UNITED SECURITY BANCSHARES
Form 10-K/A
May 25, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

Amendment No. 3

ý	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004.**
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **FOR THE TRANSITION PERIOD FROM TO .**

Commission file number: 000-32987

UNITED SECURITY BANCSHARES

(Exact name of registrant as specified in its charter)

CALIFORNIA (State or other jurisdiction of incorporation or organization)	**91-2112732** (I.R.S. Employer Identification No.)
1525 East Shaw Ave., Fresno, California (Address of principal executive offices)	**93710** (Zip Code)

Registrant s telephone number, including area code **(559) 248-4943**

Securities registered pursuant to Section 12(b) of the Act: **NONE**

Securities registered pursuant to Section 12(g) of the Act: **Common Stock, no par value**
(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required 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 for the past 90 days.

Yes ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrants knowledge, in the definitive proxy or information statements incorporated by reference in Part III of this form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ý No o

Aggregate market value of the Common Stock held by non-affiliates as of the last business day of the registrant s most recently completed second fiscal quarter - June 30, 2004: **$88,898,832**

Shares outstanding as of February 28, 2005: **5,685,724**

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the Definitive Proxy Statement for the 2005 Meeting of Shareholders is incorporated by reference into Part III.	Part III, Items 10, 11, 12 and 13

UNITED SECURITY BANCSHARES

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EXPLANATORY NOTE

This Amendment No. 3 to the Company s Annual Report on Form 10-K is solely for the purpose of re-filing the entire 2004 10-K as a result of a typographical error in Exhibit 31.2 filed with the original 2004 10-K filed on March 15, 2005 (Original Report).

All changes submitted with Amendment No. 2 are re-filed in this Amendment No. 3, including Management s Report on Internal Control Over Financial Reporting , and the Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting in Item 9A, which were initially omitted from Registrant s original 2004 Form 10-K report as permitted by the Order under Section 36 of the Securities Exchange Act of 1934 Granting an Exemption from Specified Provisions of Exchange Act Rules 13a-1 and 15d-1 issued by the Securities and Exchange Commission (SEC) on November 30, 2004.

This Amendment No. 3 does not reflect events occurring after the filing of the Original Report or modify or update the disclosures therein in any way other than as described above.

PART 1

Certain matters discussed or incorporated by reference in this Annual Report of Form 10-K including, but not limited to, those described in Item 7 - Management s Discussion and Analysis of Financial Condition and Results of Operations , are forward-looking statements as defined under the Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, among others, (1) competitive pressure in the banking industry increases significantly; (2) changes in the interest rate environment which reduces margins; (3) general economic conditions, either nationally or regionally, are less favorable than expected, resulting in, among other things, a deterioration in credit quality; (4) changes in the regulatory environment; (5) changes in business conditions and inflation; (6) changes in securities markets; (7) asset/liability matching risks and liquidity risks; (8) loss of key personnel; and (8) operational interruptions including data processing systems failure and fraud. Therefore, the information set forth therein should be carefully considered when evaluating the business prospects of the Company.

Item 1 - Business

General

United Security Bancshares (the Company) is a California corporation incorporated during March of 2001and is registered with the Board of Governors of the Federal Reserve System as a bank holding company under the Bank Holding Company Act of 1956, as amended. The Company s stock is listed on NASDAQ under the symbol UBFO . United Security Bank (the Bank) is a wholly-owned bank subsidiary of the Company and was formed in 1987. United Security Bancshares Capital Trust I (the Trust) is also a wholly-owned subsidiary of the Company and was formed during June of 2001 as a Delaware business trust for the sole purpose of issuing Trust Preferred securities. At present, the Company does not engage in any material business activities other than ownership of the Bank. References to the Company are references to United Security Bancshares, Inc. (including the Bank), except for periods prior to June 12, 2001, in which case, references to the Company are references to the Bank.

United Security Bank

On June 12, 2001, the Bank became the wholly owned subsidiary of United Security Bancshares, through a tax-free holding company reorganization, accounted for on a basis similar to the pooling of interest method. In the transaction, each share of Bank stock was exchanged for a share of Company stock on a one-to-one basis.

The Bank is a California state-chartered bank headquartered in Fresno, California. It is also a member of the Federal Reserve System (Fed member). The Bank originally commenced business on December 21, 1987 as a national bank and, during the fourth quarter of 1998, filed an application with the California Department of Financial Institutions and other regulatory authorities to become a state-chartered bank. The shareholders approved the conversion in January of 1999, and the Bank was granted approval to operate as a state-chartered bank on February 3, 1999. The Bank s operations are currently subject to federal and state laws applicable to state-chartered, Fed member banks and its deposits are insured up to the applicable limits by the Federal Deposit Insurance Corporation (the FDIC). The Bank is also subject to the Federal Deposit Insurance Act and regulatory reporting requirements of the FDIC. As a state-chartered bank and a member of the Federal Reserve System, the Bank is subject to supervision and regular examinations by the Board of Governors of the Federal Reserve System (the FRB) and the California Department of Financial Institutions (the DFI). In addition, the Bank is required to file reports with the FRB and provide such additional information as the FRB may require.

Effective August 25, 1995, the Bank consummated a merger with Golden Oak Bank, a two branch California state chartered bank located in Oakhurst, California, with assets of approximately $45 million at the date of merger. The merger was accounted for as a pooling of interests.

During February of 1997, the Bank completed the purchase of the deposits and certain assets of two branches of Wells Fargo Bank located in Caruthers and San Joaquin, both located in Fresno County. This brought the total branches operated at that time by the Bank to six and the total assets to approximately $190 million. The Bank paid a premium of approximately $1.2 million to purchase deposit accounts totaling approximately $33.4 million. The Bank also purchased cash balances as well as certain fixed assets of the branch operations.

During October of 1997, the Bank completed the purchase from Bank of America of two of its branches located in Firebaugh and Coalinga, both located in Fresno County. The acquisition brought the total branches operated by the Bank to eight at that time and the total assets to approximately $238 million. The premium paid by the Bank totaled approximately $3.0 million and the amount of

deposits totaled approximately $44.4 million. The transaction included the receipt of cash balances of approximately $1.0 million and the purchase of premises and equipment totaling approximately $600,000.

USB Investment Trust Inc. was incorporated effective December 31, 2001 as a special purpose real estate investment trust (REIT) under Maryland law. The REIT is a subsidiary of the Bank and was funded with $133.0 million in real estate-secured loans contributed by the Bank. USB Investment Trust was originally formed to give the Bank flexibility in raising capital, and reduce the expenses associated with holding the assets contributed to USB Investment Trust. For further discussion of the REIT, refer to the overview section of Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations.

Effective April 23, 2004, the Company completed a merger with Taft National Bank headquartered in Taft, California. Taft National Bank (Taft) was merged into United Security Bank and Taft s two branches operate as branches of United Security Bank. The total consideration paid to Taft shareholders was 241,447 shares of the Company s Common Stock valued at just over $6 million. In the merger, the Company acquired $15.4 million in cash and short-term investments, $23.3 million in loans, and $48.2 million in deposits. This transaction was accounted for using the purchase method of accounting, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Taft based on the fair value of those assets and liabilities. The consolidated statement of income includes the operations of Taft from the date of the acquisition to December 31, 2004.

At December 31, 2004, the Company operated ten bank branches and one construction lending office; with seven branches in Fresno County, two branches in Kern County, and one branch in Madera County. The Bank operates three branches (including its main office) and one construction lending office in Fresno and one branch each, in Oakhurst, Caruthers, San Joaquin, Firebaugh, Coalinga, Bakersfield, and Taft. In addition, the Company and Bank have administrative headquarters at 1525 East Shaw Avenue, Fresno, California, 93710.

At December 31, 2004, the consolidated Company had approximately $611.7 million in total assets, $390.3 million in net loans, $536.7 million in deposits, and $53.2 million in shareholders equity.

The following discussion of the Company s services should be read in conjunction with MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Bank Services

As a state-chartered commercial bank, United Security Bank offers a full range of commercial banking services primarily to the business and professional community and individuals located in Fresno, Madera, and Kern Counties.

The Bank offers a wide range of deposit instruments including personal and business checking accounts and savings accounts, interest-bearing negotiable order of withdrawal (NOW) accounts, money market accounts and time certificates of deposit. Most of the Bank s deposits are attracted from individuals and from small and medium-sized business-related sources.

The Bank also engages in a full complement of lending activities, including real estate mortgage, commercial and industrial, real estate construction, as well as agricultural, lease financing, and consumer loans, with particular emphasis on short and medium-term obligations. The Bank s loan portfolio is not concentrated in any one industry, although approximately 70% of the Bank s loans are secured by real estate. A loan may be secured (in whole or in part) by real estate even though the purpose of the loan is not to facilitate the purchase or development of real estate. At December 31, 2004, the Bank had loans (net of unearned fees) outstanding of $397.6 million, which represented approximately 74 % of the Bank s total deposits and approximately 65 % of its total assets.

Real estate mortgage loans are secured by deeds of trust primarily on commercial property. Repayment of real estate mortgage loans is generally from the cash flow of the borrower. Commercial and industrial loans have a high degree of industry diversification. Loans may be originated in the Company s market area, or participated with other financial institutions outside the Company s market area. A substantial portion of commercial and industrial loans are secured by accounts receivable, inventory, leases or other collateral. The remainder are unsecured; however extensions of credit are predicated on the financial capacity of the borrower to repay the extension of credit. Repayment of commercial loans is generally from the cash flow of the borrower. Real estate construction loans consist of loans to residential contractors, which are secured by single-family residential properties. All real estate loans have established equity requirements. Repayment of real estate construction loans is generally from long-term mortgages with other lending institutions. Agricultural loans are generally secured by land, equipment, inventory and receivables. Repayment of agricultural loans is from the expected cash flow of the borrower.

In the normal course of business, the Bank makes various loan commitments and incurs certain contingent liabilities. At December 31, 2004 and 2003, loan commitments of the Bank aggregated $179.6 million and $140.3 million, respectively. Of the $179.6 million in loan commitments outstanding at December 31, 2004, $77.3 million or 43 % were for loans with maturities of one year or less. Due to the nature of the business of the Bank s customers, there are no seasonal patterns or absolute predictability to the utilization of unused loan commitments; therefore the Bank is unable to forecast the extent to which these commitments will be exercised within the current year. The Bank does not believe that any such utilization will constitute a material liquidity demand.

In addition to the loan and deposit services discussed above, the Bank also offers a wide range of specialized services designed to attract and service the needs of commercial customers and account holders. These services include online banking, safe deposit boxes, ATM services, payroll direct deposit, cashier s checks, traveler s checks, money orders, and foreign drafts. The Bank does not operate a trust department; however, it makes arrangements with its correspondent bank to offer trust services to its customers on request. Most of the Bank s business originates within Fresno, Madera, and Kern Counties. Neither the Bank s business or liquidity is seasonal, and there has been no material effect upon the Bank s capital expenditures, earnings or competitive position as a result of federal, state or local environmental regulation.

Competition and Market Share

The banking business in California generally, and in the market area served by the Company specifically, is highly competitive with respect to both loans and deposits. The Company competes for loans and deposits with other commercial banks, savings and loan associations, finance companies, money market funds, credit unions and other financial institutions, including a number that are substantially larger than the Company. Deregulation of the banking industry, increased competition from non-bank entities for the cash balances of individuals and businesses, and continuing developments in the computer and communications industries have had, and most likely will continue to have, a significant impact on the Company s competitive position. With the enactment of interstate banking legislation in California, bank holding companies headquartered outside of California have and will continue to enter the California market and provide further competition for the Company. Additionally, with the Gramm-Leach-Bliley Act of 1999, traditional competitive barriers between insurance companies, securities underwriters, and commercial banks have been eased, allowing a greater number of financial intermediaries to offer a wider assortment of financial services. Many of the major commercial banks operating in the Company s market areas offer certain services such as trust and international banking services, which the Company does not offer directly. In addition, banks with larger capitalization have larger lending limits and are thereby able to serve larger customers.

The Company s primary market area is located in Fresno, Madera, and Kern Counties, in which approximately 27 FDIC-insured financial institutions compete for business. The following table sets forth information regarding deposit market share and ranking by county as of June 30, 2004, which is the most current information available.

	Rank	**Share**
Fresno County	7th	5.42%
Madera County	8th	5.16%
Kern County	15th	1.06%
Total of Fresno, Madera, Kern Counties	7th	3.92%

Supervision and Regulation

The Company

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the BHC Act), and is registered as such with the FRB. A bank holding company is required to file with the FRB annual reports and other information regarding its business operations and those of its subsidiaries and is also subject to examination by the FRB.

The BHC Act requires, among other things, prior approval before acquiring, directly or indirectly, ownership or control of any voting shares of any bank, if after such acquisition it would directly or indirectly own or control more than 5% of the voting stock of that bank, unless it already owns a majority of the voting stock of that bank. The BHC Act also provides that the FRB shall not approve any acquisition that would result in or further the creation of a monopoly, or the effect of which may be substantially to lessen competition, unless the anticompetitive effects of the proposed transaction are clearly outweighed by the probable effect in meeting the convenience and needs of the community served.

Furthermore, under the BHC Act, a bank holding company is, with limited exceptions, prohibited from (i) acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or (ii) engaging in any activity other than managing or controlling banks. With the prior approval of the FRB, however, a bank holding company may own shares of a company engaged in activities which the FRB has determined to be so closely related to banking or managing or controlling banks as to be proper incident thereto.

The BHC Act requires a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. It is the FRB s policy that a bank holding company should stand ready to use available resources to provide adequate capital funds to subsidiary banks during periods of financial stress and should maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting a subsidiary bank. Under certain conditions, the FRB may conclude that certain actions of a bank holding company, such as payment of cash dividends, would constitute unsafe and unsound banking practices because they violate the FRB s source of strength doctrine.

A bank holding company and its subsidiaries are prohibited from certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, a bank may not condition an extension of credit on a promise by its customer to obtain other services by it, its holding company or other subsidiaries, or on a promise by its customer not to obtain services from a competitor. In addition, federal law imposes certain restrictions between the Company and its subsidiaries, including the Bank. As an affiliate of the Bank, the Company is subject, with certain exceptions, to provisions of federal law imposing limitations on, and requiring collateral for, extensions of credit by the Bank to its affiliates.

In 1999 the Gramm-Leach-Bliley Act (the GLBA) was enacted. The GLBA became effective in March of 2000 and is a financial services modernization law that, among other things, facilitates broad new affiliations among securities firms, insurance companies and bank holding companies by repealing the 66-year old provisions of the Glass-Steagall Act. The GLBA allows the formation of financial holding companies (FHC s), which are bank holding companies with substantially expanded powers. A bank holding company must acquire the approval of the FRB to become a FHC. Under these expanded powers, affiliations may occur between bank holding companies, securities firms and insurance companies, subject to a blend of umbrella supervision and regulation of the newly formed consolidated entity by the Federal Reserve, oversight of the FHC s bank and thrift subsidiaries by their primary federal and state banking regulators and financial regulation of the FHC s nonbank subsidiaries by their respective specialized regulators. The Company has not applied to become a FHC.

As a public company, United Security Bancshares is subject to the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act amends the Securities and Exchange Act of 1934, and is intended to protect investors by, among other things, improving the reliability of financial reporting, increasing management accountability, and increasing the independence of Directors and the company s external accountants (see *Recent Legislation and Other Changes*).

The Company is subject to the periodic reporting requirements of the Securities Exchange Act of 1934, as amended, which include but are not limited to the filing of annual, quarterly and other current reports with the SEC.

