000 during the second quarter of 2007 compared to \$2,692,000 for the same quarter of 2006. The net interest margin declined to 3.43% for the three months ended June 30, 2007, compared to 3.94% for the three months ended June 30, 2006. The annualized net interest margin continues to be negatively impacted as rates on maturing and new deposits continue to rise while the increase in yields on earning assets have slowed as the Federal Reserve stopped increasing rates. In the Bank's local market there is competition for new certificates of deposits and under the current interest rate environment, the resulting pressures on the Bank's cost of funds will likely have a dampening effect on the Bank's future net interest margin and increases in future net interest income will most likely come predominately from increases in the volume of earning assets.

Average earning assets were \$307,893,000 for the second quarter of 2007, as compared to \$273,804,000 for the second quarter of 2006. The annualized yield on average earning assets was 7.30% and the annualized cost of average interest-bearing liabilities was 4.48% for the second quarter of 2007, as compared to the annualized yield on average earning assets of 7.21% and annualized cost of average interest-bearing liabilities of 3.57% for the second quarter of 2006.

Net interest income declined \$95,000 or 2% to \$5,399,000 during the six months ended June 30, 2007 compared to \$5,494,000 for the same period of 2006. The annualized net interest margin declined to 3.59% for the six months ended June 30, 2007, compared to 3.92% for the six months ended June 30, 2006. Average earning assets were \$303,396,000 for the six months ended June 30, 2007, as compared to \$282,891,000 for the same period in 2006. The annualized yield on average earning assets was 7.40% and the annualized cost of average interest-bearing liabilities was 4.44% for the six months ended June 30, 2007, as compared to the annualized yield on average earning assets of 6.98% and annualized cost of average interest-bearing liabilities of 3.33% for the same period in 2006.

The following tables present condensed average balance sheet information for the Bank, together with interest rates earned and paid on the various sources and uses of its funds for each of the periods presented. Nonaccrual loans are included in loans with any interest collected reflected on a cash basis.

Average Balance Sheet and Analysis of Net Interest Income
(Dollars in thousands)

	Three Months Ended			Three Months Ended		
	June 30, 2007			June 30, 2006		
	Average Balance	Interest Income/ Expense	Average Rate (4)	Average Balance	Interest Income/ Expense	Average Rate (4)
Assets						
Interest earning assets:						
Interest bearing deposits with banks	\$ 156	\$ 2	5.14%	\$ 911	\$ 10	4.40%
Taxable investment securities	43,581	617	5.68%	26,608	352	5.31%
Federal funds sold	128	2	6.27%	351	4	4.57%
Loans, net (1)	264,028	4,986	7.57%	245,934	4,554	7.43%
Total earning assets/interest income	307,893	5,607	7.30%	273,804	4,920	7.21%
Nonearning assets	22,892			21,152		
Allowance for loan losses	(3,535)			(3,692)		
Total assets	\$ 327,250			\$ 291,264		
Liabilities and Shareholders' Equity						
Interest bearing liabilities:						
Deposits:						
Interest bearing transaction	\$ 12,168	22	0.73%	\$ 13,183	13	0.40%
Savings and money market	52,584	452	3.45%	83,236	563	2.71%
Time deposits	157,457	1,952	4.97%	114,903	1,183	4.13%
Repurchase agreements	76	1	5.28%	977	6	2.46%
FHLB advances	43,564	545	5.02%	38,362	463	4.84%
Total interest bearing liabilities/interest expense	265,849	2,972	4.48%	250,661	2,228	3.57%
Noninterest bearing deposits	12,248			11,789		
Other liabilities	892			1,216		
Total liabilities	278,989			263,666		
Shareholders' equity	48,261			27,598		
Total liabilities and shareholders' equity	\$ 327,250			\$ 291,264		
Net interest income and margin (2)		\$ 2,635	3.43%	\$ 2,692		3.94%
Net interest spread (3)			2.82%			3.64%

- (1) The net amortization of deferred fees and costs on loans included in interest income was \$43,000 and \$39,000 for the three months ended June 30, 2007 and 2006, respectively.
- (2) Net interest margin is computed by dividing net interest income by average total earning assets.
- (3) Net interest spread is the difference between the average rate earned on average total earning assets and the average rate paid on average total interest bearing liabilities.
- (4) Annualized.

Average Balance Sheet and Analysis of Net Interest Income

(Dollars in thousands)

	<u>Six Months Ended</u>			<u>Six Months Ended</u>		
	<u>June 30, 2007</u>			<u>June 30, 2006</u>		
	<u>Average</u>	<u>Interest</u>	<u>Average</u>	<u>Average</u>	<u>Interest</u>	<u>Average</u>
	<u>Balance</u>	<u>Income/</u>	<u>Rate (4)</u>	<u>Balance</u>	<u>Income/</u>	<u>Rate (4)</u>
		<u>Expense</u>			<u>Expense</u>	
Assets						
Interest earning assets:						
Interest bearing deposits with banks	\$ 216	\$ 4	3.73%	\$ 1,089	\$ 25	4.63%
Taxable investment securities	41,504	1,186	5.76%	26,576	698	5.30%
Federal funds sold	102	2	3.95%	11,469	244	4.29%
Loans, net (1)	261,574	9,948	7.67%	243,757	8,824	7.30%
Total earning assets/interest income	<u>303,396</u>	11,140	7.40%	<u>282,891</u>	9,791	6.98%
Nonearning assets						
Allowance for loan losses	22,817			21,666		
	(3,584)			(3,679)		
Total assets	<u>\$ 322,629</u>			<u>\$ 300,878</u>		
Liabilities and Shareholders' Equity						
Interest bearing liabilities:						
Deposits:						
Interest bearing transaction	\$ 12,651	46	0.73%	\$ 14,966	27	0.36%
Savings and money market	57,909	1,013	3.53%	101,895	1,360	2.69%
Time deposits	151,156	3,712	4.95%	114,013	2,238	3.96%
Repurchase agreements	152	2	2.65%	561	6	2.16%
FHLB advances	39,091	968	4.99%	28,888	666	4.65%
Total interest bearing liabilities/interest expense	<u>260,959</u>	5,741	4.44%	<u>260,323</u>	4,297	3.33%
Noninterest bearing deposits						
	11,966			10,831		
Other liabilities						
	1,529			2,211		
Total liabilities	<u>274,454</u>			<u>273,365</u>		
Shareholders' equity						
	48,175			27,513		
Total liabilities and shareholders' equity	<u>\$ 322,629</u>			<u>\$ 300,878</u>		
Net interest income and margin (2)						
		<u>\$ 5,399</u>	3.59%		<u>\$ 5,494</u>	3.92%
Net interest spread (3)						
			2.96%			3.65%

- (1) The net amortization of deferred fees and costs on loans included in interest income was \$122,000 and \$86,000 for the six months ended June 30, 2007 and 2006, respectively.
- (2) Net interest margin is computed by dividing net interest income by average total earning assets.
- (3) Net interest spread is the difference between the average rate earned on average total earning assets and the average rate paid on average total interest bearing liabilities.
- (4) Annualized.

The following tables show the change in interest income and interest expense and the amount of change attributable to variances in volume and rates. Changes not attributable solely to volume or rates are allocated proportionately between both variances.

