

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 March 31, 2008

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  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  Smaller Reporting Company

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

As of April 30, 2008 there were 4,744,720 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>March 31, 2008</u>	<u>December 31, 2007</u>
	<u>(Unaudited)</u>	
<b>ASSETS</b>		
Cash and due from banks	\$ 5,240	\$ 5,695
Federal funds sold	-	7,110
Total cash and cash equivalents	<u>5,240</u>	<u>12,805</u>
Time deposits in banks	-	80
Available-for-sale investment securities - amortized cost of \$43,034 in 2008 and \$35,404 in 2007	43,041	35,426
Held-to-maturity investment securities - market value of \$5,000 in 2007	-	5,000
Loans, less allowance for loan losses of \$3,776 in 2008 and \$3,621 in 2007	266,755	267,067
Bank premises and equipment, net	8,291	8,463
Investment in Federal Home Loan Bank stock, at cost	2,546	2,850
Goodwill	4,119	4,119
Accrued interest receivable and other assets	<u>4,227</u>	<u>4,383</u>
Total assets	<u>\$ 334,219</u>	<u>\$ 340,193</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits:		
Demand - non interest-bearing	\$ 11,634	\$ 10,297
Demand - interest-bearing	12,479	12,421
Savings	11,167	12,460
Money market	33,657	29,858
Time deposits, \$100,000 and over	99,172	103,995
Other time deposits	<u>66,806</u>	<u>79,988</u>
Total deposits	234,915	249,019
Federal Home Loan Bank (FHLB) advances	50,781	42,600
Accrued interest payable and other liabilities	<u>1,021</u>	<u>859</u>
Total liabilities	<u>286,717</u>	<u>292,478</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 4,745 at March 31, 2008 and December 31, 2007	36,238	36,244
Retained earnings	11,258	11,455
Accumulated other comprehensive income, net of taxes	<u>6</u>	<u>16</u>
Total shareholders' equity	<u>47,502</u>	<u>47,715</u>
Total liabilities and shareholders' equity	<u>\$ 334,219</u>	<u>\$ 340,193</u>

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

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

	Three Months Ended	
	March 31, 2008 (Unaudited)	March 31, 2007 (Unaudited)
Interest income:		
Interest and fees on loans	\$ 4,741	\$ 4,962
Interest on Federal funds sold	69	-
Interest on investment securities and deposits in banks	599	543
Dividends on FHLB stock	33	28
Total interest income	5,442	5,533
Interest expense:		
Deposits	2,292	2,345
Securities sold under repurchase agreements	-	1
FHLB advances	503	423
Total interest expense	2,795	2,769
Net interest income before provision for loan losses	2,647	2,764
Provision for loan losses	155	71
Net interest income after provision for loan losses	2,492	2,693
Non-interest income:		
Service charges	113	85
Office leases	159	166
Gains on sales of loans	-	14
Loan servicing, net	15	10
Other income	3	19
Total non-interest income	290	294
Non-interest expense:		
Salaries and employee benefits	1,292	999
Occupancy and equipment	417	367
Other expenses	681	614
Total non-interest expense	2,390	1,980
Income before provision for income taxes	392	1,007
Provision for Income taxes	162	415
Net income	\$ 230	\$ 592
Basic earnings per share	\$ 0.05	\$ 0.12
Diluted earnings per share	\$ 0.05	\$ 0.12
Basic weighted average shares of common stock outstanding	4,745	4,828
Diluted weighted average shares of common stock outstanding	4,747	4,842

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

**SUMMIT STATE BANK AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

For the Three Months Ended March 31, 2008 (Unaudited) and the Year Ended December 31, 2007  
(In thousands, except dividends per share)