The Bank

The Bank as a state-chartered bank is subject to regulation, supervision and regular examination by the California Department of Financial Institutions. In addition, The Bank is also a member of the Federal Reserve System and, as such, is subject to applicable provisions of the Federal Reserve Act and regulations issued thereunder and, is subject to regulation, supervision and regular examination by the Federal Reserve Bank. The Bank is subject to California law, insofar as they are not preempted by federal banking law. Deposits of the Bank are insured by the FDIC in an amount up to $100,000 per customer, and, as such, the Bank is subject to the regulations of the FDIC and the Federal Deposit

Insurance Act. As a consequence of the extensive regulation of commercial banking activities in California and the United States, the Bank s business is particularly susceptible to changes in California and federal legislation and regulation, which may have the effect of increasing the cost of doing business, limiting permissible activities or increasing competition.

Various other requirements and restrictions under the laws of the United States and the State of California affect the operations of the Bank. Federal and California statutes and regulations relate to many aspects of the Bank s operations, including capital requirements and disclosure requirements to depositors and borrowers, requirements to maintain reserves against deposits, limitations on interest rates payable on deposits, loans, investments, and restrictions on borrowings and on payment of dividends. The DFI regulates the number and location of branch offices of a state-chartered bank, and may permit a bank to maintain branches only to the extent allowable under state law for state banks. California law presently permits a bank to locate a branch in any locality in the state. Additionally, California law exempts banks from California usury laws.

Effect of Governmental Policies and Recent Legislation

Banking has traditionally been a business that depends on rate differentials. In general, the difference between the interest rate paid by the Company on its deposits and other borrowings and the interest rate received on loans extended to its customers and securities held in the Company s portfolio comprise the major portion of the Company s earnings. These rates are highly sensitive to many factors which are beyond the control of the Company. Accordingly, the earnings and growth of the Company are subject to the influence of domestic and foreign economic conditions, including, but not limited to, inflation, recession and unemployment.

The earnings and growth of the Company are affected not only by general economic conditions, both domestic and foreign, but also by the monetary and fiscal policies of the United States government and its agencies, particularly the Federal Reserve Board (FRB). The FRB implements national monetary policies (with objectives such as to curb inflation and combat recession) by its open market operations in United States Government securities, by adjusting the required level of reserves for financial institutions subject to reserve requirements, and by varying the discount rates applicable to borrowing by banks which are members of the Federal Reserve System. The actions of the FRB in these areas influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. The nature and impact that future changes in fiscal or monetary policies or economic controls may have on the Company s business and earnings cannot be predicted. In addition, adverse economic conditions could make a higher provision for loan losses a prudent course and could cause higher loan charge-offs, thus adversely affecting the Company s net income.

From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial institutions. Proposals to change the laws and regulations governing the operations and taxation of banks and other financial institutions are frequently made in Congress, in the California legislature and before various bank regulatory agencies. The likelihood of any major change and the impact such change may have on the Company is impossible to predict. Certain of the potentially significant changes which have been enacted recently and other which are currently under consideration by Congress or various regulatory agencies or professional agencies are discussed below.

Recent Legislation and Other Changes

The Federal Reserve Board issued a final rule on March 1, 2005 that amends Regulation H and Regulation Y to limit restricted core capital elements (including trust preferred securities) which count as Tier 1 capital to 25 percent of all core capital elements, net of goodwill less any associated deferred tax liability. Internationally active bank holding companies, defined as those with consolidated assets greater than $250 billion or on-balance-sheet foreign exposure greater than $10 billion, will be subject to a 15 percent limit, but they may include qualifying mandatory convertible preferred securities up to the generally applicable 25 percent limit. Amounts of restricted core capital elements in excess of these limits generally may be included in Tier 2 capital. The final rule provides a five-year transition period, ending March 31, 2009, for application of the quantitative limits.

During July 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002. The purpose of the Sarbanes-Oxley Act is to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.

The Sarbanes-Oxley Act amends the Securities Exchange Act of 1934 to prohibit a registered public accounting firm from performing specified nonaudit services contemporaneously with a mandatory audit. The Sarbanes-Oxley Act also vests the audit committee of an issuer with responsibility for the appointment, compensation, and oversight of any registered public accounting firm employed to perform audit services. It requires each committee member to be a member of the board of directors of the issuer, and to be otherwise independent. The Sarbanes-Oxley

Act further requires the chief executive officer and chief financial officer of an issuer to make certain certifications as to each annual or quarterly report filed with the SEC.

In addition, the Sarbanes-Oxley Act requires officers to forfeit certain bonuses and profits under certain circumstances. Specifically, if an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer as a result of misconduct with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall be required to reimburse the issuer for (1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the SEC of the financial document embodying such financial reporting requirement; and (2) any profits realized from the sale of securities of the issuer during that 12-month period.

The Sarbanes-Oxley Act also instructs the SEC to require by rule:

disclosure of all material off-balance sheet transactions and relationships that may have a material effect upon the financial status of an issuer; and

the presentation of pro forma financial information in a manner that is not misleading, and which is reconcilable with the financial condition of the issuer under generally accepted accounting principles.

The Sarbanes-Oxley Act also prohibits insider transactions in the Company s stock during lock out periods of the company s pension plans, and any profits on such insider transactions are to be disgorged. In addition, there is a prohibition of company loans to its executives, except in certain circumstances. The Sarbanes-Oxley Act also provides for mandated internal control report and assessment with the annual report and an attestation and a report on such report by the company s auditor. The SEC is also required to issue a code of ethics for senior financial officers of the company. Further, the Sarbanes-Oxley Act adds a criminal penalty of fines and imprisonment of up to 10 years for securities fraud.

The FRB on October 31, 2002 approved a final Regulation W that comprehensively implements sections 23A and 23B of the Federal Reserve Act. Sections 23A and 23B and Regulation W restrict loans by a depository institution to its affiliates, asset purchases by a depository institution from its affiliates, and other transactions between a depository institution and its affiliates. Regulation W unifies in one public document the Board s interpretations of sections 23A and 23B. Regulation W will have an effective date of April 1, 2003.

In December of 2001 and January of 2002, the Office of the Comptroller of the Currency, FRB and the FDIC adopted final rules governing the regulatory capital treatment of equity investments in nonfinancial companies held by banks, bank holding companies and financial holding companies. The final rules became effective on April 1, 2002. The new capital requirements apply symmetrically to equity investments made by banks and their holding companies in nonfinancial companies under the legal authorities specified in the final rules. Among others, these include the merchant banking authority granted by the Gramm-Leach-Bliley Act and the authority to invest in small business investment companies (SBICs) granted by the Small Business Investment Act. Covered equity investments will be subject to a series of marginal Tier 1 capital charges, with the size of the charge increasing as the organization s level of concentration in equity investments increases. The highest marginal charge specified in the final rules requires a 25 percent deduction from Tier 1 capital for covered investments that aggregate more than 25 percent of an organization s Tier 1 capital. Equity investments through SBICs will be exempt from the new charges to the extent such investments, in the aggregate, do not exceed 15 percent of the banking organization s Tier 1 capital. The new charges would not apply to individual investments made by banking organizations prior to March 13, 2000. Grandfathered investments made by state banks under section 24(f) of the Federal Deposit Insurance Act also are exempted from coverage.

The terrorist attacks in September 2001, have impacted the financial services industry and led to federal legislation that attempts to address certain issues involving financial institutions. On October 26, 2001, President Bush signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001.

Part of the USA Patriot Act is the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (IMLA). IMLA authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to banks, bank holding companies, and/or other financial institutions. These measures may include enhanced recordkeeping and reporting requirements for certain financial transactions that are of primary money laundering concern, due diligence requirements concerning the beneficial ownership of certain types of accounts, and restrictions or prohibitions on certain types of accounts with foreign financial institutions.

Among its other provisions, IMLA requires each financial institution to: (i) establish an anti-money laundering program; (ii) establish due diligence policies, procedures and controls with respect to its private banking accounts and correspondent banking accounts involving foreign individuals and certain foreign banks; and (iii) avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign bank that does not have a physical presence in any country. In addition, IMLA contains a provision encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities. IMLA expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours. IMLA also amends the Bank Holding Company Act and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution s anti-money laundering activities when reviewing an application under these acts.

IMLA became effective July 23, 2002. Additional regulations establish minimum standards to verify customer identity, to encourage cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, to prohibit the anonymous use of concentration accounts, and to require all covered financial institutions to have in place a Bank Secrecy Act compliance program.

The Federal Reserve Board and the Secretary of the Treasury in January 2001 jointly adopted a final rule governing merchant banking investments made by financial holding companies. The rule implements provisions of the Gramm-Leach-Bliley Act discussed below that permit financial holding companies to make investments as part of a bona fide securities underwriting or merchant or investment banking activity. The rule provides that a financial holding company may not, without Federal Reserve Board approval, directly or indirectly acquire any additional shares, assets or ownership interests or make any additional capital contribution to any company the shares, assets or ownership interests of which are held by the financial holding company subject to the rule if the aggregate carrying value of all merchant banking investments held by the financial holding company exceeds:

30 percent of the Tier 1 capital of the financial holding company, or

after excluding interests in private equity funds, 20 percent of the Tier 1 capital of the financial holding company.

A separate final rule will establish the capital charge of merchant banking investments for the financial holding company.

It is impossible to predict what effect the enactment of certain of the above-mentioned legislation will have on the Company. Moreover, it is likely that other bills affecting the business of banks may be introduced in the future by the United States Congress or California legislature.

Employees

At December 31, 2004, the Company employed 122 persons on a full-time equivalent basis. The Company believes its employee relations are excellent.

Available Information

The Company files period reports and other reports under the Securities and Exchange Act of 1934 with the Securities and Exchange Commission (SEC). These reports, as well as the Company s Code of Ethics, are posted and are available at no cost on the Company s website at http://www.unitedsecuritybank.com as soon as reasonably practical after the Company files such reports with the SEC. The Company s periodic and other reports filed with the SEC are also available at the SEC s website (http://www.sec.gov).

Item 2 - Properties

The Bank s Main bank branch is located at 2151 West Shaw Avenue, Fresno, California. The Company owns the building and leases the land under a sublease dated December 1, 1986 between Central Bank and USB. The current sublessor under the master ground lease is Bank of the West, which acquired the position through the purchase of Central Bank. The lessor under the ground lease (Master Lease) is Thomas F. Hinds. The lease expires on December 31, 2015 and the Company has options to extend the term for four (4) ten-year periods and one seven (7) year period.

The Company occupies the banking premises of approximately 3,600 square feet for its East Shaw branch at 1041 E. Shaw Avenue, Fresno, California, under a lease extension expiring February 28, 2005. The lease has been renewed until August 2005, with additional extensions available to August 31, 2011.

The Company leases the Oakhurst bank branch located at the Old Mill Village Shopping Center, 40074 Highway 49, and Oakhurst, California, which was completed during April of 1999. The Company had originally maintained two branches in the Oakhurst area, and at this time consolidated its two Oakhurst branches into the new facility. The current facility, which consists of approximately 5,000 square feet, will be leased for a term of 15 years ending April 2014, and there are two five-year options to extend the lease term after that date.

The Company leases the Caruthers bank branch located at 13356 South Henderson, Caruthers, California, which consists of approximately 5,000 square feet of floor space. The branch was acquired from Wells Fargo Bank in February 1997 under a lease which expires January 19, 2006 with extensions to January 19, 2021.

The Company owns the San Joaquin branch facilities located at 21574 Manning Avenue, San Joaquin, California. The new bank branch is approximately 2,500 square feet.

The Company owns the Firebaugh bank branch located at 1067 O Street, Firebaugh, California which was purchased from Bank of America during October 1997 for a total consideration of $211,500. The premises are comprised of approximately 4,666 square feet of office space situated on land totaling approximately one-third of an acre.

The Company owns the Coalinga bank branch located at 145 East Durian, Coalinga, California which was also purchased from Bank of America during October 1997. The total price paid for the premises was $268,000 for an office building with 6,184 square feet of interior floor space situated on approximately 0.45 acres of land.

The Company leases the Convention Center branch located at 855 M Street, Suite 130, Fresno, California. Total space leased is approximately 4,520 square feet, and was occupied during March 2004. The fifteen-year lease expires in March 2019. There are no extension provisions.

The Company leases the Taft branch office premises located at 523 Cascade Place, Taft, California. The branch facilities consist of approximately 9,200 square feet of office space, and the lease expires in November 2007. The Taft branch facilities were acquired during April 2004 as the result of the merger with Taft National Bank.

The Company owns the branch facilities located at 3404 Coffee Road, Bakersfield, California, which has approximately 6,130 square feet of office space located on 1.15 acres. The Bakersfield branch facilities were acquired during April 2004 as the result of the merger with Taft National Bank.

The Company owns its administrative headquarters located at 1525 East Shaw Avenue, Fresno, California. The building consists of approximately 10,000 square feet of interior floor space.

The Company owns property at 2126 Inyo Street, Fresno, California, which it is currently developing to be its new administrative headquarters. The facility consists of approximately 21,400 square feet. A portion of the premises will be subleased to a third-party under a lease term of approximately seven years. It is anticipated that the Company will occupy the premises during the later part of 2005.

Item 3 - Legal Proceedings

From time to time, the Company is party to claims and legal proceedings arising in the ordinary course of business. At this time, the management of the Company is not aware of any material pending litigation proceedings to which it is a party or has recently been party to, which will have a material adverse effect on the financial condition or results of operations of the Company.

Item 4 - Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of shareholders during the fourth quarter of 2004.

PART II

Item 5 - Market for the Registrant s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Trading History

The Company became a NASDAQ National Market listed company on May 31, 2001 and trades under the symbol UBFO. The Company s common stock was previously quoted on the OTCBB (over-the-counter bulletin board), a quotation service for securities not listed or traded on NASDAQ or a national securities exchange. Volumes traded are shown below.

The Company currently has four market makers for its common stock. These include, The Seidler Companies, Hoeffer & Arnett, Sandler O Neill & Partners, and Hill Thompson, Magid & Company. The Company is aware of two other securities dealers: Smith Barney and Dean Witter Reynolds Inc., which periodically act as brokers in the Company s stock.

The following table sets forth the high and low closing sales prices by quarter for the Company s common stock, for the years ended December 31, 2004 and 2003.

	Closing Prices				
Quarter		**High**		**Low**	**Volume**
4th Quarter 2004	$	25.75	$	21.89	260,200
3rd Quarter 2004	$	23.44	$	20.25	225,400
2nd Quarter 2004	$	26.05	$	20.69	634,900
1st Quarter 2004	$	28.50	$	23.61	257,700
4th Quarter 2003	$	27.45	$	24.35	173,900
3rd Quarter 2003	$	26.59	$	20.82	294,000
2nd Quarter 2003	$	26.60	$	19.67	515,500
1st Quarter 2003	$	20.00	$	16.30	132,000

At January 31, 2005, there were approximately 724 record holders of common stock of the Company. This does not reflect the number of persons or entities who hold their stock in nominee or street name through various brokerage firms.

Dividends

The Company s shareholders are entitled to cash dividends when and as declared by the Company s Board of Directors out of funds legally available therefore. Dividends paid to shareholders by the Company are subject to restrictions set forth in California General Corporation Law, which provides that a corporation may make a distribution to its shareholders if retained earnings immediately prior to the dividend payout are at least equal the amount of the proposed distribution. As a bank holding company without significant assets other than its equity position in the

Bank, the Company s ability to pay dividends to its shareholders depends primarily upon dividends it receives from the Bank. Such dividends paid by the Bank to the Company are subject to certain limitations. See Management s Discussion and Analysis of Financial and Results of Operations Regulatory Matters .