Volume and Yield/Rate Variances
(Dollars in thousands)

	2007 Compared to 2006 for Quarter		
	Ended June 30		
	Change Due to		
	Volume	Yield/ Rate	Net
Interest income:			
Interest bearing deposits with banks	\$ (9)	\$ 1	\$ (8)
Taxable investment securities	239	26	265
Federal funds sold	(3)	1	(2)
Loans, net	<u>340</u>	<u>92</u>	<u>432</u>
Total interest income	567	120	687
Interest expense:			
Interest-bearing transaction	(1)	10	9
Savings and money market	(240)	129	(111)
Time deposits	496	273	769
Repurchase agreements	(8)	3	(5)
FHLB advances	<u>65</u>	<u>17</u>	<u>82</u>
Total interest expense	312	432	744
Increase (decrease) in net interest income	<u>\$ 255</u>	<u>\$ (312)</u>	<u>\$ (57)</u>

Volume and Yield/Rate Variances
(Dollars in thousands)

2007 Compared to 2006			
<u>For The Six Months Ended June 30</u>			
<u>Change Due to</u>			
	<u>Volume</u>	<u>Yield/ Rate</u>	<u>Net</u>
Interest income:			
Interest bearing deposits with banks	\$ (17)	\$ (4)	\$ (21)
Taxable investment securities	422	66	488
Federal funds sold	(224)	(18)	(242)
Loans, net	<u>664</u>	<u>460</u>	<u>1,124</u>
Total interest income	845	504	1,349
Interest expense:			
Interest-bearing transaction	(1)	20	19
Savings and money market	(438)	91	(347)
Time deposits	807	667	1,474
Repurchase agreements	(8)	4	(4)
FHLB advances	<u>13</u>	<u>289</u>	<u>302</u>
Total interest expense	373	1,071	1,444
Increase (decrease) in net interest income	<u>\$ 472</u>	<u>\$ (567)</u>	<u>\$ (95)</u>

Provision for Loan Losses

The Bank maintains an allowance for loan losses for losses that are expected to occur as an incidental part of the banking business. Write-offs of loans are charged against the allowance for loan losses, which is adjusted periodically to reflect changes in the volume of outstanding loans and estimated losses due to deterioration in the financial condition of borrowers or the value of property securing nonperforming loans, or changes in general economic conditions and other qualitative factors. Additions to the allowance for loan losses are made through a charge against income referred to as the “provision for loan losses”.

The Bank’s loan policy provides procedures designed to evaluate and assess the credit risk factors associated with its loan portfolio, to enable management to assess such credit risk factors prior to granting new loans and to evaluate the sufficiency of the allowance for loan losses. The Bank conducts an assessment of the allowance for loan losses on a monthly basis and undertakes a more critical evaluation quarterly. At the time of the quarterly review, the Board of Directors examines and formally approves the adequacy of the allowance. The quarterly evaluation includes an assessment of the following factors: any external loan review and regulatory examination, estimated potential loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquent and non-accruals loans, trends in loan volume, effects of any changes in the lending policies and procedures, changes in lending personnel, current economic conditions at the local, state and national level, and a migration analysis of historical losses and recoveries for the prior eight quarters.

For the three months ended June 30, 2007, the provision for loan losses was \$260,000 and it was \$111,000 for three months ended June 30, 2006. The provision for loan losses was \$331,000 for the six months ended June 30, 2007, compared to \$222,000 for the same period in 2006. The increase in the provision for loan losses in 2007 as compared to 2006 reflects the growth in loan totals and net loan charge-offs. Net loan charge-offs were \$642,000 and \$0 for the second quarter ended June 30, 2007 and 2006 and \$892,000 and \$134,000 for the six months ended June 30, 2007 and 2006. See Balance Sheet Activity – Non-performing Assets and Allowance for Loan Losses for additional discussion.

Non-interest Income

Non-interest income totaled \$313,000 for the three months ended June 30, 2007 and consists primarily of \$95,000 in service charges on deposit accounts, and office lease income of \$166,000. For the three months ended June 30, 2006, non-interest income totaled \$333,000, which included \$78,000 in service charges on deposit accounts and \$167,000 in office lease income. Other income in the second quarter of 2006 included the recovery of \$34,000 of 2005 loan collection legal expenses.

Gains on sales of SBA-guaranteed loans were \$27,000 and \$5,000 for the three months ended June 30, 2007 and 2006. Gains on sales of loans, real estate exchange fees and other sources of noninterest income fluctuate from quarter to quarter as a result of the volume of related activities and can be dependent on interest rates or general economic conditions. For the three months ended June 30, 2007 and 2006, service charges from the Section 1031 Exchange program were, respectively, \$2,000 and \$7,000.

For the six months ended June 30, 2007 non-interest income was \$607,000 compared to \$656,000 for the six months ended June 30, 2006.

Non-interest Expense

Non-interest expenses have increased as expansion plans were implemented and additional costs for regulatory compliance have been incurred including regulations that the Bank became subject to as a public company when it had its initial public offering in July of 2006. Additionally, the general economy has caused an increase in loan collection expenses.

For the three months ended June 30, 2007, non-interest expense totaled \$2,002,000, or 2% (annualized) of quarterly average total assets and 68% of total revenue (total revenue is defined as net interest income plus non-interest income). Non-interest expense for the second quarter of 2006 was \$1,725,000, or 2% (annualized) of quarterly average assets and 57% of total revenue. For the six months ended June 30, 2007 and 2006, non-interest expense was \$3,982,000 and \$3,458,000 respectively.

For the quarterly periods, the largest component of non-interest expense, salaries and employee benefits, totaled \$957,000, while expenses associated with the occupancy of the Bank’s premises and equipment-related expenses totaled \$390,000 and other operating expenses were \$655,000. For the second quarter 2006, salaries

and employee benefits comprised \$890,000, occupancy and equipment-related expenses totaled \$339,000, and other operating expenses were \$496,000. The increase in expenses between the periods was due to the additional staffing and other expenses related to the growth of the Bank, including increased marketing expenses related to promotional efforts to increase core deposits. Additionally, the Bank leased space and hired personnel for the new Petaluma regional office that opened in July 2007.

Provision for Income Taxes

The Bank accrues income tax based on the anticipated tax rates during the financial period covered. The provision for income taxes for the three months ended June 30, 2007 and 2006 was \$286,000 and \$507,000, respectively. Provision for income taxes was \$701,000 and \$1,037,000 for the six months ended June 30, 2007 and 2006, respectively. The combined effective Federal and State corporate income tax rates for the three months ended June 30, 2007 and 2006 were 41.7% and 42.6%, and for the six months ended June 30, 2007 and 2006 were 41.4% and 42.0%.

Balance Sheet Activity

At June 30, 2007 and December 31, 2006

Investment Portfolio

Securities classified as available-for-sale for accounting purposes are recorded at their fair value on the balance sheet. At June 30, 2007, investment securities comprised 12% of total assets. Available-for-sale investment securities carried at fair value totaled \$34,502,000 at June 30, 2007 compared to amortized cost of \$35,317,000. Securities classified as held-to-maturity are carried at cost and totaled \$5,000,000. The market value of the held-to-maturity securities was \$4,820,000 at June 30, 2007. At December 31, 2006, investment securities comprised 10% of total assets. At December 31, 2006 there were securities classified as held-to-maturity of \$5,000,000 and securities classified as available-for-sale of \$25,829,000. Changes in the fair market value of available-for-sale securities (e.g., unrealized holding gains or losses) are reported as "other comprehensive income (loss)," net of tax, and carried as accumulated other comprehensive income or loss within shareholders' equity until realized.

The Bank purchased \$10,000,000 in new issues of U.S. Government sponsored agency securities in the first quarter of 2007. These securities are callable, with maturities of 10 to 15 years and yields of 6.0% to 6.25%.

The Bank utilizes the investment portfolio to manage liquidity and attract funding that requires collateralization. At June 30, 2007, investment securities with a market value of \$31,904,000, or 81% of the portfolio, were pledged to secure time deposits from the State of California and repurchase agreements. At December 31, 2006, investment securities with a market value of \$17,679,000, or 57% of the portfolio, were pledged. At June 30, 2007, securities with a par value of \$33,250,000 mature or are callable within one year.

The Bank does not own securities of any single issuer (other than U.S. Government agencies and corporations) whose aggregate book value was in excess of 10% of the Bank's total equity at the time of purchase.

Loan Portfolio

The following table shows the composition of the loan portfolio by amount, percentage of total loans for each major loan category and the volume percentage change between the dates indicated.