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss) (Net of Taxes)	Total Shareholders' Equity	Total Comprehensive Income
	Shares	Amount				
Balance, January 1, 2007	4,795	\$ 36,698	\$ 11,256	\$ (142)	\$ 47,812	
Comprehensive income:						
Net income			1,942		1,942	\$ 1,942
Other comprehensive loss, net of tax:						
Net change in unrealized gains (losses) on available-for-sale investment securities				158	158	<u>158</u>
Total comprehensive income						<u>\$ 2,100</u>
Stock-based compensation expense		3			3	
Stock issued, net of tax benefits	50	424			424	
Stock purchases and retirements	(100)	(881)			(881)	
Cash dividends - \$.36 per share			(1,743)		(1,743)	
	<u>4,745</u>	<u>\$ 36,244</u>	<u>\$ 11,455</u>	<u>\$ 16</u>	<u>\$ 47,715</u>	
Balance, December 31, 2007	4,745	\$ 36,244	\$ 11,455	\$ 16	\$ 47,715	
Comprehensive income:						
Net income			230		230	\$ 230
Other comprehensive loss, net of tax:						
Net change in unrealized gains (losses) on available-for-sale investment securities				(10)	(10)	<u>(10)</u>
Total comprehensive income						<u>\$ 220</u>
Stock-based compensation expense		3			3	
Stock purchases and retirements		(9)			(9)	
Cash dividends - \$.09 per share			(427)		(427)	
	<u>4,745</u>	<u>\$ 36,238</u>	<u>\$ 11,258</u>	<u>\$ 6</u>	<u>\$ 47,502</u>	
Balance, March 31, 2008	4,745	\$ 36,238	\$ 11,258	\$ 6	\$ 47,502	

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

**SUMMIT STATE BANK AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Three Months Ended March 31,</b>	
(In thousands)	<b>2008</b>	<b>2007</b>
	(Unaudited)	(Unaudited)
<b>Cash flows from operating activities:</b>		
Net income	\$ 230	\$ 592
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	209	182
Loss on disposal of bank premises and equipment	8	-
Net increase in deferred loan fees	(45)	24
Provision for loan losses	155	71
Gains on sales of loans	-	(14)
Loans originated for sale	-	(170)
Proceeds from sales of loans held for sale	-	184
Dividends on Federal Home Loan Bank stock	(35)	(26)
Net change in accrued interest receivable and other assets	161	(202)
Net change in accrued interest payable and other liabilities	162	103
Stock-based compensation expense	3	-
Net cash from operating activities	848	744
<b>Cash flows from investing activities:</b>		
Decrease in time deposits in banks	80	297
Purchases of available-for-sale investment securities	(21,665)	(10,000)
Proceeds from calls and maturities of available-for-sale investment securities	14,035	14
Proceeds from calls of held to maturity investment securities	5,000	-
Purchase of Federal Home Loan Bank stock	(115)	(456)
Proceeds from the redemption of Federal Home Loan Bank stock	454	-
Net change in loans	202	(3,756)
Purchases of bank premises and equipment, net	(45)	(235)
Net cash from investing activities	(2,054)	(14,136)

(Continued)

**SUMMIT STATE BANK AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Three Months Ended March 31,</b>	
(In thousands)	<b>2008</b>	<b>2007</b>
	(Unaudited)	(Unaudited)
Cash flows from financing activities:		
Net increase in demand, NOW, savings and money market deposits	3,901	6,214
Net change in certificates of deposit	(18,005)	(737)
Net change in securities sold under repurchase agreements	-	(132)
Net change in short term FHLB advances	8,181	2,515
Proceeds from long term FHLB advances	-	2,000
Gross proceeds from issuance of common stock	-	258
Repurchase of common stock	(9)	-
Dividends paid on common stock	(427)	(435)
	<u>(6,359)</u>	<u>9,683</u>
Net cash from financing activities	<u>(6,359)</u>	<u>9,683</u>
Net change in cash and cash equivalents	(7,565)	(3,709)
Cash and cash equivalents at beginning of year	<u>12,805</u>	<u>10,606</u>
Cash and cash equivalents at end of period	<u>\$ 5,240</u>	<u>\$ 6,897</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest paid	\$ 3,016	\$ 2,763
Income taxes paid	\$ -	\$ 300

The accompanying notes are an integral part of these unaudited 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, Petaluma, 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 March 31, 2008 and for the three months ended March 31, 2008 and 2007 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 statements of the Bank.

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles for interim financial information and Article 10 of Regulation S-X of the Securities and Exchange Commission. Operating results for the three months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. 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 the consolidated financial statements and notes thereto included in the Bank's Annual Report for the year ended December 31, 2007 on Form 10-K on file with the FDIC (Form 10-K may be found at [www.summitstatebank.com](http://www.summitstatebank.com)).

The accompanying accounting and reporting policies of the Bank and subsidiary conform to U.S. Generally Accepted Accounting Principles 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 U.S. Generally Accepted Accounting Principles 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 share 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.