The Company paid cash dividends to shareholders of $ 0.145 per share on January 21, 2004, and $0.16 per share on April 21, 2004, July 21, 2004 and October 20, 2004. During the previous year, the Company paid cash dividends to shareholders of $ 0.13 per share on January 22, 2003, and $0.145 per share on April 23, 2003, July 23, 2003 and October 22, 2003.

The amount and payment of dividends by the Company to shareholders are set by the Company s Board of Directors with numerous factors involved including the Company s earnings, financial condition and the need for capital for expanded growth and general economic conditions. No assurance can be given that cash or stock dividends will be paid in the future.

Securities Authorized for Issuance under Equity Compensation Plans

The following table sets forth securities authorized for issuance under equity compensation plans as for December 31, 2004.

Plan Category	**Number of securities to be issued upon exercise of outstanding options, warrants and rights (column a)**	**Weighted-average exercise price of outstanding options, warrants and rights**	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))**
Equity compensation plans approved by security holders	108,000	$ 16.05	100,000
Equity compensation plans not approved by security holders	N/A	N/A	N/A
Total	108,000	$ 16.05	100,000

A complete description of the above plans is included in Note 10 of the Company s Financial Statements in Item 8 of this Annual Report on Form 10K, and is hereby incorporated by reference.

Purchases of Equity Securities by Affiliates and Associated Purchasers

Period	**Total Number Of Shares Purchased**	**Weighted Average Price Paid per Share**	**Total Number of Shares Purchased as Part of Publicly Announced Plan or Program**	**Maximum Number of Shares That May Yet be Purchased Under the Plans or Programs**
10/1/04 to 10/31/04	0	N/A	0	190,062
11/09/2004 to 11/29/2004	1,007	$ 23.69	1,007	189,055
12/03/2004	775	$ 24.91	775	188,280
Total fourth quarter 2004	1,782	$ 24.22	1,782	

On August 30, 2001 the Company announced that its Board of Directors approved a plan to repurchase, as conditions warrant, up to 280,000 shares of the Company s common stock on the open market or in privately negotiated transactions. The duration of the program was open-ended and the timing of purchases was dependent on market conditions. A total of 215,423 shares had been repurchased under that plan as of December 31, 2003, at a total cost of $3.7 million.

Then, on February 25, 2004 the Company announced another stock repurchase plan under which the Board of Directors approved a plan to repurchase, as conditions warrant, up to 276,500 shares of the Company s common stock on the open market or in privately negotiated transactions. As with the first plan, the duration of the new program is open-ended and the timing of purchases will depend on market conditions.

Concurrent with the approval of the new repurchase plan, the Board terminated the 2001 repurchase plan and canceled the remaining 64,577 shares yet to be purchased under the earlier plan.

Item 6 - Selected Financial Data

The following table sets forth certain selected financial data for the Bank for each of the years in the five-year periods ended December 31, 2004 and should be read in conjunction with the more detailed information and financial statements contained elsewhere herein (in thousands except per share data and ratios).

			December 31,		
(in thousands except per share data and ratios)	**2004**	**2003**	**2002**	**2001**	**2000**
Summary of Year-to-Date Earnings:					
Interest income and loan fees	$ 30,748	$ 26,927	$ 28,716	$ 30,063	$ 28,941
Interest expense	6,433	7,260	11,516	13,411	11,544
Net interest income	24,315	19,667	17,200	16,652	17,397
Provision for credit losses	1,145	1,713	1,963	1,733	1,580
Net interest income after Provision for credit losses	23,170	17,954	15,237	14,919	15,817
Noninterest income	4,868	6,271	5,368	4,277	2,538
Noninterest expense	14,667	11,855	10,860	9,818	8,648
Income before taxes on income	13,371	12,370	9,745	9,378	9,707
Taxes on income	4,966	4,664	2,912	3,185	3,450
Net Income	$ 8,405	$ 7,706	$ 6,833	$ 6,193	$ 6,257
Per Share Data:					
Net Income Basic	$ 1.49	$ 1.41	$ 1.27	$ 1.14	$ 1.16
Net Income Diluted	$ 1.48	$ 1.40	$ 1.25	$ 1.11	$ 1.12
Average shares outstanding - Basic	5,630,256	5,459,926	5,400,751	5,443,734	5,374,734
Average shares outstanding - Diluted	5,667,243	5,511,670	5,487,038	5,563,855	5,587,292
Cash dividends paid	$ 0.63	$ 0.57	$ 0.51	$ 0.45	$ 0.36
Financial Position at Period-end:					
Total assets	$ 611,696	$ 506,588	$ 519,316	$ 450,928	$ 356,832
Total net loans and leases	390,334	338,716	343,042	331,163	256,802
Total deposits	536,672	440,444	423,987	368,651	271,862
Total shareholders equity	53,236	45,036	40,561	36,059	33,749
Book value per share	$ 9.39	$ 8.17	$ 7.50	$ 6.68	$ 6.23
Selected Financial Ratios:					
Return on average assets	1.52%	1.51%	1.37%	1.55%	1.95%
Return on average shareholders equity	16.81%	17.80%	17.64%	17.25%	20.05%
Average shareholders equity to average assets	9.01%	8.48%	7.76%	9.00%	9.71%
Allowance for credit losses as a percentage of total nonperforming loans	42.51%	32.58%	36.00%	34.23%	134.27%
Net charge-offs to average loans	0.12%	0.34%	0.25%	0.35%	0.19%
Allowance for credit losses as a percentage of period-end loans	1.82%	1.76%	1.59%	1.33%	1.45%
Dividend payout ratio	43.16%	40.07%	40.94%	40.09%	32.14%

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Overview

Certain matters discussed or incorporated by reference in this Annual Report on Form 10-K are forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, but are not limited to, those described in Management s Discussion and Analysis of Financial Condition and Results of Operations. Therefore, the information set forth therein should be carefully considered when evaluating the business prospects of the Company.

The Company

On June 12, 2001, the United Security Bank (the Bank) became the wholly owned subsidiary of United Security Bancshares (the Company) through a tax free holding company reorganization, accounted for on a basis similar to the pooling of interest method. In the transaction, each share of Bank stock was exchanged for a share of Company stock on a one-to-one basis. No additional equity was issued as part of this transaction. In the following discussion, references to the Bank are references to United Security Bank. References to the Company are references to United Security Bancshares (including the Bank), except for periods prior to June 12, 2001, in which case, references to the Company are references to the Bank.

On June 28, 2001, United Security Bancshares Capital Trust I (the Trust) was formed as a Delaware business trust for the sole purpose of issuing Trust Preferred securities. On July 16, 2001, the Trust completed the issuance of $15 million in Trust Preferred securities, and concurrently, the Trust used the proceeds from that offering to purchase Junior Subordinated Debentures of the Company. The Company contributed $13.7 million of the $14.5 million in net proceeds received from the Trust to the Bank to increase its regulatory capital and used the rest for the Company s business.

Effective December 31, 2001, United Security Bank formed a subsidiary Real Estate Investment Trust (REIT) through which preferred stock was offered to private investors, to raise capital for the bank in accordance with the laws and regulations in effect at the time. The principal business purpose of the REIT was to provide an efficient and economical means to raise capital. The REIT also provided state tax benefits beginning in 2002. On December 31, 2003 the California Franchise Tax Board (FTB) announced certain tax transactions related to real estate investment trusts (REITs) and regulated investment companies (RICs) will be disallowed pursuant to Senate Bill 614 and Assembly Bill 1601, which were signed into law in the 4th quarter of 2003.

As a result, the Company reversed related net state tax benefits recorded in the first three quarters of 2003 and took no such benefit in the 4th quarter. The Company has recorded no state tax liability for 2002. United Security Bancshares and its financial advisors believe that the Company s position has merit and the Company will pursue its tax claims and defend its use of these entities and transactions. The Company cannot predict at this time what the ultimate outcome will be.

Effective April 23, 2004, the Company announced the completion of a merger with Taft National Bank headquartered in Taft, California. Taft National Bank (Taft) was merged into United Security Bank and Taft s two branches will operate as branches of United Security Bank. The total consideration paid to Taft shareholders was 241,447 shares of the Company s Common Stock valued at just over approximately $6 million. As a

result of the merger, the Company acquired $15.4 million in cash and short-term investments, $23.3 million in loans, and $48.2 million in deposits. This transaction was accounted for using the purchase accounting method, and resulted in the purchase price being allocated to the assets acquired and liabilities assumed from Taft based on the fair value of those assets and liabilities. The consolidated statement of income includes the operations of Taft from the date of the acquisition to December 31, 2004.

The Company currently has ten banking branches and one construction lending office, which provide financial services in Fresno, Madera, and Kern counties. As a community-oriented bank, the Company continues to seek ways to better meet its customers needs for financial services, and to expand its business opportunities in today s ever-changing financial services environment. The Company s strategy is to be a better low-cost provider of services to its customer base while enlarging its market area and corresponding customer base to further its ability to provide those services.

Trends Affecting Results of Operations and Financial Position

The Company s overall operations are impacted by a number of factors, including not only interest rates and margin spreads, which impact results of operations, but also the composition of the Company s balance sheet. One of the primary strategic goals of the Company is to maintain a mix of assets that will generate a reasonable rate of return without undue risk, and to finance those assets

with a low-cost and stable source of funds. Liquidity and capital resources must also be considered in the planning process to mitigate risk and allow for growth.

The following table summarizes the year-to-date averages of the components of interest-bearing assets as a percentage of total interest bearing assets, and the components of interest-bearing liabilities as a percentage of total interest-bearing liabilities:

	YTD Average 12/31/04	YTD Average 12/31/03	YTD Average 12/31/02
Loans	75.12%	75.39%	76.08%
Investment securities	18.58%	19.88%	19.24%
Interest-bearing deposits in other banks	1.57%	1.81%	0.67%
Federal funds sold	4.73%	2.92%	4.01%
Total earning assets	100.00%	100.00%	100.00%
NOW accounts	11.54%	8.25%	7.22%
Money market accounts	23.85%	20.08%	16.03%
Savings accounts	7.65%	6.34%	5.32%
Time deposits	52.77%	57.79%	58.60%
Other borrowings	0.22%	3.53%	8.86%
Trust Preferred Securities	3.97%	4.01%	3.97%
Total interest-bearing liabilities	100.00%	100.00%	100.00%

The Company has modified its business plan over the past several years to better position itself for strategic growth in the future, while reducing potential risk levels. This is in response to the relative size and complexity of the Company, as well as economic and other market factors that may affect future operations and anticipated growth.

After experiencing significant growth during 2001 and 2002, the Company reduced overall asset growth in 2003 while focusing efforts on strengthening the balance sheet to improve asset quality and enhance liquidity. During 2003, loan growth was curtailed in out-of-market-area participations, and certain liabilities including FHLB borrowings totaling $35 million, were paid off. As a result, loans declined during 2003 by approximately $3.3 million and excess funds obtained from deposit growth were used to pay down borrowings or were invested in short-term overnight investments to enhance liquidity.

During 2004, the Company increased its business development efforts, and as a result, realized increases in both loans and deposits during the year. Exclusive of loans and deposit acquired from Taft National Bank, the Company experienced increases of $30.2 million in loans, and $50.4 million in deposits between December 31, 2003 and December 31, 2004. The majority of the loan growth was in construction loans, although increases were also experienced in agricultural and installment loans. Deposit growth, exclusive of deposits acquired in the Taft merger were primarily in noninterest-bearing checking, which helped enhance the Company s core deposit base.

With increases in market rates of interest experienced during the second half of 2004, the Company has realized increased net interest margins, and should continue to experience increases into 2005. With nearly 68% of the loan portfolio in floating rate instruments, benefits of rising rates were realized almost immediately on loan yields during the later half of 2004. Deposit rates lagged during the third quarter of 2004, but deposit-pricing pressures increased during the fourth quarter of 2004 and have continued into 2005. With additional rate increases anticipated during 2005, the Company should continue to realize strong net interest margins during the upcoming year.

The Company continues to emphasize relationship banking and core deposit growth, and has continued to focus greater attention on its market area of Fresno and Madera Counties, as well as its new markets in Kern County. The San Joaquin Valley and other California markets continue to benefit from construction lending and commercial loan demand from small and medium size businesses. During 2004, loan growth totaled more than $53.0 million, with $39.6 million or $74.7% of that growth occurring in real estate construction loans. Growth also occurred in agricultural and installment loans during 2004, as the Company has sought to diversify the loan portfolio as opportunities arise. In the future, the Company will continue to emphasize its core lending strengths of commercial real estate and construction lending, as well as small business financing, while expanding opportunities in agricultural, installment, and other loan categories when possible.

Deposit growth totaled $96.2 million during 2004, as compared to $16.5 million during 2003, with $50.4 million of that 2004 deposit growth resulting from the Taft National Bank merger. During the past several years, substantial increases have been experienced in the Company s core deposit base, including noninterest-bearing checking accounts, as well as NOW and money market accounts. Time deposits have declined over the past three years, as the Company continues to emphasize core deposit growth as part of it s relationship banking strategy. Over the past several years, the Company has been able to control the level of time deposits to some degree with pricing strategies, and will continue to use pricing strategies to control the overall level of time deposits as part of its growth and liquidity planning process.

The Company will continue to evaluate its business plan as economic and market factors change in its market area. Growth and increased market share will be of primary importance during 2005 as the Company seeks additional opportunities within its market areas, particularly as a result of the recently acquired operations in Kern County.

Application of Critical Accounting Policies

The Company s consolidated financial statements are prepared in accordance with generally accepted accounting principles and follow general practices within the industry in which it operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. When third-party information is not available, valuation adjustments are estimated in good faith by management primarily through the use of internal cash flow modeling techniques.

The most significant accounting policies followed by the Company are presented in Note 1 to the Company s consolidated financial statements included herein. These policies, along with the disclosures presented in the other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for loan losses to be the accounting area that requires the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.

Allowance for Credit Losses

The allowance for loan losses represents management s estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the consolidated balance sheet. Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in the Asset Quality and Allowance for Credit Losses section of this financial review.

If the loan portfolio were to increase by 10% proportionally throughout all loan classifications, the additional estimated provision to the allowance that would be required, based on the percentage allocations utilized at December 31, 2004, would be approximately $407,000 pretax ($240,000 net of tax). This includes an additional $125,000 ($74,000 net of tax) for criticized loans (those classified as special mention or worse and excluding those considered impaired under SFAS No. 114), and an additional $283,000 ($167,000 net of tax) for the remainder of the loan portfolio that is performing.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation. Depreciation expense is computed principally on the straight-line method over the estimated useful lives of the assets. The expected useful lives of certain assets including technological

related hardware and software could be subject to change due to technological advances or new standards among computer, or other related equipment. Such equipment generally has a short depreciable life, and therefore changes in the useful lives of such equipment would not have a material impact on the net income of the Company.

Other Real Estate Owned

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at the lower of the book value of the loan, or fair value of the property, less estimated costs to sell. The excess, if any, of the loan amount over the fair value is charged to the allowance for credit losses. Subsequent declines in the fair value of other real estate owned, along with related revenue and expenses from operations, are charged to noninterest expense. The valuation of such properties is subject to change as circumstances in the Company s market area, or general economic trends, change.