LOANS

(in thousands)	<u>June 30,</u> <u>2007</u>		<u>December 31,</u> <u>2006</u>		<u>Net Change</u>	<u>Percent</u> <u>Change</u>
	\$	%	\$	%		
Commercial & Agricultural	\$ 51,957	19.5%	\$ 55,814	21.7%	\$ (3,857)	-6.91%
Real Estate - Commercial	100,481	37.7%	91,557	35.6%	8,924	9.75%
Real Estate-Construction	30,050	11.3%	30,937	12.0%	(887)	-2.87%
Real Estate - 1-4 Family	34,169	12.8%	31,451	12.2%	2,718	8.64%
Real Estate-Multifamily & Land	37,136	13.9%	35,880	14.0%	1,256	3.50%
Installment Loans to Individuals	5,253	1.9%	4,977	1.9%	276	5.55%
Lease Financing	7,749	2.9%	6,538	2.6%	1,211	18.52%
	<u>266,795</u>	<u>100%</u>	<u>257,154</u>	<u>100%</u>	<u>9,641</u>	<u>3.75%</u>
LESS:						
Allowance for Loan Losses	(3,175)		(3,736)		561	-15.02%
Deferred Loan Fees	(576)		(558)		(18)	3.23%
Total Loans, Net	<u>\$ 263,044</u>		<u>\$ 252,860</u>		<u>\$ 10,184</u>	<u>4.03%</u>

At June 30, 2007, the Bank had approximately \$45,037,000 in undisbursed loan commitments, of which approximately \$13,749,000 related to real estate construction and commercial real estate loans. Standby letters of credit amounting to \$655,000 were in place at June 30, 2007.

At December 31, 2006, the Bank had approximately \$35,471,000 in undisbursed loan commitments, of which approximately \$14,305,000 related to real estate construction loans and commercial real estate loans. At December 31, 2006, there was \$2,019,000 in standby letters of credit outstanding.

Nonperforming Assets

Nonperforming assets consist of nonperforming loans and other real estate owned. Nonperforming loans are those for which the borrower fails to perform under the original terms of the obligation and consist of nonaccrual loans, accruing loans 90 days or more past due and restructured loans.

In addition to the nonperforming loans discussed below for the respective periods, the Bank owns a General Motors Acceptance Corporation bond which matures September 2011 and has a coupon of 6.875%. The par value is \$500,000 and was carried on the Bank's financial statements at its market value of \$495,000 as of June 30, 2007. General Motors Acceptance Corporation's bonds were downgraded below investment grade in 2005 and has a current Moody's rating of Ba1. Management believes that there is no potential of loss in this bond at this time. The interest payments on this bond are being made as scheduled.

Nonaccrual loans were \$341,000, or 0.1% of gross loans outstanding, and consisted of one loan at June 30, 2007, which was restructured in 2006 and is current with the revised terms.

At June 30, 2007, the Bank had one commercial real estate property classified as other real estate owned ("OREO"). The OREO was a result of a foreclosure on a loan that was held as nonaccrual at the March 31, 2007 quarter end. The property is carried at its estimated sales price, less sales commissions, of \$921,000. The book value of the property is net of a charge-off on the loan of \$459,000 which was charged against the allowance for loan losses during the second quarter of 2007. Of this charge off, approximately \$235,000 had been specifically allocated for in the allowance for loan losses as of March 31, 2007.

At June 30, 2007, there were three loan relationships primarily secured by real estate totaling \$4,012,000 with respect to which management had concerns as to the ability of the borrowers to continue to comply with the present loan repayment terms and that were not included in nonaccrual loans.

Allowance for Loan Losses

The Bank maintains the allowance for loan losses to provide for inherent losses in the loan portfolio. Additions to the allowance for loan losses are established through a provision charged to expense. All loans which are judged to be uncollectible are charged against the allowance while any recoveries are credited to the allowance. The Bank's policy is to charge off any known losses at the time of determination. Any unsecured loan more than 90 days delinquent in payment of principal or interest and not in the process of collection is charged off in total. Secured loans are evaluated on a case by case basis to determine the ultimate loss potential to us subsequent to the liquidation of collateral. In those cases where we believe we are inadequately protected, a charge off will be made to reduce the loan balance to a level equal to the liquidation value of the collateral.

The Bank's loan policy provides procedures designed to evaluate and assess the credit risk factors associated with the loan portfolio, to enable the Bank to assess such credit risk factors prior to granting new loans and to evaluate the sufficiency of the allowance for loan losses. The Bank conducts an assessment of the allowance on a monthly basis and undertakes a more critical evaluation quarterly. At the time of the quarterly review, the Board of Directors will examine and formally approve the adequacy of the allowance. The quarterly evaluation includes an assessment of the following factors: any external loan review and regulatory examination, estimated potential loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquent and non-accrual loans, trends in loan volume, effects of any changes in lending policies and procedures, changes in lending personnel, current economic conditions at the local, state and national level and a migration analysis of historical losses and recoveries for the prior eight quarters.

In addition to the Allowance for Loan Losses, the Bank maintains an allowance for undisbursed loan commitments of \$50,000 reported in other liabilities on the financial statements.

The allowance for loan losses was \$3,175,000 at June 30, 2007 compared to \$3,736,000 at December 31, 2006. The activity in the allowance for loan losses during the second quarter of 2007 included a provision for loan losses of \$260,000 and loan charge-offs of \$642,000, for which approximately \$246,000 of estimated losses were previously allocated for in the allowance for loan losses as of March 31, 2007.

At June 30, 2007 and December 31, 2006, the Bank's allowance for loan losses was 1.19% and 1.46% of outstanding loans, respectively. The ratio of the allowance for loan losses has declined as a percent of outstanding loans; however the coverage of the allowance for loan losses to nonperforming loans increased to 931% at June 30, 2007, compared to 157% at December 31, 2006.

The following table summarized the activity in the Allowance for Loan Losses during the periods indicated.

SUMMARY OF ACTIVITY IN ALLOWANCE FOR LOAN LOSSES
(Dollars in thousands)

	<u>Six months ended</u> June 30, 2007	<u>Year Ended</u> December 31, 2006
Balance at beginning of period	\$ 3,736	\$ 3,617
Charge-offs:		
Commerical and agricultural	331	134
Real estate--construction and land development	561	-
Real estate--mortgage	-	-
Installment loans to individuals	-	-
Total loans charged-off	<u>892</u>	<u>134</u>
Recoveries:		
Commerical and agricultural	-	-
Real estate--construction and land development	-	-
Real estate--mortgage	-	-
Installment loans to individuals	-	-
Total recoveries	<u>-</u>	<u>-</u>
Net loans charged-off	892	134
Provisions for loan losses	331	253
Allowance for loan losses - end of period	<u>\$ 3,175</u>	<u>\$ 3,736</u>
Loans:		
Average loans outstanding during period, net of unearned income	\$ 261,574	\$ 248,539
Total loans at end of period, net of unearned income	\$ 266,219	\$ 256,596
Ratios:		
Net loans charged-off to average net loans (1)	0.68%	0.05%
Net loans charged-off to total loans (1)	0.67%	0.05%
Allowance for loan losses to average net loans	1.21%	1.50%
Allowance for loan losses to total loans	1.19%	1.46%
Net loans charged-off to beginning allowance for loan losses (1)	47.75%	3.70%
Net loans charged-off to provision for loan losses	269.49%	52.96%
(1) Annualized for six months ended June 30, 2007		

(in thousands)	June 30,		March 31,		December 31,	
	2007		2007		2006	
	<u>Allowance Allocation</u>	<u>Amount of Category Loans to Total Loans</u>	<u>Allowance Allocation</u>	<u>Amount of Category Loans to Total Loans</u>	<u>Allowance Allocation</u>	<u>Amount of Category Loans to Total Loans</u>
Commercial	\$ 430	19.5%	\$ 463	20.9%	\$ 521	21.7%
Commercial real estate	757	37.7%	769	36.5%	688	35.6%
Real estate - construction	329	11.3%	640	11.5%	450	12.0%
Real estate - mortgage	44	12.8%	61	12.1%	58	12.2%
Real Estate - multifamily &	224	13.9%	277	14.2%	271	14.0%
Consumer	40	1.9%	56	2.0%	36	1.9%
Lease financing	88	2.9%	82	2.8%	69	2.6%
Other	1,037		1,073		1,117	
Unallocated	226		136		526	
Total	<u>\$ 3,175</u>	<u>100%</u>	<u>\$ 3,557</u>	<u>100%</u>	<u>\$ 3,736</u>	<u>100%</u>

The allocation of the Allowance for Loan Losses to the other category is due to management's assessment of various qualitative factors. Qualitative factors included the size of individual credits, concentrations and general economic conditions. Management also considers these qualitative factors in their evaluation of the adequacy of the allowance for loan losses. An unallocated allowance can arise from fluctuations in the amount of classified and nonperforming loans ("credit grades") between periods.