The factors used in the earnings per share computation follow:

(in thousands except earnings per share)	Three Months Ended	
	March 31, 2008	March 31, 2007
Basic		
Net income	\$ 230	\$ 592
Weighted average common shares outstanding	4,745	4,828
Basic earnings per common share	\$ 0.05	\$ 0.12
Diluted		
Net income	\$ 230	\$ 592
Weighted average common shares outstanding for basic earnings per common share	4,745	4,828
Add: Dilutive effects of assumed exercises of stock options	2	14
Average shares and dilutive potential common shares	4,747	4,842
Diluted earnings per common share	\$ 0.05	\$ 0.12

## ***Adoption of New Accounting Standards***

### FASB Statement No. 157

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("SFAS No. 157"). This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued Staff Position 157-2 ("FSP"), "Effective Date of FASB Statement No. 157". This FSP delays the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The impact of adoption on January 1, 2008 was not material to the Bank's consolidated financial position or results of operations.

### FASB Statement No. 159

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities". The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new standard is effective for the Bank on January 1, 2008. The Bank did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008.

### SAB 109

On November 5, 2007, the SEC issued Staff Accounting Bulletin No. 109, "Written Loan Commitments Recorded at Fair Value through Earnings" ("SAB 109"). Previously, SAB 105, "Application of Accounting Principles to Loan Commitments", stated that in measuring the fair value of a derivative loan commitment, a

company should not incorporate the expected net future cash flows related to the associated servicing of the loan. SAB 109 supersedes SAB 105 and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in measuring fair value for all written loan commitments that are accounted for at fair value through earnings. SAB 105 also indicated that internally-developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment, and SAB 109 retains that view. SAB 109 is effective for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The impact of the adoption on January 1, 2008 was not material to the Bank's consolidated financial position or results of operations.

## 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 \$(10,000) and \$13,000 for the three months ended March 31, 2008 and 2007. Total comprehensive income was \$220,000 and \$605,000 for the three months ended March 31, 2008 and 2007.

## 3. REGULATORY CAPITAL

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

	<u>March 31, 2008</u>	
	<u>Amount</u>	<u>Ratio</u>
<u>Tier 1 Leverage Ratio</u>		
Summit State Bank .....	\$ 43,315,000	13.0%
Minimum requirement for "Well-Capitalized" institution .....	\$ 16,696,000	5.0%
Minimum regulatory requirement .....	\$ 13,357,000	4.0%
<u>Tier 1 Risk-Based Capital Ratio</u>		
Summit State Bank .....	\$ 43,315,000	15.3%
Minimum requirement for "Well-Capitalized" institution .....	\$ 17,028,000	6.0%
Minimum regulatory requirement .....	\$ 11,352,000	4.0%
<u>Total Risk-Based Capital Ratio</u>		
Summit State Bank .....	\$ 46,866,000	16.5%
Minimum requirement for "Well-Capitalized" institution .....	\$ 28,381,000	10.0%
Minimum regulatory requirement .....	\$ 22,704,000	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. There were no stock options granted during the first quarter of 2008.

## 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 consolidated 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 \$32,169,000 and \$40,437,000 at March 31, 2008 and December 31, 2007, 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 \$36,000 and \$48,000 at March 31, 2008 and December 31, 2007, 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 March 31, 2008 and December 31, 2007. The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

## 6. FAIR VALUE

Statement 157 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of securities available-for-sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used to in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

The fair values of impaired loans, which are collateral dependent, are based on a valuation model which incorporates the most current real estate appraisals available as well as, assumptions used to be estimated the fair value of all non-real estate collateral (Level 2 inputs).

### Assets and Liabilities Measured on a Recurring Basis

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

	Fair Value Measurements at March 31, 2008 Using			
	March 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available for sale securities	\$43,041,000	\$1,267,000	\$41,774,000	

## Assets and Liabilities Measured on a Non-Recurring Basis

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

	Fair Value Measurements at March 31, 2008 Using			
	March 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans – collateral dependent	\$1,072,000	\$ -	\$1,072,000	\$ -

The following represent impairment charges recognized during the period:

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$1,171,000, with a valuation allowance of \$99,000. No additional provision for loan losses was required for the three months ended March 31, 2008.