Goodwill

Business combinations involving the Company s acquisition of the equity interests or net assets of another enterprise or the assumption of net liabilities in an acquisition of branches constituting a business may give rise to goodwill. The acquisition of Taft National Bank during April 2004 gave rise to goodwill totaling approximately $750,000. Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed in transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company s ability to generate net earnings after the acquisition. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed for impairment at a reporting unit level at least annually. While the Company believes all assumptions utilized in its assessment of goodwill for impairment are reasonable and appropriate, changes in earnings, the effective tax rate, historical earnings multiples and the cost of capital could all cause different results for the calculation of the present value of future cash flows.

Income Taxes

Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company s assets and liabilities. Deferred taxes are measured using current tax rates applied to such taxable income in the years in which those temporary differences are expected to be recovered. If the Company s future income is not sufficient to apply the deferred tax assets within the tax years to which they may be applied, the deferred tax asset may not be realized and the Company s income will be reduced.

On December 31, 2003 the California Franchise Tax Board (FTB) announced certain tax transactions related to real estate investment trusts (REITs) and regulated investment companies (RICs) will be disallowed pursuant to Senate Bill 614 and Assembly Bill 1601, which were signed into law in the 4th quarter of 2003. As a result, the Company reversed related net state tax benefits recorded in the first three quarters of 2003 and took no such benefit in the 4th quarter. The Company continues to review the information available from the FTB and its financial advisors and believe that the Company s position has merit. The Company will pursue its tax claims and defend its use of these entities and transactions. At this time, the Company cannot predict what the ultimate outcome will be; however, management believes it is not probable that these benefits will be reversed for the year ended December 31, 2002. If the FTB were to prevail against the Company in its defense of tax benefits taken during 2002, the negative effect to net income would be approximately $624,000, excluding any possible penalties and interest.

Stock-Based Compensation

For all years presented in the Consolidated Financial Statements, the Company accounted for stock options under the provisions APB No. 25. Accordingly, no compensation expense related to the issuance of stock options is reflected in the income statements. Pro forma disclosures of the impact of compensation expense (and related tax benefit) associated with stock options are included in Note 1 in the Notes to the Consolidated Financial Statements. The pro forma amounts are calculated on the estimated fair value of the options at the date of the grant, based on assumptions made during the year of the grant. Those assumptions are outlined in Note 10. Stock Options in the Company s Notes to Financial Statements.

In December 2004, the FASB issued SFAS No. 123 (revised 2004) (SFAS 123(R)), Share-Based Payment , which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123(R) eliminates the ability to account for share-based compensation transactions using Accounting Principles Board Opinion No. 25 and requires that such transactions be accounted for using a fair value-based method. The Company will adopt the requirements of SFAS No. 123R using the modified-prospective method during the second quarter of 2005. SFAS No. 123R will require the Company to recognize as compensation expense, the fair value of

stock options granted to employees and Directors of the Company beginning with the effective date (a) based on the requirements of Statement 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123 for all awards granted to employees prior to the effective date of Statement 123(R) that remain unvested on the effective date. The estimated additional pretax compensation expense to be recognized during 2005 is approximately $41,000.

Revenue recognition

The Company s primary sources of revenue are interest income from loans and investment securities. Interest income is generally recorded on an accrual basis, unless the collection of such income is not reasonably assured or cannot be reasonably estimated. Pursuant to SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases , nonrefundable fees and costs associated with originating or acquiring loans are recognized as a yield adjustment to the related loans by amortizing them into income over the term of the loan using a method which approximates the interest method. Other credit-related fees, such as standby letter of credit fees, loan placement fees and annual credit card fees are recognized as noninterest income during the period the related service is performed.

For loans placed on nonaccrual status, the accrued and unpaid interest receivable may be reversed at management s discretion based upon management s assessment of collectibility, and interest is thereafter credited to principal to the extent necessary to eliminate doubt as to the collectibility of the net carrying amount of the loan.

Results of Operations

For the year ended December 31, 2004, the Company reported net income of $8.4 million or $1.49 per share ($1.48 diluted) as compared to $7.7 million or $1.41 per share ($1.40 diluted) for the year ended December 31, 2003, and $6.8 million or $1.27 per share ($1.25 diluted) for the year ended December 31, 2002. Net income for 2004 increased $699,000 from the previous year primarily as the result of increased yield and volume in earning assets combined with a substantial decrease in the cost of interest-bearing liabilities. Increases in market rates of interest during the second half of the year improved yields on earning assets, and the Company s net interest margin.

The Company s return on average assets was 1.52 % for the year ended December 31, 2004 as compared to 1.51 % and 1.37 % for the same twelve-month periods of 2003 and 2002, respectively. The Company s return on average equity was 16.81% for the year ended December 31, 2004 as compared to 17.80 % and 17.64 % for the same twelve-month periods of 2003 and 2002, respectively.

Net Interest Income

Net interest income, the most significant component of earnings, is the difference between the interest and fees received on earning assets and the interest paid on interest-bearing liabilities. Earning assets consist primarily of loans, and to a lesser extent, investments in securities issued by federal, state and local authorities, and corporations, as well as interest-bearing deposits and overnight funds with other financial institutions. These earning assets are funded by a combination of interest-bearing and noninterest-bearing liabilities, primarily customer deposits and short-term and long-term borrowings.

Net interest income before provision for credit losses totaled $24.3 million for the year ended December 31, 2004 as compared to $19.7 million for the year ended December 31, 2003, and $17.2 million for the year ended December 31, 2002. This represents an increase of $4.6 million or 23.6 % between the years ended December 31, 2003 and 2004, as compared to an increase of $2.5 million or 14.3% between 2002 and 2003. The increase in net interest income between 2003 and 2004 is primarily the result of substantial growth in net average earning assets, combined with a decline in the cost of average interest-bearing liabilities, which was enhanced by an increase in average market rates of interest between those two twelve-month periods. The increase in net interest income between 2002 and 2003 is primarily the result of growth in net average earning assets, combined with a decline in average interest-bearing liabilities, which more than offset the decline in average market rates of interest between those two twelve-month periods.

Table 1. Distribution of Average Assets, Liabilities and Shareholders Equity:

Interest rates and interest differentials

Years Ended December 31, 2004, 2003, and 2002

	2004			2003			2002		
(Dollars in thousands)	**Average Balance**	**Interest**	**Yield/ Rate**	**Average Balance**	**Interest**	**Yield/ Rate**	**Average Balance**	**Interest**	**Yield/ Rate**
Assets:									
Interest-earning assets:									
Loans (1)	$ 374,748	$ 26,558	7.09%	$ 353,562	$ 23,134	6.54%	$ 347,192	$ 24,521	7.06%
Investment Securities taxable	90,473	3,442	3.80%	90,608	3,169	3.50%	84,904	3,617	4.26%
Investment Securities nontaxable (2)	2,242	123	5.49%	2,613	132	5.05%	2,889	139	4.81%
Interest on deposits in other banks	7,845	310	3.95%	8,496	345	4.06%	3,048	138	4.53%
Federal funds sold and reverse repos	23,616	315	1.33%	13,714	147	1.07%	18,322	301	1.64%
Total interest-earning assets	498,924	$ 30,748	6.16%	468,993	$ 26,927	5.74%	456,355	$ 28,716	6.29%
Allowance for possible loan losses	(7,013)			(5,375)			(5,372)		
Noninterest-bearing assets:									
Cash and due from banks	24,141			18,449			17,728		
Premises and equipment, net	6,608			3,960			2,839		
Accrued interest receivable	2,141			2,226			2,891		
Other real estate owned	2,417			4,348			9,186		
Other assets	27,507			17,690			15,580		
Total average assets	$ 554,725			$ 510,291			$ 499,207		
Liabilities and Shareholders Equity:									
Interest-bearing liabilities:									
NOW accounts	$ 44,585	$ 171	0.38%	$ 30,840	$ 146	0.47%	$ 27,275	$ 208	0.76%
Money market accounts	92,159	1,298	1.41%	75,111	1,103	1.47%	60,573	1,131	1.87%
Savings accounts	29,548	136	0.46%	23,705	124	0.52%	20,106	165	0.82%
Time deposits	203,839	3,983	1.95%	216,127	4,563	2.11%	221,387	7,686	3.47%
Other borrowings	858	23	2.68%	13,206	540	4.09%	33,476	1,427	4.26%
Trust Preferred securities	15,349	822	5.36%	15,000	784	5.23%	15,000	899	5.99%
Total interest-bearing liabilities	386,338	$ 6,433	1.67%	373,989	$ 7,260	1.94%	377,817	$ 11,516	3.05%
Noninterest-bearing liabilities:									
Noninterest-bearing checking	113,836			89,713			79,974		
Accrued interest payable	773			756			1,141		
Other liabilities	3,791			2,539			1,544		
Total average liabilities	504,738			466,997			460,476		
Total average shareholders equity	49,987			43,294			38,731		
Total average liabilities and Shareholders equity	$ 554,725			$ 510,291			$ 499,207		
Interest income as a percentage of average earning assets			6.16%			5.74%			6.29%
Interest expense as a percentage of average earning assets			1.29%			1.55%			2.52%
Net interest margin			4.87%			4.19%			3.77%

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(1) Loan amounts include nonaccrual loans, but the related interest income has been included only if collected for the period prior to the loan being placed on a nonaccrual basis. Loan interest income includes loan fees of approximately $3,216,000, $1,889,000, and $1,352,000 for the years ended December 31, 2004, 2003, and 2002, respectively.

(2) Applicable nontaxable securities yields have not been calculated on a tax-equivalent basis because they are not material to the Company s results of operations.

As summarized in Table 2, the increase in net interest income between the two twelve-month periods ended December 31, 2004 and 2003 is comprised of an increase in total interest income of approximately $3.8 million, which was enhanced by a decrease in total interest expense of approximately $827,000. The Bank s net interest margin, as shown in Table 1, increased to 4.87% at December 31, 2004 from 4.19% at December 31, 2003, an increase of 68 basis points (100 basis points = 1%) between the two periods. The net margin of 4.19% reported during 2003 represents an increase of 42 basis points from the 3.77% net margin realized by the Company during 2002. While assets have grown over the past three years and the balance sheet mix has changed, interest rate movements over those three years have played a significant role in net interest income trends. Market rates of interest decreased significantly between the years ended December 31, 2000 and 2001, and declined only moderately during 2002 and 2003. Then during the second half of 2004, rates began to rise significantly, with the prime rate rising 125 basis points between June 30, 2004 and December 31, 2004. As a result, the prime rate averaged 4.34% for the year ended December 31, 2004 as compared to 4.12% and 4.63% for the years ended December 31, 2003 and 2002, respectively.

Both the Company s net interest income and net interest margin are affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as volume change. Both are also affected by changes in yields on interest-earning assets and rates paid on interest-bearing liabilities, referred to as rate change . The following table sets forth the changes in interest income and interest expense for each major category of interest-earning asset and interest-bearing liability, and the amount of change attributable to volume and rate changes for the years indicated. Changes in interest income and expense, which are not attributable specifically to either rate or volume, are allocated proportionately between the two variances based on the absolute dollar amounts of the change in each.

Table 2. Rate and Volume Analysis

	2004 compared to 2003			2003 compared to 2002		
(In thousands)	**Total**	**Rate**	**Volume**	**Total**	**Rate**	**Volume**
Increase (decrease) in interest income:						
Loans	$ 3,424	$ 1,979	$ 1,445	$ (1,387)	$ (1,830)	$ 443
Investment securities	264	282	(18)	(455)	(677)	222
Interest-bearing deposits in other banks	(35)	(10)	(25)	207	10	197
Federal funds sold and securities purchased under agreements to resell	168	42	126	(154)	(89)	(65)
Total interest income	3,821	2,293	1,528	(1,789)	(2,586)	797
Decrease in interest expense:						
Interest-bearing demand accounts	220	(119)	339	(90)	(336)	246
Savings accounts	12	(16)	28	(41)	(67)	26
Time deposits	(580)	(331)	(249)	(3,123)	(2,944)	(179)
Other borrowings	(517)	(139)	(378)	(887)	(56)	(831)
Trust Preferred securities	38	19	19	(115)	(115)	0
Total interest expense	(827)	(586)	(241)	(4,256)	(3,518)	(738)
Increase in net interest income	$ 4,648	$ 2,879	$ 1,769	$ 2,467	$ 932	$ 1,535

Total interest income increased approximately $3.8 million or 14.2% between the years ended December 31, 2003 and 2004, and is attributable to an increase in earning asset volume, as well as the yields on those earning assets. As with the previous year, earning asset growth was mainly in loans, with minor growth in federal funds sold during 2004. On average, loans grew by approximately $21.2 million between 2003 and 2004. The Company continues to maintain a high percentage of loans in its earning asset mix with loans averaging 75.1% of total earning assets for the year ended December 31, 2004, as compared to 75.4% and 76.1% for the years ended December 31, 2003 and 2002, respectively.

Total interest expense decreased approximately $827,000 between the years ended December 31, 2003 and 2004, as a result of decreases in the volume of interest-bearing liabilities, as well as the rates paid on those liabilities. Rates paid on interest-bearing liabilities declined in all categories except Trust Preferred securities, with the greatest declines experienced in time deposits and other borrowings. The Company s deposit mix continues to change with continued declines in time deposit volume, which was more than offset by increases in the average volume of interest-bearing demand and savings accounts. On average, time deposits decreased $12.3 million, while interest-bearing demand and savings accounts increased on average by $30.8 million and $5.8 million, respectively, between the years ended December 31, 2003 and December 31, 2004.

Total interest income decreased approximately $1.8 million or 6.2% for the year ended December 31, 2003 as compared to the previous year. The change is attributable primarily to an increase in the overall volume of earning assets, which was more than offset by a decrease in market rates of interest. Earning asset growth was mainly in loans, which are traditionally the Company s highest earning asset and, to a smaller degree, in investment securities and interest-bearing deposits. On average, loan growth totaled nearly $6.4 million or 1.8% during 2003.

Total interest expense decreased approximately $4.3 million or 37.0% for the year ended December 31, 2003 as compared to the year ended December 31, 2002. As with the previous year, the decrease between these two periods is primarily the result of a substantial decrease in the average rates paid on all interest-bearing categories, which was combined with a decrease in average balances of time deposits and other borrowings during the year. Average time deposit balances decreased $5.3 million and average balances on other borrowings decreased $20.3 million during 2003, and the average rate paid on time deposits and other borrowings declined 136 and 17 basis points, respectively, when compared to the year ended December 31, 2002. All other interest bearing-liability categories experienced increases in average volumes during 2003, which were more than offset by the average rates paid on those liabilities.

Provision for Credit Losses

Provisions for credit losses and the amount added to the allowance for credit losses is determined on the basis of management s continuous credit review of the loan portfolio, consideration of past loan loss experience, current and future economic conditions, and other pertinent factors. Such factors consider the allowance for credit losses to be adequate when it covers estimated losses inherent in the loan portfolio. Based on the condition of the loan portfolio, management believes the allowance is sufficient to cover risk elements in the loan portfolio. For the year ended December 31, 2004 the provision to the allowance for credit losses amounted to $1.1 million as compared to $1.7 and $2.0 million for the years ended December 31, 2003 and 2002, respectively. In contrast to 2002 and 2003, the provisions made during 2004 were relatively stable throughout the year. The provision made during the fourth quarter of 2003 totaled $841,000, or approximately 49.1% of the total provision made during 2003, while the provision made during the fourth quarter of 2002 totaled $744,000, or approximately 39.4% of the total provision made during that year. The additional provisions made during the fourth quarters of 2003 and 2002 were in response to increased levels of nonperforming loans during those periods. Specifically, additional provisions for credit losses taken during the fourth quarter of 2003 are primarily the result of a nonperforming lease portfolio totaling approximately $5.5 million. For further discussion, see Asset quality and allowance for credit losses included in the financial condition section of this Management s Discussion and Analysis of Financial Condition and Results of Operations. The amount provided to the allowance for credit losses during 2004 brought the allowance to 1.82% of net outstanding loan balances at December 31, 2004, as compared to 1.76% of net outstanding loan balances at December 31, 2003, and 1.59% at December 31, 2002.