Deposits

At June 30, 2007, the Bank had a deposit mix of 70% in time deposits, 20% in money market and savings accounts, and 10% in checking accounts. At December 31, 2006, the Bank had a deposit mix of 61% in time deposits, 29% in money market and savings accounts, 10% in checking accounts.

At June 30, 2007, the State of California had \$33,000,000 in time deposits with the Bank with maturities of 3 to 6 months and collateralized by investment securities or letters of credit issued by the Federal Home Loan Bank. These deposits are received through a program run by the Treasurer of the State of California to place public deposits with community banks. At December 31, 2006, these time deposits totaled \$20,000,000. At June 30, 2007, the Bank had \$28,085,000 in brokered time deposits, which included \$567,000 in deposits raised through the CDARS program locally, this compares to \$19,191,000 in brokered time deposits at December 31, 2006.

Liquidity and Capital Resources

Maintenance of adequate liquidity requires that sufficient resources be available at all times to meet cash flow requirements of the Bank. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of customers and to take advantage of investment opportunities as they arise. A bank may achieve desired liquidity from both assets and liabilities. Cash and deposits held in other banks, Federal funds sold, other short term investments, maturing loans and investments, payments of principal and interest on loans and investments, and potential loan sales are sources of asset liquidity. Deposit growth and access to credit lines established with correspondent banks and market sources of funds are sources of liability liquidity. The Bank reviews its liquidity position on a regular basis based upon its current position and expected trends of loans and deposits. The policy of the Board of Directors is to maintain sufficient capital at not less than the "well-capitalized" thresholds established by banking regulators. Management believes that the Bank maintains adequate sources of liquidity to meet its liquidity needs.

The Bank's liquid assets, defined as cash and cash equivalents, deposits with banks and market value of unpledged investment securities, totaled \$13,505,000 at June 30, 2007 and constituted 4% of total assets at that date compared to \$23,756,000 or 8% of total assets from December 31, 2006.

Although the Bank's sources of liquidity include liquid assets, the Bank maintains lines of credit with the Federal Home Loan Bank and its correspondent banks. The total of these lines of credit were \$118,925,000 at June 30, 2007, of which \$43,220,000 in Federal Home Loan Bank advances and letter of credit were outstanding. The Bank actively utilizes its borrowing capacity with the Federal Home Loan Bank to manage

liquidity as well as a funding alternative to time deposits if the Federal Home Loan Bank's rates and terms are more favorable. The advances from the Federal Home Loan Bank can have maturities from overnight to multiple years. At June 30, 2007, \$23,620,000 was due within one year and \$13,000,000 had maturities greater than a year.

Federal regulations establish guidelines for calculating "risk-adjusted" capital ratios and minimum ratio requirements. Under these regulations, banks are required to maintain a total risk-based capital ratio of 8.0% and Tier 1 risk-based capital (primarily shareholders' equity) of at least 4.0% of total qualifying capital. The Bank had total and Tier 1 risk-based capital ratios of 16.7% and 15.5% at June 30, 2007, and was "well-capitalized" under the regulatory guidelines.

In addition, regulators have adopted a minimum leverage ratio standard for Tier 1 risk-based capital to total assets. The minimum ratio for top-rated institutions may be as low as 3%. However, regulatory agencies have stated that most institutions should maintain ratios at least 1 to 2 percentage points above the 3% minimum. As of June 30, 2007, the Bank's leverage ratio was 13.7%. Capital levels for the Bank remain above established regulatory capital requirements.

Impact of Inflation

The primary impact of inflation on the Bank is its effect on interest rates. The Bank's primary source of income is net interest income, which is affected by changes in interest rates. The Bank attempts to limit the impact of inflation on its net interest margin through management of rate-sensitive assets and liabilities and analyses of interest rate sensitivity. The effect of inflation on premises and equipment as well as on noninterest expenses has not been significant for the periods presented.

Item 3 Quantitative and Qualitative Disclosures About Market Risk

Proper management of the rate sensitivity and maturities of assets and liabilities is required to provide an optimum and stable net interest margin. Interest rate sensitivity spread management is an important tool for achieving this objective and for developing ways in which to improve profitability. Management has assessed its market risk at June 30, 2007, and believes that there have been no material changes since December 31, 2006.

The Bank constantly monitors earning asset and deposit levels, developments and trends in interest rates, liquidity, capital adequacy and marketplace opportunities. Management responds to all of these to protect and possibly enhance net interest income while managing risks within acceptable levels as set forth in the Bank's policies. In addition, alternative business plans and transactions are contemplated for their potential impact. This process is known as asset/liability management and is carried out by changing the maturities and relative proportions of the various types of loans, investments, deposits and borrowings in the ways described above.

The tool most commonly used to manage and analyze the interest rate sensitivity of a bank is known as a computer simulation model. To quantify the extent of risks in both the Bank's current position and in transactions it might make in the future, the Bank uses a model to simulate the impact of different interest rate scenarios on net interest income. The hypothetical impact of sudden shock (generally, an immediate change in interest rates of +/- 2.00%) and smaller incremental interest rate changes are modeled at least quarterly, representing the primary means the Bank uses for interest rate risk management decisions.

At June 30, 2007, given a +2.00% or -2.00% shock in interest rates, the model results in the Bank's net interest income for the next twelve months changing by \$(634,000) or -6% and \$448,000 or 4%, respectively.

When preparing its modeling, the Bank makes significant assumptions about the lag in the rate of change in various asset and liability categories. The Bank bases its assumptions on past experience and comparisons with other banks, and tests the validity of its assumptions by reviewing actual results with projected expectations.

Item 4 Controls and Procedures

Under the supervision and with the participation of the Bank's management, including its chief executive officer and chief financial officer, the Bank conducted an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures as defined by Rule 13a-15(e) under the Securities Exchange Act of 1934.

Based on the evaluation, the chief executive officer and chief financial officer concluded that as of the end of the period covered by this report the disclosure controls and procedures were adequate and effective, and that the material information required to be included in this report, including information from the Bank's

consolidated subsidiary, was properly recorded, processed, summarized and reported, and was made known to the chief executive officer and chief financial officer by others within the Bank in a timely manner, particularly during the period when this quarterly report on Form 10-Q was being prepared.

There was no change in the Bank's internal control over financial reporting that occurred during the most recent fiscal quarter that materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

PART II OTHER INFORMATION

Item 1 Legal Proceedings

There is no pending, or to management's knowledge any threatened, material legal proceedings to which the Bank is a party or to which any of the Bank's properties are subject.

Item 1A Risk Factors

There have been no material changes from the risk factors previously disclosed in the Bank's Form 10 and Form 10-K.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

N/A

Item 3 Defaults Upon Senior Securities

None.

Item 4 Submission of Matters to a Vote of Security Holders

The Annual meeting of Shareholders was held on May 21, 2007 at which time shareholders approved the election of the 13 proposed Directors, the selection of Crowe Chizek and Company, LLP as the independent certified public accountants for the fiscal year ending December 31, 2007, and the adoption of the 2007 Stock Option Plan.

The 13 Directors were reelected through proxies solicited pursuant to Regulation 14 and there was no solicitation in opposition to the nominees.