## 7. SUBSEQUENT EVENT

### *Cash Dividend*

On April 28, 2008, the Board of Directors declared a \$.09 per share cash dividend to shareholders of record at the close of business on May 12, 2008, to be paid on May 21, 2008.

## 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 March 31, 2008 and December 31, 2007, and results of operations for the three months ended March 31, 2008 and 2007. The following analysis should be read in conjunction with the consolidated financial statements of the Bank and the notes thereto appearing elsewhere in the report, which were prepared in accordance with U.S. Generally Accepted Accounting Principles. The interim financial information provided as of and for the three months ended March 31, 2008 and 2007 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 yields, cost of liabilities and net interest margin are annualized for the periods discussed.

**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 probable 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 \$3,776,000 at March 31, 2008 and \$3,621,000 at December 31, 2007.

**Earnings Summary  
(In Thousands)**

	Three Months Ended	
	March 31, 2008	March 31, 2007
	(Unaudited)	(Unaudited)
<b>Statement of Income Data:</b>		
Net interest income	\$ 2,647	\$ 2,764
Provision for loan losses	155	71
Non-interest income	290	294
Non-interest expense	2,390	1,980
Provision for Income taxes	162	415
Net income	\$ 230	\$ 592
<b>Selected per Share Data:</b>		
Basic earnings per share	\$ 0.05	\$ 0.12
Diluted earnings per share	\$ 0.05	\$ 0.12
Book value per share (2)	\$ 10.01	\$ 9.96
<b>Selected Ratios:</b>		
Return on average assets (1)	0.27%	0.76%
Return on average equity (1)	1.94%	4.99%
Return on average tangible equity (1)	2.12%	5.46%
Efficiency ratio	81.38%	64.75%
Net interest margin (1)	3.32%	3.75%
Dividend payout ratio	185.65%	73.48%
Average equity to average assets	14.13%	15.13%
Nonperforming loans to total loans (2)	0.53%	0.81%
Nonperforming assets to total assets (2)	0.43%	0.65%
Allowance for loan losses to total loans (2)	1.40%	1.37%
Allowance for loan losses to nonperforming loans (2)	262.59%	168.58%

(1) Annualized.

(2) As of period end

**Results of Operations**

*Three months ended March 31, 2008 and March 31, 2007*

**Net Income**

For the three months ended March 31, 2008 net income was \$230,000, or \$0.05 per diluted share, representing an annualized return on average assets of 0.27%. This compares with earnings of \$592,000, or \$0.12 per diluted share, for the three months ended March 31, 2007, representing an annualized return on average assets of 0.76%. The period-over-period earnings decline of \$362,000, or 61% is primarily attributable to a decline in net interest margin, increased provision for loan losses and higher non-interest expenses partially offset by lower provision for income taxes.

Non-interest expense for the first quarter of 2008 included \$110,000 in after tax severance expenses related to changes in senior management and after tax core data processor conversion expenses of \$81,000 (see "Non-interest Expense" below). Exclusion of these one time expenses and related tax impacts, would have resulted in net income of \$421,000 or \$0.09 per diluted share for the quarter ended March 31, 2008.

**Net Interest Income and Net Interest Margin**

Net interest income declined \$117,000 or 4% to \$2,647,000 during the first quarter of 2008 compared to \$2,764,000 for the same quarter of 2007. The annualized net interest margin declined to 3.32% for the first quarter of 2008, compared to 3.75% for the first quarter of 2007. The net interest margin was negatively impacted by the immediate declines in loan rates indexed to the prime lending rate versus the timing of repricing of maturing time deposits. The Bank's liquidity position at the beginning of this year has allowed management to aggressively bring

down interest rates for renewing time deposits. It is anticipated that the net interest margin may increase once general economic interest rates stabilize.

Average earning assets were \$320,839,000 for the first quarter of 2008, as compared to \$298,851,000 for the same quarter of 2007. The annualized yield on average earning assets was 6.82% and the annualized cost of average interest-bearing liabilities was 4.04% for the first quarter of 2008, as compared to the annualized yield on average earning assets of 7.51% and annualized cost of interest-bearing liabilities of 4.39% for the same quarter of 2007.