Noninterest Income

The following table summarizes significant components of noninterest income for the years indicated and the net changes between those years:

	Years Ended December 31,			Increase (decrease) during Year	
(In thousands)	**2004**	**2003**	**2002**	**2004**	**2003**
Customer service fees	$ 4,438	$ 3,789	$ 3,895	$ 649	$ (106)
Gain (loss) on sale of securities	35	(58)	485	93	(543)
Gain on sale of loans	0	21	103	(21)	(82)
(Loss) gain on sale of OREO	(98)	80	4	(178)	76
Gain on sale of interest-bearing deposits in other banks	0	186	0	(186)	186
Shared appreciation income	8	1,813	267	(1,805)	1,546
Other	485	440	614	45	(174)
Total	$ 4,868	$ 6,271	$ 5,368	$ (1,403)	$ 903

Noninterest income consists primarily of fees and commissions earned on services that are provided to the Company s banking customers and, to a lesser extent, gains on sales of Company assets and other miscellaneous income. Noninterest income for the year ended December 31, 2004 decreased $1.4 million when compared to the previous year, and decreased $500,000 when compared to the year ended December 31, 2002. Increases in customer service fees totaled $649,000 between 2003 and 2004, and were comprised of increases in ATM and overdraft charges, as well as additional fee revenue generated by the two Kern County branches acquired during April 2004. Shared appreciation income declined $1.8 million between 2003 and 2004, as 2003 levels were not again realized during 2004. Shared appreciation income results from agreements between the Company and the borrower on certain construction loans where the Company agrees to receive interest on the loan at maturity rather than monthly and the borrower agrees to share in the profits of the project. The profit is determined by the appraised value of the completed project and subsequent refinancing or sale of the project. Due to the difficulty in calculating future values, shared appreciation income is recognized when received. The Company does not participate in a significant number of shared appreciation projects, and as a result, does not anticipate large amounts of shared appreciation income on an ongoing basis.

Noninterest income for the year ended December 31, 2003 increased $900,000 when compared to the previous year. Shared appreciation income on commercial real estate increased $1.5 million between the two years ended December 31, 2003 and 2002, and was a major contributing factor to the overall increase in noninterest income during 2003. Customer service fees declined by $106,000 during the year ended December 31, 2003, which is attributable to modest declines in checking service charges and overdraft fee income. Gain on sale of interest-bearing deposits in other banks totaled $186,000 during 2003, and resulted from the sale of investment CD s. In addition, and in contrast to previous years, losses on sales of securities were experienced during 2003 as securities were called prior to maturity.

Noninterest Expense

The following table sets forth the components of total noninterest expense in dollars and as a percentage of average earning assets for the years ended December 31, 2004, 2003 and 2002:

	2004		2003		2002	
(Dollars in thousands)	**Amount**	**% of Average Earning Assets**	**Amount**	**% of Average Earning Assets**	**Amount**	**% of Average Earning Assets**
Salaries and employee benefits	$ 6,663	1.34%	$ 5,089	1.09%	$ 4,895	1.07%
Occupancy expense	2,197	0.44%	1,658	0.35%	1,730	0.38%
Data processing	659	0.13%	515	0.11%	553	0.12%
Professional fees	1,209	0.24%	991	0.21%	965	0.21%
Directors fees	192	0.04%	184	0.04%	201	0.04%
Amortization of intangibles	470	0.09%	353	0.08%	360	0.08%
Correspondent bank service charges	318	0.06%	281	0.06%	289	0.06%
Writedowns on OREO	35	0.01%	403	0.09%	132	0.03%
Loss on CA Tax Credit Partnership	395	0.08%	276	0.06%	210	0.05%
Other	2,529	0.51%	2,105	0.45%	1,525	0.33%
Total	$ 14,667	2.94%	$ 11,855	2.53%	$ 10,860	2.38%

Noninterest expense, excluding provision for credit losses and income tax expense, totaled $14.7 million for the year ended December 31, 2004 as compared to $11.9 million and $10.9 million for the years ended December 31, 2003 and 2002, respectively. These figures represent an increase of $2.8 million or 23.7% between the years ended December 31, 2004 and 2003 and an increase of $1.0 million or 9.2% between the years ended December 31, 2003 and 2002. Noninterest expense increases between the three years presented are associated primarily with normal, anticipated growth of the Company, as well as additional costs associated with the two new Kern County branches acquired in the Taft merger, and the new downtown Convention Center branch, all three of which are 2004 additions. As a percentage of average earning assets, total noninterest expense has experienced moderate increases over the past three years as the Company has controlled overhead expenses while experiencing profitable growth. Noninterest expense amounted to 2.94% of average earning assets for the year ended December 31, 2004 as compared to 2.53% at December 31, 2003 and 2.38% at December 31, 2002.

With the addition of the Taft and Bakersfield branches acquired as part of the Taft National Bank merger in April 2004, increases have been experienced in salaries, occupancy, data processing, intangible amortization, and other related expenses. Professional fees increased over the three years presented as the result of additional legal expenses associated with impaired loans during 2003, increased audit fees, and the formation of the Bank s subsidiary REIT during 2002. While legal fees associated with impaired loans declined between 2003 and 2004, the Company incurred an additional $463,000 in audit fees associated with Sarbanes-Oxley compliance during 2004. The Company became an accelerated filer during 2004 (as defined by the SEC), and as a result became subject to the Section 404 internal control reporting requirements of the Sarbanes-Oxley Act effective December 31, 2004. Increases in other noninterest expense over the three years presented are associated with normal business growth and, include a number of items such as telephone, postage, insurance, and armored car expenses. The increases in other noninterest expense during 2003 included an additional $164,000 in expenses to maintain OREO properties, and a decline of $233,000 in OREO expenses between 2003 and 2004.

Financial Condition

Total assets increased by $105.1 million or 20.8% during the year to $611.7 million at December 31, 2004, and increased $92.4 million or 17.8% from the balance of $519.3 million at December 31, 2002. The increase in assets experienced during 2004 was partially the result of the purchase of Taft National Bank during April 2004, which added approximately $50.0 million in assets. Deposit growth experienced during the year, particularly in noninterest-bearing checking, NOW, and money market accounts, added additional growth which was utilized to fund loan growth or increase the Company s security portfolio. During the year ended December 31, 2004, net loans increased $51.6 million, investment securities increased $28.5 million, while federal funds sold and interest-bearing deposits in other banks remained level between the two period-ends. Total deposits of $536.7 million at December 31, 2004 increased $96.2 million or 21.9% from the balance reported at December 31, 2003, and increased $112.7 million or 26.6% from the balance of $424.0 million reported at December 31, 2002.

Earning assets averaged approximately $498.9 million during the year ended December 31, 2004, as compared to $469.0 million and $456.4 million for the years ended December 31 2003 and 2002, respectively. Average interest-bearing liabilities increased to $386.3 million for the year ended December 31, 2004, as compared to $374.0 million for the year ended December 31, 2003, and increased from the balance of $377.8 million for the year ended December 31, 2002.

Loans

The Company s primary business is that of acquiring deposits and making loans, with the loan portfolio representing the largest and most important component of its earning assets. Loans totaled $398.7 million at December 31, 2004, representing an increase of $53.0 million or 15.3% when compared to the balance of $345.7 million at December 31, 2003, and an increase of $49.6 million or 14.2% when compared to the balance of $349.1 million reported at December 31, 2002. Average loans totaled $374.7 million, $353.6 million, and $347.2 million for the years ended December 31, 2004, 2003 and 2002, respectively. During 2004 average loans increased 6.0% when compared to the year ended December 31, 2003 and increased 7.9% compared to the year ended December 31, 2002.

The following table sets forth the amounts of loans outstanding by category and the category percentages as of the year-end dates indicated:

	2004		2003		2002		2001		2000	
(In thousands)	**Dollar Amount**	**% of Loans**	**Dollar Amount**	**% of Loans**	**Dollar Amount**	**% of Loans**	**Dollar Amount**	**% of Loans**	**Dollar Amount**	**% of Loans**
Commercial and industrial	$ 123,720	31.0%	$ 116,991	33.9%	$ 117,293	33.6%	$ 102,280	30.4%	$ 66,435	25.4%
Real estate - mortgage	88,187	22.1	96,381	27.9	100,417	28.9	111,425	33.1	113,140	43.3
Real estate construction	137,523	34.5	97,930	28.3	95,024	27.2	92,764	27.6	61,038	23.4
Agricultural	23,416	5.9	15,162	4.4	16,877	4.8	12,987	3.9	7,240	2.8
Installment/other	13,257	3.3	6,617	1.9	7,811	2.2	6,647	2.0	10,291	3.9
Lease financing	12,581	3.2	12,581	3.6	11,632	3.3	10,184	3.0	3,225	1.2
Total Loans	$ 398,684	100.0%	$ 345,662	100.0%	$ 349,054	100.0%	$ 336,287	100.0%	$ 261,369	100.0%

Loans increased more than $53.0 million during 2004 due in part to the merger with Taft National Bank, and in part to internal loan growth. The Taft merger brought with it approximately $23.3 million in loans, and the additional increase of $30.2 million included increases of $35.0 million in construction loans, $7.2 million in agricultural loans, and $5.3 million in consumer installment loans. Exclusive of the Taft merger, commercial and industrial loans declined by $9.0 million, and real estate mortgage loans declined by $8.4 million. The Company has experienced substantial increases in construction lending during 2004, as the residential housing and commercial real estate markets remain strong within the San Joaquin Valley. Between the time of the merger during April 2004 and year-end, the two branches acquired from Taft National in Kern County have experienced increases in loans of almost $11.4 million.

Loans declined during 2003 as part of the Company s plan to slow overall asset growth and better position itself for sustained and stable growth in the future. During this time loan participations in other market areas were curtailed and the Company began to focus more on its market area of Fresno and Madera Counties as local economies began to improve. Total loan participations declined from $79.5 million at December 31, 2001 to $63.8 million and $42.7 million at December 31, 2002 and 2003, respectively. As a result, commercial and industrial, real estate mortgage, and construction loans showed only minor changes between December 31, 2002 and December 31, 2003.

Loan volume continues to be greatest in what has historically been the Bank s primary lending emphasis: commercial, real estate mortgage, and construction lending. During 2004, loan growth occurred in all categories except real estate mortgage loans, with total loans growing by $53.0 million or 15.3% between December 31, 2003 and December 31, 2004. The only loan growth experienced during 2003 occurred in real estate construction and lease financing loans, which increased by $3.0 million or 3.1%, and $949,000 or 8.2%, respectively, during the year. Modest decreases were experienced in all other loan categories during 2003. At December 31, 2004, approximately 82% of commercial and industrial loans have floating rates and, although some may be secured by real estate, many are secured by accounts receivable, inventory, and other business assets. Construction loans continue to be a significant focus for the Company and increased $39.6 million or 40.0 % during 2004, increased $3.0 million or 3.1% during 2003, and increased $2.3 million or 2.4% during 2002. Construction loans are generally short-term, floating-rate obligations, which consist of both residential and commercial projects. Agricultural loans consisting of mostly short-term, floating rate loans for crop financing, increased $8.3 million or 54.4% between December 31, 2003 and December 31, 2004, while installment loans increased $6.6 million or 100.3% during that same period. Since 2000, the Company has offered lease financing, with growth of $1.0 million or 8.2% experienced during 2003, as compared to $1.4 million or 14.5% during the year ended December 31, 2002. Lease financing loans remained level during 2004.

The real estate mortgage loan portfolio totaling $88.2 million at December 31, 2004 consists of commercial real estate, residential mortgages, and home equity loans. Commercial real estate is the core of this segment of the portfolio, with balances of $62.5 million, $86.1 million, and $82.6 million at December 31, 2004, 2003, and 2002, respectively. Commercial real estate loans are generally a mix of short to medium-term, fixed and floating rate instruments and, are mainly tied to commercial income and multi-family residential properties. The Company does not currently offer traditional residential mortgage loans and, as a result, that portion of the portfolio generally has been small over time with balances of $21.6 million, $5.2 million, and $7.8 million at December 31, 2004, 2003 and 2002, respectively. The Company purchased a portfolio of fixed-rate jumbo mortgages during the fourth quarter of 2004, which accounted for $14.0 million of the outstanding mortgage loans at December 31, 2004. The Company does provide mortgage loans through a third-party service provider through the Company s website. The Company also offers short to medium-term, fixed-rate, home equity loans, which totaled $4.1 million at December 31, 2004, $5.0 million at December 31, 2003, and $10.0 million at December 31, 2002.

The following table sets forth the maturities of the Bank s loan portfolio at December 31, 2004. Amounts presented are shown by maturity dates rather than repricing periods:

(In thousands)	Due in one year or less	Due after one Year through Five years	Due after Five years	Total
Commercial and agricultural	$ 73,118	$ 60,891	$ 13,127	$ 147,136
Real estate construction	111,198	26,284	41	137,523
	184,316	87,175	13,168	284,659
Real estate mortgage	12,297	51,001	24,889	88,187
All other loans	7,289	16,057	2,492	25,838
Total Loans	$ 203,902	$ 154,233	$ 40,549	$ 398,684

The average yield on loans was 7.09% for the year ended December 31, 2004, representing an increase of 55 basis points when compared to the year ended December 31, 2003 and was a result of a significant increase in average market rates of interest during the second half of 2004. For the year ended December 31, 2003, the overall average yield on the loan portfolio was 6.54%, representing a decrease of 52 basis points when compared to 7.06% for the same twelve-month period of 2002 and was a result of a general decline in average market rates of interest during 2003. The Bank s loan portfolio is generally comprised of short-term or floating rate loans and is therefore susceptible to fluctuations in market rates of interest. At December 31, 2004, 2003 and 2002, approximately 67.4%, 66.5% and 68.7% of the Bank s loan portfolio consisted of floating rate instruments, with the majority of those tied to the prime rate.