Results of Annual Meeting of Shareholders held on May 21, 2007

Director	Votes for	Votes against	Abstentions and broker non-votes
Terrance M. Davis	3,945,012	-	10,300
John F. DeMeo	3,945,012	-	10,300
Michael J. Donovan	3,945,012	-	10,300
Richard A. Dorr	3,945,012	-	10,300
Todd R. Fry	3,945,012	-	10,300
George I. Hamamoto	3,945,012	-	10,300
Allan J. Hemphill	3,945,012	-	10,300
Jeanne D. Hubbard	3,945,012	-	10,300
John C. Lewis	3,945,012	-	10,300
Ronald A. Metcalfe	3,945,012	-	10,300
Marshall T. Reynolds	3,945,012	-	10,300
Robert B. St. Clair	3,945,012	-	10,300
Eugene W. Traverso	3,945,012	-	10,300

Approval of Crowe Chizek and Company LLP as independent auditors for 2007:

Votes for	3,938,342
Votes against	10,800
Abstentions and broker non-votes	6,170

Approval of the 2007 Stock Option Plan:

Votes for	2,531,484
Votes against	77,508
Abstentions and broker non-votes	1,346,320

Item 5 Other Information

None

Item 6 Exhibits

The exhibits filed as part of this report are listed on the Exhibit Index filed as part of this report.

SIGNATURES

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

Summit State Bank

(registrant)

_____8/10/07_____

Date

/s/ John C. Lewis

John C. Lewis, Chief Executive Officer

_____8/10/07_____

Date

/s/ Dennis E. Kelley

Dennis E. Kelley, Senior Vice
President and Chief Financial Officer

EXHIBIT INDEX

Exhibit Number	Description
31.01	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002
31.02	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002
32.01	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. §1350 as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002
99	2007 Stock Option Plan

Exhibit 31.02

Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002

I, Dennis E. Kelley, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Summit State Bank (the registrant) for the quarter ended June 30, 2007;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-13(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure and controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

8/10/07 _____ /s/ Dennis E. Kelley

Date Dennis E. Kelley
Senior Vice President
and Chief Financial Officer
Summit State Bank

EXHIBIT 32.01

Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. §1350 as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002

In connection with the quarterly report on Form 10-Q of Summit State Bank (the Registrant) for the quarter ended June 30, 2007, as filed with the Federal Deposit Insurance Corporation, the undersigned hereby certify pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- 1) such Form 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) the information contained in such Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

_____8/10/07_____ /s/ John C. Lewis

John C. Lewis, Chief Executive Officer

_____8/10/07_____ /s/ Dennis E. Kelley
Dennis E. Kelley, Chief Financial Officer

This certification accompanies each report pursuant to §906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Registrant for purposes of §18 of the Securities Exchange Act of 1934, as amended.

**SUMMIT STATE BANK
2007 STOCK OPTION PLAN**

1. Purpose

The purpose of the Summit State Bank 2007 Stock Option Plan (the “Plan”) is to advance the interests of Summit State Bank (the “Bank”) and its shareholders by providing Key Employees and Directors of the Bank and its Affiliates, upon whose judgment, initiative and efforts the successful conduct of the business of the Bank and its Affiliates largely depends, with an additional incentive to perform in a superior manner as well as to attract people of experience and ability.

2. Definitions

“*Affiliate*” means any “parent corporation” or “subsidiary corporation” of the Bank, as such terms are defined in Section 424(e) or 424(f), respectively, of the Code, or a successor to a parent corporation or subsidiary corporation.

“*Award*” means an Award of Non-Statutory Stock Options and Incentive Stock Options granted under the provisions of the Plan.

“*Beneficiary*” means the person or persons designated by a Participant to receive any benefits payable under the Plan in the event of such Participant’s death. Such person or persons shall be designated in writing on forms provided for this purpose by the Committee and may be changed from time to time by similar written notice to the Committee. In the absence of a written designation, the Beneficiary shall be the Participant’s surviving spouse, if any, or if none, his/her estate.

“*Board*” or “*Board of Directors*” means the board of directors of the Bank, unless otherwise noted herein.

“*Cause*” means personal dishonesty, incompetence, willful misconduct, any breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, or the willful violation of any law, rule or regulation (other than traffic violations or similar offenses) or a final cease-and-desist order, any of which results in a material loss to the Bank or an Affiliate.

“*Change in Control*” a Change in Control shall be deemed to have occurred at such time as (a) any “person” (as the term is used in Sections 13(d) and 14(d) of the Exchange Act) is or becomes the “beneficial owner” (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Bank representing 50% or more of the combined voting power of the Bank’s outstanding securities, except for any person disclosed in the Bank’s Offering Circular dated July 6, 2006, as the beneficial owner of 5% or more of the Bank’s common stock (“Current 5% Owner”), as well as the heirs, devisees, beneficiaries, estates, successors, affiliates, legal representatives, or distributees of any such Current 5% Owner; or (b) individuals who constitute the Board on the date hereof (the “Incumbent Board”) cease for any reason to constitute at least a majority thereof, *provided* that any person becoming a director subsequent to the date hereof whose election was approved by a vote of at least three-quarters of the directors comprising the Incumbent Board, or whose nomination for election by the Bank’s shareholders was approved by the same Nominating Committee serving under an Incumbent Board, shall be considered, for purposes of this clause (b), as though he were a member of the Incumbent Board; or (c) a plan of reorganization, merger, consolidation, or sale of all or substantially all the assets of the Bank or similar transaction in which the Bank is not the surviving corporation occurs; or

(d) a proxy statement is distributed soliciting proxies from shareholders of the Bank, by someone other than the then current Board of Directors of the Bank, seeking shareholder approval of a plan of reorganization, merger or consolidation of the Bank, or a similar transaction with one or more corporations, as a result of which the shareholders of the Bank approve such plan and subsequently exchange or convert their outstanding shares of common stock of the Bank into cash or property or securities not issued by the Bank; or (e) a tender offer is made for 50% or more of the voting securities of the Bank and the shareholders owning beneficially or of record 50% or more of the outstanding securities of the Bank have tendered or offered to sell their shares pursuant to such tender offer and such tendered shares have been accepted by the tender offeror, except for any voting securities purchased pursuant to a tender offer by a Current 5% Owner, or the heirs, devisees, beneficiaries, estates, successors, affiliates, legal representatives, or distributees of any such Current 5% Owner.

“*Code*” means the Internal Revenue Code of 1986, as amended.

“*Committee*” means the committee consisting of either (i) at least two Non-Employee Directors of the Bank, or (ii) the entire Board of the Bank.

“*Common Stock*” means shares of the common stock of the Bank, no par value.

“*Bank*” means Summit State Bank or a successor corporation.

“*Continuous Service*” means employment as a Key Employee without any interruption or termination of such employment. Continuous Service shall also mean a continuation as a member of the Board of Directors following a cessation of employment as a Key Employee. In the case of a Key Employee, employment shall not be considered interrupted in the case of sick leave, military leave or any other approved leave of absence or in the case of transfers between payroll locations of the Bank, its subsidiaries or its successor.

“*Date of Grant*” means the actual date on which an Award is granted by the Committee.

“*Director*” means a member of the Board.

“*Disability*” means a condition where an individual is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months. An individual shall not be considered to be disabled for purposes of this Plan unless he furnishes proof of the existence thereof.

“*Effective Date*” means the date of, or a date determined by the Board of Directors following, approval of the Plan by the Bank’s shareholders.

“*Fair Market Value*” means, when used in connection with the Common Stock on a certain date, the reported closing price of the Common Stock as reported on the Nasdaq stock market (as published in *The Wall Street Journal*, if published) on the day prior to such date, or if the Common Stock was not traded on the day prior to such date then, on the next preceding day on which the Common Stock was traded; *provided, however*, that if the Common Stock is not reported on the Nasdaq stock market, Fair Market Value shall mean the average sale price of all shares of Common Stock sold during the 30-day period immediately preceding the date on which such stock option was granted, and if no shares of stock have been sold within such 30-day period, the average sale price of the last three sales of Common Stock sold during the 90-day period immediately preceding the date on which such stock option was granted. In the event Fair Market Value cannot be determined in the manner described above, then Fair Market Value shall be determined by the Committee. The Committee is authorized, but is not required, to obtain an independent appraisal to determine the Fair Market Value of the Common Stock.