The following table presents 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		
	March 31, 2008			March 31, 2007		
	Average Balance	Interest Income/ Expense	Average Rate (4)	Average Balance	Interest Income/ Expense	Average Rate (4)
<b>Assets</b>						
Interest earning assets:						
Interest bearing deposits with banks	\$ 7	\$ -	0.00%	\$ 278	\$ 2	2.92%
Taxable investment securities	42,966	632	5.92%	39,404	569	5.86%
Federal funds sold	8,021	69	3.46%	76	-	0.00%
Loans, net (1)	269,845	4,741	7.07%	259,093	4,962	7.77%
Total earning assets/interest income	<u>320,839</u>	<u>5,442</u>	<u>6.82%</u>	<u>298,851</u>	<u>5,533</u>	<u>7.51%</u>
Non-earning assets	20,902			22,741		
Allowance for loan losses	(3,650)			(3,634)		
Total assets	<u>\$ 338,091</u>			<u>\$ 317,958</u>		
<b>Liabilities and Shareholders' Equity</b>						
Interest bearing liabilities:						
Deposits:						
Interest bearing transaction	\$ 12,676	26	0.82%	\$ 13,139	24	0.74%
Savings and money market	40,666	276	2.73%	63,268	562	3.60%
Time deposits	181,055	1,990	4.42%	144,786	1,759	4.93%
Repurchase agreements	-	-		228	1	1.78%
FHLB advances	43,750	503	4.62%	34,569	423	4.96%
Total interest bearing liabilities/interest expense	<u>278,147</u>	<u>2,795</u>	<u>4.04%</u>	<u>255,990</u>	<u>2,769</u>	<u>4.39%</u>
Non-interest bearing deposits	11,270			11,684		
Other liabilities	886			2,170		
Total liabilities	<u>290,303</u>			<u>269,844</u>		
Shareholders' equity	<u>47,788</u>			<u>48,114</u>		
Total liabilities and shareholders' equity	<u>\$ 338,091</u>			<u>\$ 317,958</u>		
Net interest income and margin (2)		<u>\$ 2,647</u>	3.32%		<u>\$ 2,764</u>	3.75%
Net interest spread (3)			2.78%			3.12%

- (1) The net amortization of deferred fees and costs on loans included in interest income was \$34,000 and \$79,000 for the three months ended March 31, 2008 and 2007, 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 table shows 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.

	2008 Compared to 2007 For The Three		
	Months Ended March 31,		
	Change Due to		
	Net	Volume	Yield/ Rate
Interest income:			
Interest bearing deposits with banks	\$ (2)	\$ (2)	\$ -
Taxable investment securities	63	52	11
Federal funds sold	69	69	0
Loans, net	(221)	200	(421)
Total interest income	(91)	319	(410)
Interest expense:			
Interest-bearing transaction	2	(1)	3
Savings and money market	(286)	(172)	(114)
Time deposits	231	410	(179)
Repurchase agreements	(1)	(1)	0
FHLB advances	80	107	(27)
Total interest expense	26	343	(317)
Increase (decrease) in net interest income	\$ (117)	\$ (24)	\$ (93)

### 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 probable 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 March 31, 2008, the provision for loan losses was \$155,000 and it was \$71,000 for three months ended March 31, 2007. The provision for loan losses reflects changes in the general real estate economy and adjustments in various qualitative factors related to measurement of the adequacy of the allowance for loan losses. There were no loan recoveries for the first quarters of 2008 and 2007. There were no loans charged-off for the first quarter of 2008 and \$250,000 in loans charged-off in the first quarter of 2007. The increase in the provision for loan losses for the three months ended March 31, 2008, as compared to the three months ended March 31, 2007, resulted from management’s assessment of negative current economic trends. See Balance Sheet Activity – Nonperforming Assets and Allowance for Loan Losses for additional discussion.

### Non-interest Income

Non-interest income totaled \$290,000 for the three months ended March 31, 2008 and consists primarily of \$113,000 in service charges on deposit accounts, and office lease income of \$159,000. For the three months ended

March 31, 2007, non-interest income totaled \$294,000, which included \$85,000 in service charges on deposit accounts and \$166,000 in office lease income.

Gains on sales of SBA-guaranteed loans were \$0 and \$14,000 for the three months ended March 31, 2008 and 2007. 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.