The following table sets forth the contractual maturities of the Bank s fixed and floating rate loans at December 31, 2004. Amounts presented are shown by maturity dates rather than repricing periods, and do not consider renewals or prepayments of loans:

(In thousands)	Due in one year or less	Due after one Year through Five years	Due after Five years	Total
Accruing loans:				
Fixed rate loans	$ 38,436	$ 53,652	$ 25,416	$ 117,504
Floating rate loans	160,600	88,798	15,100	264,498
Total accruing loans	199,036	142,450	40,516	382,002
Nonaccrual loans:				
Fixed rate loans	615	5,325	33	5,973
Floating rate loans	4,251	6,458	0	10,709
Total nonaccrual loans	4,866	11,783	33	16,682
Total Loans	$ 203,902	$ 154,233	$ 40,549	$ 398,684

Securities

Following is a comparison of the amortized cost and approximate fair value of available-for-sale and held-to-maturity securities for the three years indicated:

	December 31, 2004				December 31, 2003			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value (Carrying Amount)**	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value (Carrying Amount)**
Available-for-sale:								
U.S. Treasuries	$ 399	$ 0	$ (2)	$ 397	$ 0	$ 0	$ (0)	$ 0
U.S. Government agencies	$ 89,329	$ 312	$ (764)	$ 88,877	$ 58,666	$ 613	$ (354)	$ 58,925
U.S. Government agency collateralized mortgage obligations	31	0	0	31	54	0	0	54
Obligations of state and political subdivisions	2,242	155	0	2,397	2,613	201	0	2,814
Other investment securities	20,703	70	(225)	20,548	21,646	421	(125)	21,942
Total available-for-sale	$ 112,704	$ 537	$ (991)	$ 112,250	$ 82,979	$ 1,235	$ (479)	$ 83,735

	December 31, 2002			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Available-for-sale:				
U.S. Government agencies	$ 63,794	$ 1,570	$ (0)	$ 65,364
U.S. Government agency collateralized mortgage obligations	84	4	(0)	88
Obligations of state and political subdivisions	2,795	178	(0)	2,973
Other investment securities	36,158	5	(21)	36,142
Total available-for-sale	$ 102,831	$ 1,757	$ (21)	$ 104,567

Included in other investment securities at December 31, 2004, is a short-term government securities mutual fund totaling $7.8 million, a commercial asset-backed trust totaling $4.6 million, a CRA-qualified mortgage fund totaling $5.0 million, and Trust Preferred securities pools totaling $3.2 million. Included in other debt securities at December 31, 2003 is a short-term government securities mutual fund totaling $7.9 million, a commercial asset-backed trust totaling $5.6 million, and Trust Preferred securities pools totaling $8.4 million. Included in other debt securities at December 31, 2002 is a short-term government securities mutual fund totaling $10.0 million, a money market mutual fund totaling $23.0 million, and a Trust Preferred securities pool totaling $3.1 million. The commercial asset-backed trust consists of fixed and floating rate commercial and multifamily mortgage loans. The short-term government securities mutual fund invests in debt securities issued or guaranteed by the U.S. Government, its agencies or instrumentalities, with a maximum duration equal to that of a 3-year U.S. Treasury Note.

Realized gains on securities available-for-sale totaled $152,000 during 2004, $11,000 during 2003, and $509,000 during 2002. Realized losses on securities available-for-sale totaled $117,000 during 2004, $69,000 during 2003 and $24,000 during 2002.

Investment securities increased $28.5 million between December 31, 2003 and December 31, 2004, as deposit growth during 2004 outpaced loan growth. The Taft merger during April 2004 contributed an additional $9.2 million in investment securities, and $10.0 million in federal funds sold to the balance sheet during 2004.

Investment securities decreased $20.82 million between December 2002 and December 2003, as maturing securities were utilized to fund borrowing runoff. Excess funds were temporarily invested in overnight funds to enhance the Company s liquidity position. The decrease in securities during 2003 was primarily in other investment securities, and included the sale of a short-term money market mutual fund with Janus Investments totaling $23.0 million.

Securities that have been temporarily impaired less than 12 months at December 31, 2004 are comprised of twenty-two (22) U.S. government agency securities, one other investment security, and one U.S. treasury security with a total weighted average life of 4.2 years. As of December 31, 2004, there were four U.S. government agency securities and two other investment securities with a total weighted average life of 0.81 years that have been temporarily impaired for twelve months or more. Because the decline in market value is attributable to changes in market rates of interest rather than credit quality, and because the Company has the ability and intent

to hold these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2004.

The following summarizes temporarily impaired investment securities at December 31, 2004:

(In thousands)	Less than 12 Months Fair Value (Carrying Amount)	Less than 12 Months Unrealized Losses	12 Months or More Fair Value (Carrying Amount)	12 Months or More Unrealized Losses	Total Fair Value (Carrying Amount)	Total Unrealized Losses
Securities available for sale:						
U.S. Treasury securities	$ 398	$ (2)	$ 0	$ 0	$ 398	$ (2)
U.S. Government agencies	58,533	(570)	10,174	(194)	68,707	(764)
U.S. Government agency collateralized mortgage Obligations	0	0	0	0	0	0
Obligations of state and political subdivisions	0	0	0	0	0	0
Other investment securities	1,590	(5)	12,824	(220)	14,414	(225)
Total impaired securities	$ 60,521	$ (577)	$ 22,998	$ (414)	$ 83,519	$ (991)

The contractual maturities of investment securities as well as yields based on amortized cost of those securities at December 31, 2004 are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	One year or less Amount	One year or less Yield (1)	After one year to five years Amount	After one year to five years Yield (1)	After five years to ten years Amount	After five years to ten years Yield (1)	After ten years Amount	After ten years Yield (1)	Total Amount	Total Yield (1)
Available-for-sale:										
U.S. Treasuries	$ 397	1.88%	$	%	$	%	$	%	$ 397	1.88%
U.S. Government agencies	4,910	3.20%	59,034	3.37%		%	24,933	3.32%	88,877	3.32%
U.S. Government agency collateralized mortgage obligations							31	5.15%	31	5.15%
Obligations of state and political subdivisions	393	4.53%		%	678	4.78%	1,326	4.99%	2,397	5.19%
Other investment securities	7,817	3.07%	4,963	2.52%			7,768	7.01%	20,548	4.39%
Total estimated fair value	$ 13,517	3.12%	$ 63,997	3.30%	$ 678	4.78%	$ 34,058	4.23%	$ 112,250	3.55%

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(1) Weighted average yields are not computed on a tax equivalent basis

At December 31, 2004 and 2003, available-for-sale securities with an amortized cost of approximately $70.7 million and $61.3 million, respectively (fair value of $70.4 million and $61.7 million, respectively) were pledged as collateral for public funds, FHLB borrowings, and treasury tax and loan balances.

Deposits

The Bank attracts commercial deposits primarily from local businesses and professionals, as well as retail checking accounts, savings accounts and time deposits. Total deposits increased $96.2 million or 21.9% during the year to a balance of $536.7 million at December 31, 2004 and increased $16.5 million or 3.9% between December 31, 2002 and December 31, 2003. Deposit growth during 2004 is largely attributable to deposits acquired through the merger with Taft National Bank, which amounted to $48.2 million at the date of merger. Core deposits, consisting of all deposits other than time deposits of $100,000 or more and brokered deposits, continue to provide the foundation for the Bank s principal sources of funding and liquidity. These core deposits amounted to 73.4%, 70.1% and 69.4% of the total deposit portfolio at December 31, 2004, 2003 and 2002, respectively.

The following table sets forth the year-end amounts of deposits by category for the years indicated, and the dollar change in each category during the year:

	December 31,			Change during Year	
(In thousands)	**2004**	**2003**	**2002**	**2004**	**2003**
Noninterest-bearing deposits	$ 129,970	$ 94,597	$ 89,000	$ 35,373	$ 5,597
Interest-bearing deposits:					
NOW and money market accounts	173,943	120,375	100,199	53,568	20,176
Savings accounts	32,775	23,691	21,138	9,084	2,553
Time deposits:					
Under $100,000	61,626	75,640	85,564	(14,014)	(9,924)
$100,000 and over	138,358	126,141	128,086	12,217	(1,945)
Total interest-bearing deposits	406,702	345,847	334,987	60,855	10,860
Total deposits	$ 536,672	$ 440,444	$ 423,987	$ 96,228	$ 16,457

During the years ended December 31, 2004 and December 31, 2003, increases were experienced in all deposit categories, except in time deposits, with the greatest increases being in interest-bearing checking accounts. The Company continues to emphasize core deposits as part of its relationship banking strategy. As a result, deposits continue to grow in the Company s deposit categories of NOW and money market accounts, and savings accounts, as well as noninterest-bearing checking accounts. Substantial increases have been experienced in these deposit categories between 2002 and 2004 as the result of both an increase in the total number of accounts as well as an increase in the average balance per account, particularly in money market accounts. With market rates of interest at or near historical lows during that period, money market accounts, with their tiered interest-rate features, have become increasingly attractive to depositors.

As mentioned previously, growth in time deposits has fluctuated over the past several years, as the Company has been able to control the level of these deposits to some degree with pricing strategies. Time deposits, including brokered and other out-of-market deposits were allowed to grow during 2002 as the funds were needed for loan growth, but then allowed to run-off as they matured during 2003 as the need for such deposits diminished. During 2004, total time deposits remained level when compared to the previous year, yet decreases of $14.0 million were experienced in time deposits under $100,000, which were almost offset by increases of $12.2 million in time deposits of $100,000 or more. Increase in time deposits of $100,000 or more were primarily the result of brokered deposits acquired to maintain liquidity levels and to fund loan growth. The Company has utilized brokered deposits over the past several years to enhance its deposit growth, with brokered deposits totaling $37.8 million, $32.4 million, and $26.3 million at December 31, 2004, 2003 and 2002, respectively. In addition, the Company has been able to obtain time deposits from the State of California, which totaled $40.0 million at December 31, 2004, 2003 and 2002. The time deposits of the State of California are collateralized by pledged securities in the Company s investment portfolio. The Company will continue to use pricing strategies to control the overall level of time deposits as part of its growth and liquidity planning process.

The Company s deposit base consists of two major components represented by noninterest-bearing (demand) deposits and interest-bearing deposits. Interest-bearing deposits consist of time certificates, NOW and money market accounts and savings deposits. Total interest-bearing deposits increased $60.9 million or 17.6% between December 31, 2003 and December 31, 2004, while noninterest-bearing deposits increased $35.4 million or 37.4% between the same two periods presented. Between December 31, 2002 and December 31, 2003, total interest-bearing deposits increased $10.9 million or 3.2%, while noninterest-bearing deposits increased $5.6 million or 6.3%.

On a year-to-date average, the Company experienced an increase of $48.5 million or 11.1 % in total deposits between the years ended December 31, 2003 and December 31, 2004. Between these two periods, average interest-bearing deposits increased $24.3 million or 7.0%, while total noninterest-bearing checking increased $24.1 million or 26.9% on a year-to-date average basis. On average, the Company experienced increases in all deposit categories between the years ended December 31, 2003 and December 31, 2004, except time deposits, which decreased $12.3 million on average during 2004. On a year-to-date average basis, total deposits increased $26.2 million or 6.4% between the years ended December 31, 2002 and December 31, 2003. Of that total, interest-bearing deposits increased by $16.4 million or 5.0%, while noninterest-bearing deposits increased $9.7 million or 12.2% during 2003.

The following table sets forth the average deposits and average rates paid on those deposits for the years ended December 31, 2004, 2003 and 2002:

	2004		2003		2002	
(Dollars in thousands)	**Average Balance**	**Rate %**	**Average Balance**	**Rate %**	**Average Balance**	**Rate %**
Interest-bearing deposits:						
Checking accounts	$ 136,744	1.07%	$ 105,951	1.18%	$ 87,848	1.52%
Savings	29,548	0.46%	23,705	0.52%	20,106	0.82%
Time deposits (1)	203,839	1.95%	216,127	2.11%	221,387	3.47%
Noninterest-bearing deposits	113,836		89,713		79,974	

(1) Included at December 31, 2004, are $138.4 million in time certificates of deposit of $100,000 or more, of which $37.9 million matures in three months or less, $59.7 million matures in 3 to 6 months, $21.7 million matures in 6 to 12 months, and $19.1 million matures in more than 12 months.

Short-term Borrowings

The Company has the ability to obtain borrowed funds consisting of federal funds purchased, securities sold under agreements to repurchase (repurchase agreements) and Federal Home Loan Bank (FHLB) advances as alternatives to retail deposit funds. The Company has established collateralized and uncollateralized lines of credit with several correspondent banks, as well as a securities dealer, for the purpose of obtaining borrowed funds as needed. The Company may continue to borrow funds in the future as part of its asset/liability strategy, and may use these funds to acquire certain other assets as deemed appropriate by management for investment purposes and to better utilize the capital resources of the Bank. Federal funds purchased represent temporary overnight borrowings from correspondent banks and are generally unsecured. Repurchase agreements are collateralized by mortgage backed securities and securities of U.S. Government agencies, and generally have maturities of one to six months, but may have longer maturities if deemed appropriate as part of the Company s asset/liability management strategy. FHLB advances are collateralized by the Company s investment in FHLB stock, securities, and certain qualifying mortgage loans. In addition, the Company has the ability to obtain borrowings from the Federal Reserve Bank of San Francisco, which would be collateralized by certain pledged loans in the Company s loan portfolio. The lines of credit are subject to periodic review of the Company s financial statements by the grantors of the credit lines. Lines of credit may be modified or revoked at any time if the grantors feel there are adverse trends in the Company s financial position.

The Company had collateralized and uncollateralized lines of credit aggregating $169.1 million and $130.6 million, as well as FHLB lines of credit totaling $26.7 million and $31.8 million at December 31, 2004 and 2003, respectively. These lines of credit generally have interest rates tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR.

The table below provides further detail of the Company s federal funds purchased, repurchase agreements and FHLB advances for the years ended December 31, 2004, 2003 and 2002:

	December 31,		
(Dollars in thousands)	**2004**	**2003**	**2002**
At period end:			
Federal funds purchased	$ 0	$ 0	$ 0
Repurchase agreements	0	0	0
FHLB advances	0	0	35,400
Total at period end	$ 0	$ 0	$ 35,400
Average ending interest rate total	0.00%	0.00%	4.17%
Average for the year:			
Federal funds purchased	$ 658	$ 745	$ 77
Repurchase agreements	0	0	218
FHLB advances	0	11,973	32,398
Total average for the year	$ 658	$ 12,718	$ 32,693
Average interest rate total	1.92%	4.04%	4.22%
Maximum total borrowings outstanding at any month-end during the year:			
Federal funds purchased	$ 6,480	$ 0	$ 1,995
Repurchase agreements/FHLB advances	0	35,400	35,400
Total	$ 6,480	$ 35,400	$ 37,395

Asset Quality and Allowance for Credit Losses

Lending money is the Company s principal business activity, and ensuring appropriate evaluation, diversification, and control of credit risks is a primary management responsibility. Implicit in lending activities is the fact that losses will be experienced and that the amount of such losses will vary from time to time, depending on the risk characteristics of the loan portfolio as affected by local economic conditions and the financial experience of borrowers.

The allowance for credit losses is maintained at a level deemed appropriate by management to provide for known and inherent risks in existing loans and commitments to extend credit. The adequacy of the allowance for credit losses is based upon management s continuing assessment of various factors affecting the collectibility of loans and commitments to extend credit; including current economic conditions, past credit experience, collateral, and concentrations of credit. There is no precise method of predicting specific losses or amounts which may ultimately be charged off on particular segments of the loan portfolio. The collectibility of a loan is subjective to some degree, but must relate to the borrower s financial condition, cash flow, quality of the borrower s management expertise, collateral and guarantees, and the state of the local economy. When determining the adequacy of the allowance for credit losses, the Company follows, in accordance with GAAP, the guidelines set forth in the Interagency Policy Statement on the Allowance for Loan and Lease Losses (Statement) issued jointly by banking regulators during July 2001. The Statement outlines characteristics that should be used in segmentation of the loan portfolio for purposes of the analysis including risk classification, past due status, type of loan, industry or collateral. It also outlines factors to consider when adjusting the loss factors for various segments of the loan portfolio. Securities and Exchange Commission Staff Accounting Bulletin No. 102 was also released at this time which represents the SEC staff s view relating to methodologies and supporting documentation for the Allowance for Loan and Lease Losses that should be observed by all public companies in complying with the federal securities laws and the Commission s interpretations. It is also generally consistent with the guidance published by the banking regulators.