“*Incentive Stock Option*” means an Option granted by the Committee to a Key Employee, which Option is designated as an Incentive Stock Option pursuant to Section 9.

“*Key Employee*” means any person who is currently employed by the Bank or an Affiliate who is chosen by the Committee to participate in the Plan.

“*Non-Employee Director*” means, for purposes of the Plan, a Director who (a) is not employed by the Bank or an Affiliate; (b) does not receive compensation directly or indirectly as a consultant (or in any other capacity than as a Director) greater than \$60,000; (c) does not have an interest in a transaction requiring disclosure under Item 404(a) of Regulation S-K; or (d) is not engaged in a business relationship for which disclosure would be required pursuant to Item 404(b) of Regulation S-K.

“*Non-Statutory Stock Option*” means an Option granted by the Committee to a Participant and such Option is either (a) not designated by the Committee as an Incentive Stock Option, or (b) fails to satisfy the requirements of an Incentive Stock Option as set forth in Section 422 of the Code and the regulations thereunder.

“*Option*” means an Award granted under Section 8 or Section 9.

“*Participant*” means a Key Employee or Director of the Bank or its Affiliates who receives or has received an Award under the Plan.

“*Termination for Cause*” means the termination of employment caused by the individual’s personal dishonesty, willful misconduct, any breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, or the willful violation of any law, rule or regulation (other than traffic violations or similar offenses), or a final cease-and-desist order, any of which results in material loss to the Bank or one of its Affiliates.

3. Administration of the Plan

(a) *Role of the Committee.* The Plan shall be administered by the Committee. The interpretation and construction by the Committee of any provisions of the Plan or of any Option granted hereunder shall be final and binding. The Committee shall act by vote or written consent of a majority of its members. Subject to the express provisions and limitations of the Plan, the Committee may adopt such rules and procedures as it deems appropriate for the conduct of its affairs. The Committee shall report its actions and decisions with respect to the Plan to the Board at appropriate times, but in no event less than one time per calendar year.

(b) *Role of the Board.* The members of the Committee shall be appointed or approved by, and will serve at the pleasure of, the Board of Directors of the Bank. The Board may in its discretion from time to time remove members from, or add members to, the Committee. The Board shall have all of the powers allocated to it in the Plan, may take any action under or with respect to the Plan that the Committee is authorized to take, and may reverse or override any action taken or decision made by the Committee under or with respect to the Plan.

(c) *Plan Administration Restrictions.* All transactions involving a grant, award or other acquisitions from the Bank shall:

(i) be approved by the Bank’s full Board or by the Committee;

(ii) be approved, or ratified, in compliance with Section 14 of the Exchange Act, by either: the affirmative vote of the holders of a majority of the shares present, or represented and entitled to vote at a meeting duly held in accordance with the laws under which the Bank is incorporated; or the written consent of the holders of a majority of the securities of the issuer entitled to vote, *provided* that such ratification occurs no later than the date of the next annual meeting of shareholders; or

(iii) result in the acquisition of Common Stock that is held by the Recipient for a period of six months following the date of such acquisition.

(d) *Limitation on Liability.* No member of the Board or the Committee shall be liable for any determination made in good faith with respect to the Plan or any Awards granted under it. If a member of the Board or the Committee is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of anything done or not done by him in such capacity under or with respect to the Plan or the Bank shall indemnify such member against expense (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding if he/she acted in good faith and in a manner he/she reasonably believed to be in the best interests of the Bank and, with respect to any criminal action or proceeding, had no reasonable cause to believe his/her conduct was unlawful.

Notwithstanding anything herein to the contrary, and subject to any adjustment that may be made pursuant to Section 15 hereof, once an Option has been awarded at Fair Market Value, the Committee shall not have authority to reprice such Option so that the exercise price of the Option shall be less than the exercise price on the Date of Grant.

4. Types of Awards

Awards under the Plan may be granted in any one or a combination of: (a) Incentive Stock Options; and (b) Non-Statutory Stock Options.

5. Stock Subject to the Plan

Subject to adjustment as provided in Section 15, the maximum number of shares reserved for issuance under the Plan is 150,000 shares. Shares issued under the Plan may be issued by the Bank from authorized but unissued shares or shares acquired by the Bank in open market purchases. The maximum number of Options that may be awarded to a Key Employee is 45,000 shares. The maximum number of shares that may be awarded pursuant to the exercise of Incentive Stock Options is 150,000 shares. To the extent that Options granted under the Plan are exercised, the shares covered will be unavailable for future grants under the Plan; to the extent that Options granted under the Plan terminate, expire or are forfeited without having been exercised, shares under such Options shall be available for subsequent Awards under this Plan.

Any shares that are issued by the Bank, and any Awards that are granted by, or become obligations of, the Bank, through the assumption by the Bank or an affiliate thereof, or in substitution for, outstanding Awards previously granted by an acquired company, shall not be counted against the shares available for issuance under the Plan.

6. Eligibility

Key Employees of the Bank and its Affiliates shall be eligible to receive Incentive Stock Options and Non-Statutory Stock Options under the Plan. Directors of the Bank and its Affiliates shall be eligible to receive Non-Statutory Stock Options under the Plan.

7. General Terms and Conditions of Options

The Committee shall have full and complete authority and discretion except as expressly limited by the Plan, to grant Options and to provide the terms and conditions (which need not be identical among Participants) thereof. In particular, the Committee shall prescribe the following terms and conditions: (i) the Exercise Price of any Option, which shall not be less than the Fair Market Value per share on the Date of Grant, (ii) the number of shares of Common Stock subject to, and the expiration date of, any Option, which expiration date shall not exceed ten years from the Date of Grant, (iii) the manner, time and rate (cumulative or otherwise) of exercise of such Option, and (iv) the restrictions, if any, to be placed upon such Option or upon shares of Common Stock which may be issued upon exercise of such Option. No awards shall vest at a rate in excess of 20% per year beginning one year from the Date of Grant.

8. Non-Statutory Stock Options

The Committee may, from time to time, grant Non-Statutory Stock Options to eligible Key Employees and Directors. Non-Statutory Stock Options granted under the Plan, including Non-Statutory Stock Options granted in exchange for and upon surrender of previously granted Awards, are subject to the terms and conditions set forth in this Section.

(a) *Option Agreement.* Each Option shall be evidenced by a written option agreement between the Bank and the Participant specifying the number of shares of Common Stock that may be acquired through its exercise and containing such other terms and conditions that are not inconsistent with the terms of the Plan.

(b) *Price.* The purchase price per share of Common Stock deliverable upon the exercise of each Non-Statutory Stock Option shall be the Fair Market Value of the Common Stock of the Bank on the Date of Grant. Shares may be purchased only upon full payment of the purchase price in one or more of the manners set forth in Section 11 hereof, as determined by the Committee.

(c) *Vesting.* Subject to Section 7 hereof, a Non-Statutory Stock Option granted under the Plan shall vest in a Participant at the rate or rates determined by the Committee. No Options shall become vested in a Participant unless the Participant maintains Continuous Service until the vesting date of such Option, except as set forth herein. The Committee may accelerate the time at which any Non-Statutory Stock Option may be exercised in whole or in part.

(d) *Exercise of Options.* A vested Option may be exercised from time to time, in whole or in part, by delivering a written notice of exercise to the President or Chief Executive Officer of the Bank, or his/her designee. Such notice shall be irrevocable and must be accompanied by full payment of the purchase price in cash or shares of Common Stock at the Fair Market Value of such shares, determined on the exercise date in the manner described in Section 2 hereof. If previously acquired shares of Common Stock are tendered in payment of all or part of the exercise price, the value of such shares shall be determined as of the date of such exercise.