### **Non-interest Expense**

For the first quarter of 2008, non-interest expense increased \$410,000, or 21%, to \$2,390,000, compared to \$1,980,000 for the same quarter in 2007. In the first quarter of 2008, Thomas Duryea was appointed President and Chief Executive Officer, Terrance Davis resigned as President and Chief Operating Officer and John Lewis retired as Chief Executive Officer, but continues as Chairman of the Board. Also the Bank entered into a contract to convert its core data processing system to a new vendor. Excluding \$189,000 of expenses associated with the senior officer changes and \$140,000 of expenses related to our core data processor change, total non-interest expense would have increased \$81,000, or 4%, to \$2,061,000 for the first quarter of 2008 compared to \$1,980,000 for the same quarter last year.

Excluding the expenses associated with the senior officer changes, salaries and employee benefits expense would have increased \$104,000, or 10%, to \$1,103,000. Occupancy and equipment expenses increased \$50,000, or 14% and other expenses, excluding the core data processor change expense would have decreased \$73,000, or 12%, for the first quarter of 2008 as compared to the first quarter of 2007. Additional expenses associated with the core data processor conversion will occur during the second and third quarters of 2008, as continued work on the conversion of the data processing systems takes place.

### **Provision for Income Taxes**

The Bank accrues income tax expense based on the anticipated tax rates during the financial period covered. The provision for income taxes for the three months ended March 31, 2008 and 2007 was \$162,000 and \$415,000, respectively. The combined effective Federal and State corporate income tax rates for the three months ended March 31, 2008 and 2007 were 41.3% and 41.2%.

### **Balance Sheet Activity**

#### **At March 31, 2008 and December 31, 2007**

### **Investment Portfolio**

Securities classified as available-for-sale for accounting purposes are recorded at their fair value on the balance sheet. Available-for-sale investment securities carried at fair value totaled \$43,041,000 at March 31, 2008 and comprised 13% of total assets compared to amortized cost of \$43,034,000. There were no securities classified as held-to-maturity at March 31, 2008 as the \$5,000,000 in securities classified as held-to-maturity at December 31, 2007 were called during the first quarter. At December 31, 2007, investment securities comprised 12% of total assets. At December 31, 2007 there were securities classified as held-to-maturity of \$5,000,000 and securities classified as available-for-sale of \$35,426,000. 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.

Changes in the investment portfolio occurred during the first quarter of 2008 as a result of calls of securities and subsequent new investments purchased. During the first quarter there was \$14,035,000 in par value of available-for-sale securities called. New purchases during the quarter included \$19,002,000 in US government agency securities with yields of 5.4% to 6.0%, maturities ranging between 15 and 20 years and are callable. There were \$2,663,000 in corporate securities purchased with yields of 6.0% to 7.5% and maturities ranging between 6 and 10 years. The overall portfolio yield at March 31, 2008 was 6.1% compared to 6.0% at December 31, 2007.

The Bank utilizes the investment portfolio to manage liquidity and attract funding that requires collateralization. At March 31, 2008 investment securities with a market value of \$17,193,000, or 40% of the portfolio, were pledged to secure time deposits from the State of California. At December 31, 2007, investment securities with a market value of \$19,771,000, or 49% of the portfolio, were pledged. At March 31, 2008, securities with a par value of \$32,010,000 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 shareholders' 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 dollar volume and percentage change between the dates indicated.

(in thousands)	<u>March 31, 2008</u>		<u>December 31, 2007</u>		Net Change	Percent Change
		%		%		
Commercial & Agricultural	\$ 56,849	21.0%	\$ 54,846	20.2%	\$ 2,003	3.65%
Real Estate - Commercial	103,973	38.4%	114,775	42.3%	(10,802)	-9.41%
Real Estate-Construction	19,272	7.1%	27,085	10.0%	(7,813)	-28.85%
Real Estate - Single family units	43,796	16.2%	40,940	15.1%	2,856	6.98%
Real Estate-Multifamily & Land	33,942	12.5%	20,545	7.6%	13,397	65.21%
Consumer	6,000	2.2%	5,711	2.1%	289	5.06%
Lease financing	7,163	2.6%	7,295	2.7%	(132)	-1.81%
	<u>270,995</u>	<u>100%</u>	<u>271,197</u>	<u>100%</u>	<u>(202)</u>	-0.07%
<u>LESS:</u>						
Allowance for Loan Losses	(3,776)		(3,621)		(155)	4.28%
Deferred Loan Fees	(464)		(509)		45	-8.84%
Total Loans, Net	<u>\$ 266,755</u>		<u>\$ 267,067</u>		<u>\$ (312)</u>	-0.12%

The increase in multifamily loans and decline in real estate construction loans was primarily due to the reclassification of a construction loan of a mixed commercial and apartment property upon completion to a permanent amortizing multifamily loan according to the original terms of the construction financing.