The Company segments the loan and lease portfolio into eleven (11) segments, primarily by loan class and type, that have homogeneity and commonality of purpose and terms for analysis under SFAS No. 5. Those loans which are determined to be impaired under SFAS No. 114 are not subject to the general reserve analysis under SFAS No. 5, and evaluated individually for specific impairment. The eleven segments of the Company s loan portfolio are as follows (subtotals are provided as needed to allow the reader to reconcile the amounts to the Company s loan classification reported elsewhere in these financial statements):

Loan Segments for Loan Loss Reserve Analysis (dollars in 000 s)		**Loan Balance at December 31,**				
		2004	**2003**	**2002**	**2001**	**2000**
1	Commercial and Business Loans	$ 115,831	$ 107,068	$ 105,513	$ 88,864	$ 55,993
2	Government Program Loans	7,889	9,923	11,780	13,416	10,442
	Total Commercial and Industrial	123,720	116,991	117,293	102,280	66,435
3	Commercial Real Estate Term Loans	62,501	86,142	82,600	83,328	89,504
4	Single Family Residential Loans	21,567	5,240	7,827	13,363	6,147
5	Home Improvement/Home Equity Loans	4,119	4,999	9,990	14,734	17,489
	Total Real Estate Mortgage	88,187	96,381	100,417	111,425	113,140
6	Total Real Estate Construction Loans	137,523	97,930	95,024	92,764	61,038
7	Total Agricultural Loans	23,416	15,162	16,877	12,987	7,240
8	Consumer Loans	12,440	6,134	7,423	6,131	9,814
9	Overdraft protection Lines	664	341	221	341	289
10	Overdrafts	153	142	167	175	188
	Total Installment/other	13,257	6,617	7,811	6,647	10,291
11	Total Lease Financing	12,581	12,581	11,632	10,184	3,225
	Total Loans	$ 398,684	$ 345,662	$ 349,054	$ 336,287	$ 261,369

The Company s methodology for assessing the adequacy of the allowance for credit losses consists of several key elements, which include:

the formula allowance,

specific allowances for problem graded loans (classified loans)

and the unallocated allowance

In addition, the allowance analysis also incorporates the results of measuring impaired loans as provided in:

Statement of Financial Accounting Standards (SFAS) No. 114, Accounting by Creditors for Impairment of a Loan and

SFAS 118, Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures.

The formula allowance is calculated by applying loss factors to outstanding loans and certain unfunded loan commitments. Loss factors are based on the Company s historical loss experience and on the internal risk grade of those loans and, may be adjusted for significant factors that, in management s judgment, affect the collectibility of the portfolio as of the evaluation date. Factors that may affect collectibility of the loan portfolio include:

Levels of, and trends in delinquencies and nonaccrual loans;

Trends in volumes and term of loans;

Effects of any changes in lending policies and procedures including those for underwriting, collection, charge-off, and recovery;

Experience, ability, and depth of lending management and staff;

National and local economic trends and conditions and;

Concentrations of credit that might affect loss experience across one or more components of the portfolio, including high-balance loan concentrations and participations.

Management determines the loss factors for problem-graded loans (substandard, doubtful, and loss), special mention loans, and pass graded loans, based on a loss migration model. The migration analysis incorporates loan losses over the past twelve quarters (three years) and loss factors are adjusted to recognize and quantify the loss exposure from changes in market conditions and trends in the Company s loan portfolio. For purposes of this analysis, loans are grouped by internal risk classifications, which are pass , special mention , substandard , doubtful , and lo Certain loans are homogenous in nature and are therefore pooled by risk grade. These homogenous loans include consumer installment and home equity loans. Special mention loans are currently performing but are potentially weak, as the borrower has begun to exhibit deteriorating trends, which if not corrected, could jeopardize repayment of the loan and result in further downgrade. Substandard loans have well-defined weaknesses which, if not corrected, could jeopardize the full satisfaction of the debt. A loan classified as doubtful has critical weaknesses that make full collection of the obligation improbable. Classified loans, as defined by the Company, include loans categorized as substandard, doubtful, and loss.

Loan participations are reviewed for allowance adequacy under the same guidelines as other loans in the Company s portfolio, with an additional participation factor added, if required, for specific risks associated with participations. In general, participations are subject to certain thresholds set by the Company, and are reviewed for geographic location as well as the well-being of the underlying agent bank.

The formula allowance includes reserves for certain off-balance sheet risks including letters of credit, unfunded loan commitments, and lines of credit. Reserves for undisbursed commitments are generally formula allocations based on the Company s historical loss experience and other loss factors, rather than specific loss contingencies. During 2004, the Company reclassified reserves for off-balance sheet commitments totaling $507,000 as other liabilities pursuant to current accounting guidance. Prior to 2004, the reserves for these off-balance sheet commitments are included in the Company s allowance for credit losses, rather than a separate liability on the balance sheet because the reserve amounts are considered to be immaterial in relation to total liabilities. At December 31, 2004, 2003 and 2002 the formula reserve allocated to undisbursed commitments totaled $507,000, $399,000 and $224,000, respectively.

Specific allowances are established based on management s periodic evaluation of loss exposure inherent in classified loans, impaired loans, and other loans in which management believes there is a probability that a loss has been incurred in excess of the amount determined by the application of the formula allowance. Specific allowance amounts include those calculated under SFAS No. 114. Under SFAS No. 114, specific allowances are determined based on the collateralized value of the underlying properties, the net present value of the anticipated cash flows, or the market value of the underlying assets. Under SFAS No. 5, specific allowances, where required, are determined on the basis of additional risks involved with individual loans that may be in excess of risk factors associated with the loan portfolio as a whole. The specific allowance is different from the formula allowance in that the specific allowance is determined on a loan-by-loan basis based on risk factors directly related to a particular loan, as opposed to the formula allowance which is determined for a pool of loans with similar characteristics, based on past historical trends and other risk factors which may be relevant on an ongoing basis.

The unallocated portion of the allowance is the result of both expected and unanticipated changes in various conditions that are not directly measured in the determination of the formula and specific allowances. The conditions may include, but are not limited to, general economic and business conditions affecting the key lending areas of the Company, credit quality trends, collateral values, loan volumes and concentrations, and other business conditions.

The Company s methodology includes features that are intended to reduce the difference between estimated and actual losses. The specific allowance portion of the analysis is designed to be self-correcting by taking into account the current loan loss experience based on that portion of the portfolio. By analyzing the probable estimated losses inherent in the loan portfolio on a quarterly basis, management is able to adjust specific and inherent loss estimates using the most recent information available. In performing the periodic migration analysis, management believes that historical loss factors used in the computation of the formula allowance need to be adjusted to reflect current changes in market conditions and trends in the Company s loan portfolio. There are a number of other factors, which are reviewed when determining adjustments in the historical loss factors. They include 1) trends in delinquent and nonaccrual loans, 2) trends in loan volume and terms, 3) effects of changes in lending policies, 4) concentrations of credit, 5) competition, 6) national and local economic trends and conditions, 7) experience of lending staff, 8) loan review and Board of Directors oversight, 9) high balance loan concentration, and 10) other business conditions. The ninth factor above for high balance loan concentration was added during 2002, and as a result, the impact to the allowance for credit losses for the inclusion of that factor amounted to approximately $206,000, $183,000, and $132,000 for 2004, 2003, and 2002, respectively. Other than the added factor just mentioned, there were no changes in estimation methods or assumptions during 2003 that affected the methodology for assessing the overall adequacy of the allowance for credit losses.

Management and the Company s lending officers evaluate the loss exposure of classified and impaired loans on a weekly/monthly basis and through discussions and officer meetings as conditions change. The Company s Loan Committee meets weekly and serves as a forum to discuss specific problem assets that pose significant concerns to the Company, and to keep the Board of Directors informed through committee minutes. All special mention and classified loans are reported quarterly on Criticized Asset Reports, which are reviewed by senior management. With this information, the migration analysis and the impaired loan analysis are performed on a quarterly basis and adjustments are made to the allowance as deemed necessary.

The Company considers a loan to be impaired when, based upon current information and events, it believes it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans include nonaccrual loans, restructured debt, and currently performing loans in which full payment of principal or interest is not expected. Management bases the measurement of these impaired loans on the fair value of the loan s collateral or the expected cash flows on the loans discounted at the loan s stated interest rates. Cash receipts on impaired loans not performing to contractual terms and that are on nonaccrual status are used to reduce principal balances. Impairment losses are included in the allowance for credit losses through a charge to the provision, if applicable. Impaired loans are measured based on the present value of the expected future cash flows discounted at the loan s effective interest rate or the fair value of the collateral if the loan is collateral dependent. The amount of impaired loans is not directly comparable to the amount of nonperforming loans disclosed later in this section. The primary differences between impaired loans and nonperforming loans are: i) all loan categories are considered in determining nonperforming loans while impaired loan recognition is limited to commercial and industrial loans, commercial and residential real estate loans, construction loans, and agricultural loans, and ii) impaired loan recognition considers not only loans 90 days or more past due, restructured loans and nonaccrual loans but also may include problem loans other than delinquent loans.

At December 31, 2004 and 2003, the Company s recorded investment in loans for which impairment has been recognized totaled $17.7 million and $18.7 million, respectively. Included in total impaired loans at December 31, 2004, are $12.0 million of impaired loans for which the related specific allowance is $3.2 million, as well as $5.7 million of impaired loans that as a result of write-downs or the fair value of the collateral, did not have a specific allowance. Total impaired loans at December 31, 2003 included $7.3 million of impaired loans for which the related specific allowance is $2.3 million, as well as $11.4 million of impaired loans that as a result of write-downs or the fair value of the collateral, did not have a specific allowance. The average recorded investment in impaired loans was $16.6 million, $18.1 million and $11.3 million during the years ended December 31, 2004, 2003 and 2002, respectively. In most cases, the Company uses the cash basis method of income recognition for impaired loans. In the case of certain troubled debt restructuring for which the loan is performing under the current contractual terms, income is recognized under the accrual method. For the years ended December 31, 2004 and 2003, the Company recognized no income on such loans. For the year ended December 31, 2002, the Company recognized $3,000 of income on such loans.

The Company focuses on competition and other economic conditions within its market area, which may ultimately affect the risk assessment of the portfolio. The Company continues to experience increased competition from major banks, local independents and non-bank institutions creating pressure on loan pricing. With interest rates rising significantly over the last six months, the Federal Reserve perceives economic growth as strong. Both business and consumer spending have improved during the past 18 months, with GDP currently ranging between 3.5%

and 4.0%. It is difficult to determine how long the Federal Reserve will continue to adjust interest rates in an effort to control the economy, however with the 125 basis point increase in the prime rate during the second half of 2004, and an additional 25 basis point increase during February 2005, further increases are anticipated during 2005. It is likely that the business environment in California will continue to be influenced by these domestic as well as global events. The local market has improved economically during the past several years while the rest of the state and the nation has experienced slowed economic

growth. The local area residential housing markets continue to be very strong, which should bode well for sustained growth in the Company s market areas of Fresno and Madera, and Kern Counties. Local unemployment rates remain high primarily as a result of the areas agricultural dynamics, however unemployment rates have improved during first several months of 2005. It is difficult to predict what impact this will have on the local economy. The Company believes that the Central San Joaquin Valley will continue to grow and diversify as property and housing costs remain reasonable relative to other areas of the state, although this growth may begin to slow as the Federal Reserve raises interest rates to control what it perceives as an accelerating economy. Management recognizes increased risk of loss due to the Company s exposure from local and worldwide economic conditions, as well as potentially volatile real estate markets, and takes these factors into consideration when analyzing the adequacy of the allowance for credit losses.

The following table provides a summary of the Company s allowance for credit losses, provisions made to that allowance, and charge-off and recovery activity affecting the allowance for the years indicated.

			December 31,		
(Dollars in thousands)	**2004**	**2003**	**2002**	**2001**	**2000**
Total loans outstanding at end of period before deducting allowances for credit losses	$ 397,584	$ 344,797	$ 348,598	$ 335,620	$ 260,575
Average net loans outstanding during period	$ 374,748	$ 353,562	$ 347,192	$ 297,653	$ 230,305
Balance of allowance at beginning of period	$ 6,081	$ 5,556	$ 4,457	$ 3,773	$ 2,642
Loans charged off:					
Real estate	0	0	0	0	0
Commercial and industrial	(14)	(1,080)	(659)	(874)	(430)
Lease financing	(496)	(161)	(238)	(162)	(0)
Installment and other	(80)	(33)	(36)	(40)	(44)
Total loans charged off	(590)	(1,274)	(933)	(1,076)	(474)
Recoveries of loans previously charged off:					
Real estate	0	0	0	0	0
Commercial and industrial	82	61	37	23	11
Lease financing	29	25	31	4	0
Installment and other	25	0	1	0	14
Total loan recoveries	136	86	69	27	25
Net loans charged off	(454)	(1,188)	(864)	(1,049)	(449)
Reclassification of off-balance sheet reserve	(507)	0	0	0	0
Reserve acquired in business acquisition	986	0	0	0	0
Provision charged to operating expense	1,145	1,713	1,963	1,733	1,580
Balance of allowance for credit losses at end of period	$ 7,251	$ 6,081	$ 5,556	$ 4,457	$ 3,773
Net loan charge-offs to total average loans	0.12%	0.34%	0.25%	0.35%	0.19%
Net loan charge-offs to loans at end of period	0.11%	0.34%	0.25%	0.31%	0.17%
Allowance for credit losses to total loans at end of period	1.82%	1.76%	1.59%	1.33%	1.45%
Net loan charge-offs to allowance for credit losses	6.26%	19.54%	15.55%	23.54%	11.90%

Net loan charge-offs to provision for credit losses	39.65%	69.35%	44.01%	60.53%	28.42%

Management believes that the 1.82% credit loss allowance to total loans at December 31, 2004 is adequate to absorb known and inherent risks in the loan portfolio. No assurance can be given, however, that the economic conditions which may adversely affect the Company s service areas or other circumstances will not be reflected in increased losses in the loan portfolio. Management is not currently aware of any conditions that may adversely affect the levels of losses incurred in the Company s loan portfolio.

Although the Company does not normally allocate the allowance for credit losses to specific loan categories, an allocation to the major categories has been made for the purposes of this report as set forth in the following table. The allocations are estimates based on the same factors as considered by management in determining the amount of additional provisions to the credit loss allowance and the overall adequacy of the allowance for credit losses.

(Dollars in thousands)	2004 Allowance for Loan Losses	2004 % of Loans	2003 Allowance for Loan Losses	2003 % of Loans	2002 Allowance For Loan Losses	2002 % of Loans	2001 Allowance for Loan Losses	2001 % of Loans	2000 Allowance for Loan Losses	2000 % of Loans
Commercial and industrial	$ 2,497	31.0%	$ 1,755	33.9%	$ 3,080	33.6%	$ 1,951	30.4%	$ 1,328	25.4%
Real estate mortgage	386	22.1%	508	27.9%	803	28.9%	899	33.1%	1,141	43.3%
Real estate construction	1,753	34.5%	1,067	28.3%	1,046	27.2%	893	27.6%	606	23.4%
Agricultural	197	5.9%	188	4.4%	229	4.8%	123	3.9%	65	2.8%
Installment/other	103	3.3%	97	1.9%	99	2.2%	102	2.0%	72	3.9%
Lease financing	2,312	3.2%	2,466	3.6%	298	3.3%	120	3.0%	82	1.2%
Not allocated	3		0		1		369		479	
	$ 7,251	100.0%	$ 6,081	100.0%	$ 5,556	100.0%	$ 4,457	100.0%	$ 3,773	100.0%

During 2004, reserve allocations increased for both commercial and industrial loans, as well as real estate construction loans. Increases in reserve allocations for commercial and industrial loans are the result of increases in classified loans in that category, while increases in reserve allocations for real estate construction loans are the result of increases in the overall volume of construction loans.