(e) *Amount of Awards.* Subject to Section 7 hereof, Non-Statutory Stock Options may be granted to any Participant in such amounts as determined by the Committee. In granting Non-Statutory Stock Options, the Committee shall consider such factors as it deems relevant, which factors may include, among others, the position and responsibility of the Participant, the length and value of his/her service to the Bank or the Affiliate, the compensation paid to the Participant, and the Committee's evaluation of the performance of the Bank or the Affiliate, according to measurements that may include, among others, key financial ratios, level of classified assets and independent audit findings.

(f) *Term of Options.* Unless the Committee determines otherwise, the term during which Non-Statutory Stock Options may be exercised shall not exceed ten years from the Date of Grant. In no event shall a Non-Statutory Stock Option be exercisable in whole or in part more than ten years from the Date of Grant.

(g) *Termination of Continuous Service.* Upon the termination of a Participant's Continuous Service, for any reason other than death, Disability, Termination for Cause, termination following a Change in Control (other than for Cause following a Change in Control), the Participant's Non-Statutory Stock Options shall be exercisable only as to those shares that were vested on the date of termination and only for one year following termination. In the event of Termination for Cause, all rights under a Participant's Non-Statutory Stock Options shall expire upon termination. In the event of the Participant's termination of Continuous Service due to death, Disability, or following a Change in Control, all Non-Statutory Stock Options held by the Participant, whether or not vested at such time, shall vest and become exercisable by the Participant or his/her legal representative or beneficiaries for one year following the date of such termination, death or

cessation of employment, *provided* that in no event shall the period extend beyond the expiration of the Non-Statutory Stock Option term.

(h) *Transferability.* In the discretion of the Board, all or any Non-Statutory Stock Options granted hereunder may be transferable by the Participant once the Option has vested in the Participant, *provided, however*, that the Board may limit the transferability of such Option or Options to a designated class or classes of persons.

9. Incentive Stock Options

The Committee may, from time to time, grant Incentive Stock Options to Key Employees. The total number of Incentive Stock Options granted pursuant to the Plan shall be up to 150,000 and shall be subject to the following terms and conditions:

(a) *Option Agreement.* Each Option shall be evidenced by a written option agreement between the Bank and the Key Employee specifying the number of shares of Common Stock that may be acquired through its exercise and containing such other terms and conditions that are consistent with the terms of the Plan.

(b) *Price.* Subject to Section 15 hereof and Section 422 of the Code, the purchase price per share of Common Stock deliverable upon the exercise of each Incentive Stock Option shall be not less than 100% of the Fair Market Value of the Bank's Common Stock on the date the Incentive Stock Option is granted. However, if a Key Employee owns stock possessing more than 10% of the total combined voting power of all classes of stock of the Bank or its Affiliates (or under Section 424(d) of the Code is deemed to own stock representing more than 10% of the total combined voting power of all classes of stock of the Bank or its Affiliates by reason of the ownership of such classes of stock, directly or indirectly, by or for any brother, sister, spouse, ancestor or lineal descendent of such Key Employee, or by or for any corporation, partnership, estate or trust of which such Key Employee is a shareholder, partner or Beneficiary), the purchase price per share of Common Stock deliverable upon the exercise of each Incentive Stock Option shall not be less than 110% of the Fair Market Value of the Bank's Common Stock on the date the Incentive Stock Option is granted. Shares may be purchased only upon payment of the full purchase price. Payment of the purchase price may be made, in whole or in part, through the surrender of shares of the Common Stock of the Bank at the Fair Market Value of such shares determined on the exercise date.

(c) *Vesting.* Subject to Section 7 hereof, Incentive Stock Options awarded to Key Employees shall vest at the rate or rates determined by the Committee. No Incentive Stock Option shall become vested in a Participant unless the Participant maintains Continuous Service until the vesting date of such Option, except as set forth herein.

(d) *Exercise of Options.* Vested Options may be exercised from time to time, in whole or in part, by delivering a written notice of exercise to the President or Chief Executive Officer of the Bank, or his/her designee. Such notice is irrevocable and must be accompanied by full payment of the exercise price in cash or shares of Common Stock at the Fair Market Value of such shares determined on the exercise date.

The Options comprising each installment may be exercised in whole or in part at any time after such installment becomes vested, *provided* that the amount able to be first exercised in a given year is consistent with the terms of Section 422 of the Code. To the extent required by Section 422 of the Code, the aggregate Fair Market Value (determined at the time the Option is granted) of the Common Stock for which Incentive Stock Options are exercisable for the first time by a Participant during any calendar year (under all plans of the Bank and its Affiliates) shall not exceed \$100,000.

The Committee may, in its sole discretion, accelerate the time at which any Incentive Stock Option may be exercised in whole or in part, *provided* that it is consistent with the terms of Section 422 of the Code. Notwithstanding the above, in the event of a Change in Control of the Bank, all Incentive Stock Options that have been awarded shall become immediately exercisable, *provided, however*, that if the aggregate Fair Market Value (determined at the time the Option is granted) of Common Stock for which Options are exercisable as a result of a Change in Control, together with the aggregate Fair Market Value (determined at the time the Option is granted) of all other Common Stock for which Incentive Stock Options become exercisable during such year, exceeds \$100,000, then the first \$100,000 of Incentive Stock Options (determined as of the Date of Grant) shall be exercisable as Incentive Stock Options and any excess shall be exercisable as Non-Statutory Stock Options (but shall remain subject to the provisions of this Section to the extent permitted).

(e) *Amounts of Awards.* Subject to Section 7 hereof, Incentive Stock Options may be granted to any eligible Key Employee in such amounts as determined by the Committee; *provided* that the amount granted is consistent with the terms of Section 422 of the Code. In granting Incentive Stock Options, the Committee shall consider such factors as it deems relevant, which factors may include, among others, the position and responsibilities of the Key Employee, the length and value of his/her service to the Bank, or the Affiliate, the compensation paid to the Key Employee and the Committee's evaluation of the performance of the Bank, or the Affiliate, according to measurements that may include, among others, key financial ratios, levels of classified assets, and independent audit findings. The provisions of this subsection (e) shall be construed and applied in accordance with Section 422(d) of the Code and the regulations, if any, promulgated thereunder.

(f) *Terms of Options.* The term during which each Incentive Stock Option may be exercised shall be determined by the Committee, provided, however, in no event shall an Incentive Stock Option be exercisable in whole or in part more than 10 years from the Date of Grant. If any Key Employee, at the time an Incentive Stock Option is granted to him, owns stock representing more than 10% of the total combined voting power of all classes of stock of the Bank or its Affiliate (or, under Section 424(d) of the Code, is deemed to own stock representing more than 10% of the total combined voting power of all classes of stock, by reason of the ownership of such classes of stock, directly or indirectly, by or for any brother, sister, spouse, ancestor or lineal descendent of such Key Employee, or by or for any corporation, partnership, estate or trust of which such Key Employee is a shareholder, partner or Beneficiary), the Incentive Stock Option granted to him shall not be exercisable after the expiration of five years from the Date of Grant.

(g) *Termination of Continuous Service.* Upon the termination of a Key Employee's Continuous Service for any reason other than death, Disability, Termination for Cause or termination following a Change in Control (other than for Cause following a Change in Control) the Key Employee's Incentive Stock Options shall be exercisable only as to those shares that were vested and exercisable by such Key Employee at the date of termination for a period of three months following termination. Upon termination of a Key Employee's Continuous Service due to death or Disability or following a Change in Control, all Incentive Options held by a Key Employee, whether or not vested at such time, shall vest and become exercisable by the Participant or his/her legal representative or beneficiaries for one year following the date of such termination, death or cessation of Continuous Service, *provided* that in no event shall the period extend beyond the expiration of the Stock Option term, and *provided, further*, that, except in the event of death or Disability, such Option shall not be eligible for treatment as an Incentive Stock Option in the event such Option is exercised more than three months following termination. In the event of Termination for Cause, all rights under the Incentive Stock Options shall expire upon termination.

In order to obtain Incentive Stock Option treatment for Options exercised by heirs or devisees of an Optionee, the Optionee's death must have occurred while employed or within three months of termination of Continuous Service.