At March 31, 2008, the Bank had approximately \$32,169,000 in undisbursed loan commitments, of which approximately \$4,397,000 related to real estate construction and commercial real estate loans. Standby letters of credit amounting to \$36,000 were in place at March 31, 2008.

At December 31, 2007, the Bank had approximately \$40,437,000 in undisbursed loan commitments, of which approximately \$10,669,000 related to real estate construction loans and commercial real estate loans. At December 31, 2007, there was \$48,000 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. Nonperforming assets at March 31, 2008 consisted of \$1,438,000 of loans on nonaccrual status. These loans consisted of \$1,028,000 represented by several loans secured by commercial real estate, \$267,000 secured by a single family residence and \$143,000 which is backed by a partial guarantee by the Small Business Administration.

In addition to the nonperforming loans discussed above 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 is carried on the Bank's consolidated balance sheet at its market value of \$376,000 as of March 31, 2008. General Motors Acceptance Corporation's bonds were downgraded below investment grade in 2005 and have a current Moody's rating of Ba1. Management believes that there is no likely loss in this bond at this time. The interest payments on this bond are being made as scheduled.

The Bank owns class D-1 notes with a par value of \$250,000 issued by ALESCO Preferred Funding IX, Ltd. These notes are collateralized by a pool of trust preferred securities issued by financial and insurance holding companies. The notes are current and performing. The market values of the notes have been impacted by the disruption in the credit markets and are carried at a market value of \$188,000 at March 31, 2008.

At March 31, 2008, there were loan relationships primarily secured by real estate totaling \$4,156,000 with respect to loans that were not classified as nonperforming and that have shown some weakness but continue to perform according to terms of the 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 for loan losses 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 evaluates 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-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 consolidated balances sheet as of March 31, 2008.

The allowance for loan losses was \$3,776,000 at March 31, 2008 compared to \$3,621,000 at December 31, 2007. The activity in the allowance for loan losses during the first quarter of 2008 included a provision for loan losses of \$155,000 and there were no loan recoveries or charge-offs. At March 31, 2008 and December 31, 2007, the Bank's allowance for loan losses was 1.40% and 1.34% of outstanding loans, respectively.

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

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

	<u>Three months ended</u> March 31, 2008	<u>Year Ended</u> December 31, 2007
Balance at beginning of period	\$ 3,621	\$ 3,736
Charge-offs:		
Commerical and agricultural	-	331
Real estate--construction and land development	-	561
Real estate--mortgage	-	-
Installment loans to individuals	-	-
	<u>-</u>	<u>892</u>
Total loans charged-off	-	892
Recoveries:		
Commerical and agricultural	-	28
Real estate--construction and land development	-	-
Real estate--mortgage	-	-
Installment loans to individuals	-	-
	<u>-</u>	<u>28</u>
Total recoveries	-	28
Net loans charged-off	-	864
Provision for loan losses	155	749
Allowance for loan losses - end of period	<u>\$ 3,776</u>	<u>\$ 3,621</u>
Loans:		
Average loans outstanding during period, net of unearned income	\$ 269,845	\$ 268,310
Total loans at end of period, net of unearned income	\$ 270,531	\$ 270,688
Ratios:		
Net loans charged-off to average net loans (1)	0.00%	0.32%
Net loans charged-off to total loans (1)	0.00%	0.32%
Allowance for loan losses to average net loans	1.40%	1.35%
Allowance for loan losses to total loans	1.40%	1.34%
Net loans charged-off to beginning allowance for loan losses (1)	0.00%	23.13%
Net loans charged-off to provision for loan losses	0.00%	115.35%
(1) Annualized for Three months ended March 31, 2008		

## Allowance For Loan Losses

	March 31,		December 31,	
	2008		2007	
(in thousands)	<u>Allowance</u>	<u>Amount of</u>	<u>Allowance</u>	<u>Amount of</u>
	<u>Allocation</u>	<u>Category</u>	<u>Allocation</u>	<u>Category</u>
		<u>Loans to</u>		<u>Loans to</u>
		<u>Total Loans</u>		<u>Total Loans</u>
Commercial & agricultural	\$ 512	21.0%	\$ 450	20.2%
Real estate - commercial	893	38.4%	1,156	42.3%
Real estate - construction	710	7.1%	749	10.0%
Real estate - single family units	80	16.2%	67	15.1%
Real estate - multifamily & land	260	12.5%	126	7.6%
Consumer	48	1.9%	66	2.1%
Lease financing	75	2.6%	79	2.7%
Other qualitative factors	714		756	
Unallocated	484		172	
Total	<u>\$ 3,776</u>	<u>100%</u>	<u>\$ 3,621</u>	<u>100%</u>

The allocation of the Allowance for loan Losses to the other qualitative factors 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 ("changes in credit grades") between periods.

### Deposits

At March 31, 2008, the Bank had a deposit mix of 71% in time deposits, 19% in money market and savings accounts, and 10% in demand accounts. At December 31, 2007, the Bank had a deposit mix of 74% in time deposits, 17% in money market and savings accounts, and 9% in demand accounts.

At March 31, 2008 and December 31, 2007, the State of California had \$38,000,000 in time deposits with the Bank with maturities of 3 to 6 months and collateralized by investment securities, letters of credit issued by the Federal Home Loan Bank and mortgage loans. These deposits are received through a program run by the Treasurer of the State of California to place public deposits with community banks. At March 31, 2008, the Bank had \$12,446,000 in brokered time deposits, this compares to \$20,842,000 in brokered time deposits at December 31, 2007.

### 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 the carrying value of unpledged investment securities, totaled \$31,088,000 at March 31, 2008 and constituted 9% of total assets at that date compared to \$33,540,000 or 10% of total assets at December 31, 2007.

Although the Bank's sources of liquidity include liquid assets, the Bank maintains lines of credit with the Federal Home Loan Bank and other correspondent banks. The total of these lines of credit were \$93,818,000 at March 31, 2008 and December 31, 2007, of which \$57,381,000 were in available Federal Home Loan Bank advances and letter of credit were outstanding at March 31, 2008 and \$49,200,000 was outstanding at December 31, 2007. The increase in borrowings during the quarter was primarily to fund time deposit runoff as management actively lowered the interest rates on renewing time deposits. The Bank actively utilizes its borrowing capacity with the Federal Home Loan Bank to manage liquidity as well as to provide a funding alternative to time deposits if the Federal Home Loan

Bank's interest rates and terms are more favorable. The advances from the Federal Home Loan Bank can have maturities from overnight to multiple years. At March 31, 2008, \$27,781,000 was due within one year and \$23,000,000 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 16.5% and 15.3% at March 31, 2008, and was "well-capitalized" under the regulatory guidelines.

In addition, regulators have adopted a minimum leverage ratio standard for Tier 1 capital to average 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 March 31, 2008, the Bank's leverage ratio was 13.0%. 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 non-interest 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 March 31, 2008, and believes that there have been no material changes since December 31, 2007.

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 March 31, 2008, 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 \$(577,000) or (5.4)% and \$157,000 or 1.5%, 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 Form10 and Form 10-K.

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

None.

### **Item 3 Defaults Upon Senior Securities**

None.

### **Item 4 Submission of Matters to a Vote of Security Holders**

None.

### **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)

May 6, 2008

*/s/ Thomas M. Duryea*

Date

Thomas M. Duryea, President & Chief Executive Officer

May 6, 2008

*/s/ Dennis E. Kelley*

Date

Dennis E. Kelley, SVP & 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

**Exhibit 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**

I, Thomas M. Duryea., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Summit State Bank (the registrant) for the quarter ended March 31, 2008;
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-15(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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusion about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) 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.

May 6, 2008 /s/ Thomas M. Duryea  
Date Thomas M. Duryea  
President & Chief Executive Officer  
Summit State Bank

**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 March 31, 2008;
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-15(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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) 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
  - (d) 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.

May 6, 2008 \_\_\_\_\_ /s/ Dennis E. Kelley

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

**EXHIBIT 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**

In connection with the quarterly report on Form 10-Q of Summit State Bank (the Registrant) for the quarter ended March 31, 2008, 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.

May 6, 2008 /s/ Thomas M. Duryea  
Thomas M. Duryea, Chief Executive Officer

May 6, 2008 /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.