(h) *Transferability.* No Incentive Stock Option granted under the Plan is transferable except by will or the laws of descent and distribution and is exercisable during his/her lifetime only by the Key Employee to which it is granted.

(i) *Compliance with Code.* The options granted under this Section are intended to qualify as Incentive Stock Options within the meaning of Section 422 of the Code, but the Bank makes no warranty as to the qualification of any Option as an Incentive Stock Option within the meaning of Section 422 of the Code. If an Option granted hereunder fails for whatever reason to comply with the provisions of Section 422 of the Code, and such failure is not or cannot be cured, such Option shall be a Non-Statutory Stock Option.

10. Surrender of Option

In the event of a Participant's termination of employment as a result of death or Disability, the Participant (or his/her personal representative(s), heir(s), or devisee(s)) may, in a form acceptable to the Committee, make application to surrender all or part of the Options held by such Participant in exchange for a cash payment from the Bank of an amount equal to the difference between the Fair Market Value of the Common Stock on the date of termination of employment and the exercise price per share of the Option. Whether the Bank accepts such application or determines to make payment, in whole or part, is within its absolute and sole discretion, it being expressly understood that the Bank is under no obligation to any Participant whatsoever to make such payments. In the event that the Bank accepts such application and determines to make payment, such payment shall be in lieu of the exercise of the underlying Option and such Option shall cease to be exercisable.

11. Alternate Option Payment Mechanism

The Committee has sole discretion to determine what form of payment it will accept for the exercise of an Option. The Committee may indicate acceptable forms in the agreement with the Participant covering such Options or may reserve its decision to the time of exercise. No Option is to be considered exercised until payment in full is accepted by the Committee or its agent.

(a) *Cash Payment.* The exercise price may be paid in cash or by certified check. To the extent permitted by law, the Committee may permit all or a portion of the exercise price of an Option to be paid through borrowed funds.

(b) *Cashless Exercise.* Subject to vesting requirements, if applicable, a Participant may engage in a "cashless exercise" of the Option. Upon a cashless exercise, the Participant shall give the Bank written notice of the exercise of the Option together with an order to a registered broker-dealer or equivalent third party, to sell part or all of the Common Stock subject to the Option and to deliver enough of the proceeds to the Bank to pay the Option exercise price and any applicable withholding taxes. If the Participant does not sell the Common Stock subject to the Option through a registered broker-dealer or equivalent third party, the Participant may give the Bank written notice of the exercise of the Option and the third party purchaser of the Common Stock subject to the Option shall pay the Option exercise price plus applicable withholding taxes to the Bank.

(c) *Exchange of Common Stock.* The Committee may permit payment of the option exercise price by the tendering (or constructively tendering) of previously acquired shares of Common Stock. All shares of Common Stock tendered in payment of the exercise price of an Option shall be valued at the Fair Market Value of the Common Stock. No tendered shares of Common Stock which were acquired by the Participant upon the previous exercise of an Option or as awards under a stock award plan, if any, shall be accepted for exchange unless the Participant has held such shares (without restrictions imposed by said plan or award) for at least six months prior to the exchange.

12. Rights of a Stockholder

A Participant shall have no rights as a shareholder with respect to any shares covered by a Non-Statutory and/or Incentive Stock Option until the date of issuance of a stock certificate for such shares. Nothing in the Plan or in any Award granted confers on any person any right to continue in the employ of the Bank or its Affiliates, or interferes in any way with the right of the Bank or its Affiliates to terminate his/her services as an officer or employee or otherwise at any time.

13. Agreement with Participants

Each Award of Options will be evidenced by a written agreement, executed by the Participant and the Bank or its Affiliates that describes the conditions for receiving the Awards, including the date of Award, the purchase price, applicable periods, and any other terms and conditions as may be required by the Board or applicable securities laws.

14. Designation of Beneficiary

A Participant may, with the consent of the Committee, designate a person or persons to receive, in the event of death, any Option to which he/she would then be entitled. Such designation will be made upon forms supplied by and delivered to the Bank and may be revoked in writing. If a Participant fails effectively to designate a Beneficiary, then his/her estate will be deemed to be the Beneficiary.

15. Dilution and Other Adjustments

In the event of any change in the outstanding shares of Common Stock by reason of any stock dividend or split, pro rata return of capital to all shareholders, recapitalization, or any merger, consolidation, spin-off, reorganization, combination or exchange of shares, or other similar corporate change, or other increase or decrease in such shares, without receipt or payment of consideration by the Bank, the Committee will make such adjustments to previously granted Awards, to prevent dilution or enlargement of the rights of the Participant, including any or all of the following:

- (a) adjustments in the aggregate number or kind of shares of Common Stock that may be awarded under the Plan;
- (b) adjustments in the aggregate number or kind of shares of Common Stock covered by Awards already made under the Plan; or
- (c) adjustments in the purchase price of outstanding Incentive and/or Non-Statutory Stock Options.

No such adjustments may, however, materially change the value of benefits available to a Participant under a previously granted Award. With respect to Incentive Stock Options, no such adjustment shall be made if it would be deemed a “modification” of the Award under Section 424 of the Code.

16. Effect of a Change in Control on Option Awards

In the event of a Change in Control, the Committee and the Board of Directors will take one or more of the following actions to be effective as of the date of such Change in Control:

- (a) provide that such Options shall be assumed, or equivalent options shall be substituted (“Substitute Options”) by the acquiring or succeeding corporation (or an affiliate thereof), provided that: (1) any such Substitute Options exchanged for Incentive Stock Options shall meet the requirements of Section 424(a) of the Code, and (2) the shares of

stock issuable upon the exercise of such Substitute Options shall be registered in accordance with the Securities Act of 1933, as amended (“1933 Act”) or such securities shall be exempt from such registration in accordance with Sections 3(a)(2) or 3(a)(5) of the 1933 Act, (collectively, “Registered Securities”), or in the alternative, and in the sole discretion of the Bank, if the securities issuable upon the exercise of such Substitute Options shall not constitute Registered Securities, then the Participant will receive upon consummation of the Change in Control a cash payment for each Option surrendered equal to the difference between the (1) fair market value of the consideration to be received for each share of Common Stock in the Change in Control times the number of shares of Common Stock subject to such surrendered Options, and (2) the aggregate exercise price of all such surrendered Options; or

(b) in the event of a transaction under the terms of which the holders of Common Stock will receive upon consummation thereof a cash payment (the “Merger Price”) for each share of Common Stock exchanged in the Change in Control transaction, make or provide for a cash payment to the Participants equal to the difference between (1) the Merger Price times the number of shares of Common Stock subject to such Options held by each Participant (to the extent then exercisable at prices not in excess of the Merger Price), and (2) the aggregate exercise price of all such surrendered Options.

17. Withholding

There may be deducted from each distribution of cash and/or Common Stock under the Plan the minimum amount of any federal or state taxes, including payroll taxes, that are applicable to such supplemental taxable income and that are required by any governmental authority to be withheld. Shares of Common Stock will be withheld where required from any distribution of Common Stock.

18. Amendment of the Plan

The Board may at any time, and from time to time, modify or amend the Plan in any respect, or modify or amend an Award received by Participants; provided, however, that no such termination, modification or amendment may affect the rights of a Participant, without his/her consent, under an outstanding Award.

19. Effective Date of Plan

The Plan shall become effective upon the date of approval of the Plan by the Bank’s shareholders.

20. Termination of the Plan

The right to grant Awards under the Plan will terminate upon the earlier of (i) 10 years after the Effective Date, or (ii) the date on which the exercise of Options equaling the maximum number of shares reserved under the Plan occurs. The Board may suspend or terminate the Plan at any time, *provided* that no such action will, without the consent of a Participant, adversely affect his/her rights under a previously granted Award.

21. Applicable Law

This Plan, the Awards, all documents evidencing Awards and all other related documents shall be governed by, and will be construed and administered in accordance with the laws of the State of California, except to the extent that federal law shall apply.