The increase in reserve allocations for lease financing loans between 2002 and 2003 is the result of the nonperformance of a purchased lease portfolio totaling $5.5 million. This lease portfolio is an impaired credit on non-accrual and has a specific allowance of $2.1 million allocated to it at December 31, 2004. The specific allowance was determined based on an estimate of expected future cash flows. The guarantor of those leases has entered court proceedings to discharge their guarantee based on the fact that many of the underlying leases were fraudulent. The Company, based upon advice from its counsel, does not believe it is probable the guarantors fraud defense will prevail and intends to vigorously pursue the guarantee. The Company believes the specific allowance as determined under SFAS No. 114 is adequate to cover probable losses for this lease portfolio.

During a regulatory examination during the fourth quarter of 2003, the lease portfolio in question was classified as doubtful by the Bank s regulators based upon state regulatory guidelines. California Financial Code Section 1951 requires that a credit where interest is past due and unpaid for more than one year, is not well secured and not in the process of collection be charged off. The regulators requested that the Bank charge-off the principal balance in the first or second quarter of 2004 for regulatory purposes if the judge had not made a ruling on the case by March 31, 2004 or, if a ruling had been made but no principal payments had been received by June 30, 2004 because of the appeals process. The Company believes that under generally accepted accounting principles, a total loss of principal is not probable and the specific allowance of $2.1 million calculated for the impaired lease portfolio under SFAS No. 114 is adequate. At this time it is uncertain how much the Company will collect; however, management believes the Company will collect part, if not all, of the amounts due.

The court has not made a ruling on the lease case at this time. As a result, effective March 31, 2004, the Company charged off the entire $5.5 million principal balance for regulatory purposes. As a result of the regulatory charge-off, the Company has a difference between its regulatory accounting principles (RAP) books and its generally accepted accounting principles (GAAP) books. The financial entries made for regulatory reporting purposes resulted in a $5.5 million reduction in loan balances with a corresponding reduction in the reserve for credit losses. Additional provisions for credit losses of $3.5 million were also required for regulatory accounting purposes, which resulted in a reduction of $2.1 million in regulatory net income (net tax benefit of $1.4 million) for the year ended December 31, 2004 as compared to the financial statement presented under GAAP in this Form 10-K.

Company management was asked to meet on August 30, 2004 with representatives of Kemper Insurance Company (a wholly-owned subsidiary of Lumbermens Mutual Casualty Company) to discuss the possibility of settlement and other matters. Kemper representatives provided information regarding Kemper s run-off plan, financial condition and discussed the concept of settlement. At the conclusion of the meeting, the

Company decided to seek professional assistance in determining more about Kemper s financial condition and the run-off plan through an independent source. Kemper agents indicated they would formulate and submit an offer of settlement in the future. The Company has hired a professional who is currently investigating the matter. The Company has recently received an offer of settlement from Kemper. The Company has made a counter-offer and is awaiting a response from Kemper.

The Company became aware of Kemper s financial condition and run-off plan through Kemper representatives and from other Kemper-produced documents about the run-off plan approved by the Illinois Department of Financial and Professional Regulation-Division of Insurance. The three-year plan is designed to help the Kemper meet its goal of resolving, to the maximum extent possible, all valid policyholder claims. Risks and uncertainties involved in implementing the plan include the needs to achieve significant policy buybacks and contract replacement, to commute reinsurance agreements, to conclude other surplus-enhancing transactions, to hire and retain the staff and resources necessary to implement the plan, to further reduce expenses, and to consummate agreements with regulators and other third parties. No assurance can be given that the plan will be successfully implemented. Kemper initiated a review of all

reserves as of June 30, 2004 and can provide no assurance that additional reserves in excess of the June 30, 2004 surplus will not be required as a result of the planned reserve review.

If Kemper does not successfully implement its plan, current financial trends would render the company unable to meet its current policyholder obligations in the first few months of 2005. It is through initiatives such as a policy buyback effort, under which the company buys back certain commercial line policies in order to reduce its future loss exposure, and aggressive expense control measures that the company intends to successfully implement the plan. The run-off plan Kemper filed with State Regulators projects that the company will create approximately $200 million in surplus through various initiatives and further reduce already substantially downsized expenses by another $30 million. If successful, Kemper is projected to have a nominal amount of surplus and liquidity remaining as of December 31, 2006. In view of the risks and uncertainties involved in implementing the plan, including the need to achieve significant policy buybacks, commutation of reinsurance agreements, and further agreements with regulators, no assurance can be given that the plan will be successfully implemented. The Illinois Department of Insurance will continue to closely monitor Kemper s progress in achieving the objectives of the run-off plan.

The allowance allocation attributable to commercial and industrial loans increased approximately $1.1 million between 2001 and 2002 primarily as the result of a single commercial loan totaling $700,000, which was classified as doubtful at December 31, 2002. The loan was subsequently charged-off during the first quarter of 2003, and a result the allowance allocation for that loan category declined during 2003.

During 2003, the Company revised its methodology for allocating the total allowance for credit losses between the formula allowance and the specific allowance. Prior to 2003, the entire loan portfolio was reviewed under the guidelines set by SFAS No. 5 Accounting for Contingencies . In addition, those loans considered to be impaired were also reviewed under standards required by SFAS No. 114, and specific reserves were calculated under those guidelines. For purposes of allocating the formula allowance and the specific allowance, loans identified as impaired under SFAS No. 114 were allocated a formula reserve as calculated under SFAS No. 5, and an additional specific allowance if required under SFAS No. 114. As a result, a portion of the allowance for impaired loans might be included in the formula allowance as calculated under SFAS No. 5, and the remainder would be designated a specific allowance, so that the entire allowance for impaired loans would be adequate under SFAS No. 114. Effective June 2003, the Company segregated those loans considered impaired under SFAS No. 114 from the loan portfolio and analyzed the remainder of the loan portfolio under SFAS No. 5. Then loans considered impaired under SFAS No. 114 were reviewed separately for specific allowance allocation. As a result, all allowance reserves allocated to impaired loans are now considered specific reserves for purposes of the Company s evaluation of the adequacy of the allowance for credit losses, rather than a combination of formula allowance and specific allowance.

The following summarizes the Company s allowance for credit losses related to the specific, formula, and unallocated reserves for the year-ends shown (amounts shown prior to 2003 have been adjusted to reflect the revised methodology for allocating the total allowance between the formula allowance and the specific allowance as discussed above):

			December 31,		
(Dollars in 000 s)	**2004**	**2003**	**2002**	**2001**	**2000**
Formula allowance	$ 2,827	$ 3,737	$ 4,216	$ 3,973	$ 3,160
Specific allowance	4,421	2,344	1,339	115	134
Unallocated allowance	3	0	1	369	479
Total allowance	$ 7,251	$ 6,081	$ 5,556	$ 4,457	$ 3,773

At December 31, 2004, the Company s allowance for credit losses was $7.3 million, consisting of $2.8 million in formula allowance, $4.4 million in specific allowance, and $3,000 in unallocated allowance. At December 31, 2004, $1.3 million of the specific allowance was allocated to commercial and industrial loans, and the remaining $2.1 million, $955,000 and $55,000 were allocated to lease financing loans, construction loans, and real estate mortgage loans, respectively. At December 31, 2003, the Company s allowance for credit losses was $6.1 million,

consisting of $3.7 million in formula allowance, and $2.3 million in specific allowance. At December 31, 2003, the specific allowance consisted of $49,000 allocated to commercial and industrial loans, and $2.3 million to lease financing loans. At December 31, 2002, the Company s allowance for credit losses was $5.6 million, consisting of $4.2 million in formula allowance, $1.3 million in specific allowance, and $1,000 in unallocated allowance.

The total formula allowance decreased approximately $910,000 between 2003 and 2004, with decreases of $486,000, $269,000, and $177,000 experienced in commercial and industrial loans, construction loans, and real estate mortgage loans, respectively. The decrease in the formula allowance during 2004 was, in part, the result of a decrease of $5.2 million in special mention loans, and a decrease of $1.3 million in substandard loans.

The total formula allowance decreased approximately $479,000 between 2002 and 2003, with decreases of $309,000 and $187,000 experienced in commercial and industrial loans and real estate mortgage loans. During 2003, the Company experienced, a decrease of $5.3 million in substandard loans, an increase of $3.9 million in special mention loans, a decrease of $700,000 in doubtful loans, and a decrease of approximately $2.0 million in pass loans.

The formula allowance increased in all loan categories except mortgage and installment loans during 2002 as the result of increases in loan balances during the year, as well as increases in the level of classified loans. The formula allowance increased by approximately $243,000 between December 31, 2001 and December 31, 2002. The increase in the formula allowance during 2002 was the result of several factors including, an increase of $5.7 million in substandard loans, an increase of $677,000 in doubtful loans, and an increase of approximately $13.6 million in pass loans during 2002. Special mention loans decreased approximately $506,000 between December 31, 2001 and December 31, 2002.

Although in some instances, the downgrading of a loan resulting from the factors used by the Company in its allowance analysis has been reflected in the formula allowance, management believes that in some instances, the impact of material events and trends has not yet been reflected in the level of nonperforming loans or the internal risk grading process regarding these loans. Accordingly, the Company s evaluation of probable losses related to these factors may be reflected in the unallocated allowance. The evaluation of the inherent losses concerning these factors involve a higher degree of uncertainty because they are not identified with specific problem credits, and therefore the Company does not spread the unallocated allowance among segments of the portfolio. At December 31, 2004 the Company had an unallocated allowance of $3,000, reflecting an increase from the balance of $0 and $1,000 at December 31, 2003 and 2002, respectively Management s estimates of the unallocated allowance are based upon a number of underlying factors including 1) the effect of deteriorating national and local economic trends, 2) the effects of export market conditions on certain agricultural and manufacturing borrowers, 3) the effects of abnormal weather patterns on agricultural borrowers, as well as other borrowers that may be impacted by such conditions, 4) the effect of increased competition in the Company s market area and the resultant potential impact of more relaxed underwriting standards to borrowers with multi-bank relationships, 5) the effect of soft real estate markets, and 6) the effects of having a larger number of borrowing relationships which are close to the Company s lending limit, any one if which were not to perform to contractual terms, would have a material impact on the allowance.

The Company s loan portfolio has concentrations in commercial real estate, commercial, and construction loans, however these portfolio percentages fall within the Company s loan policy guidelines.

It is the Company s policy to discontinue the accrual of interest income on loans for which reasonable doubt exists with respect to the timely collectibility of interest or principal due to the inability of the borrower to comply with the terms of the loan agreement. Such loans are placed on nonaccrual status whenever the payment of principal or interest is 90 days past due or earlier when the conditions warrant, and interest collected is thereafter credited to principal to the extent necessary to eliminate doubt as to the collectibility of the net carrying amount of the loan. Management may grant exceptions to this policy if the loans are well secured and in the process of collection.

The following table sets forth the Company s nonperforming assets as of the dates indicated:

	December 31,				
(Dollars in thousands, except footnote)	**2004**	**2003**	**2002**	**2001**	**2000**
Nonaccrual loans (1)	$ 16,682	$ 18,656	$ 15,432	$ 13,019	$ 2,810
Restructured loans	0	9	0	0	0
Total nonperforming loans	16,682	18,665	15,432	13,019	2,810
Other real estate owned	1,615	2,718	9,685	5,390	2,959

Total nonperforming assets	$	18,297	$	21,383	$	25,117	$	18,409	$	5,769
Loans, past due 90 days or more, still accruing	$	375	$	0	$	0	$	0	$	595
Nonperforming loans to total gross loans		4.18%		5.40%		4.42%		3.87%		1.08%
Nonperforming assets to total gross loans		4.59%		6.19%		7.20%		5.47%		2.21%

(1) There are no nonaccrual loans at December 31, 2004 and 2003, which are restructured. Included in nonaccrual loans at December 31, 2002 are restructured loans totaling $21,400. The interest income that would have been earned on nonaccrual loans outstanding at December 31, 2004 in accordance with their original terms is approximately $1.4 million.

The overall level of nonperforming assets has increased since 2000, primarily as the result of a small number of large lending relationships, which have become nonperforming during that period. During 2001, three large relationships totaling approximately $12.0 million were classified as nonaccrual, while approximately $2.9 million in nonaccrual loans were transferred to other real estate owned through foreclosure. During 2002, $5.0 million, representing one of the three large relationships that had become nonaccrual during the previous year, was foreclosed upon and transferred to other real estate owned through foreclosure. In addition during 2002, a nonperforming lease portfolio totaling $5.5 million was taken to nonaccrual status. Aside from the small number of large nonperforming relationships just discussed, the Company does not foresee an overall increase in nonperforming assets as a result of the condition of the loan portfolio, and in fact nonperforming levels have begun to decline during 2004 as Management has increased efforts to resolve nonperforming assets. Continued high levels of nonperforming assets have the potential to impact the future earnings growth of the Company, however Management believes that with declining nonperforming balances combined with prudent lending policies and adequate loan loss reserves, the Company will not experience any significant impact on earnings.

The overall level of nonaccrual loans increased between December 31, 2002 and December 31, 2003 as commercial and commercial real estate delinquencies increased, but then declined during 2004 as efforts increased to workout nonaccrual loans. A substantial portion of the nonaccrual loans at December 31, 2004 are collateralized by real estate. Other real estate owned through foreclosure declined significantly during 2003 as the result of both sales, and transfers of properties for other uses. One property totaling more than $5.0 million was sold during the first quarter of 2003, while two additional properties totaling more than $2.7 million were transferred to bank premises during the second quarter of 2003. One of these transferred properties with a carrying value of $923,000 was subsequently sold during the fourth quarter of 2003. The remaining transferred property will be used in the Company s ongoing operations (see Note 4 to the Company s financial statements). Other real estate owned through foreclosure continued to decline during 2004 as four properties were disposed of.

Loans past due more than 30 days are receiving increased management attention and are monitored for increased risk. The Company continues to move past due loans to nonaccrual status in its ongoing effort to recognize loan problems at an earlier point in time when they may be dealt with more effectively. As impaired loans, nonaccrual and restructured loans are reviewed for specific reserve allocations and the allowance for credit losses is adjusted accordingly.

Except for the loans included in the above table, there were no loans at December 31, 2004 where the known credit problems of a borrower caused the Company to have serious doubts as to the ability of such borrower to comply with the present loan repayment terms and which would result in such loan being included as a nonaccrual, past due or restructured loan at some future date.

Liquidity and Asset/Liability Management

The primary function of asset/liability management is to provide adequate liquidity and maintain an appropriate balance between interest-sensitive assets and interest-sensitive liabilities.

Liquidity

Liquidity management may be described as the ability to maintain sufficient cash flows to fulfill both on- and off-balance sheet financial obligations, including loan funding commitments and customer deposit withdrawals, without straining the Company s equity structure. To maintain an adequate liquidity position, the Company relies on, in addition to cash and cash equivalents, cash inflows from deposits and short-term borrowings, repayments of principal on loans and investments, and interest income received. The Company s principal cash outflows are for loan origination, purchases of investment securities, depositor withdrawals and payment of operating expenses. Other sources of liquidity

not on the balance sheet at December 31, 2004 include unused collateralized and uncollateralized lines of credit from other banks, the Federal Home Loan Bank, and from the Federal Reserve Bank totaling $195.7 million. The Company has maintained significant positive cash flows from operations over the past three years, which amounted to $9.6 million, $12.1 million, and $11.2 million for the years ended December 31, 2004, 2003, and 2002, respectively.

Liquidity risk arises from the possibility the Company may not be able to satisfy current or future financial commitments, or the Company may become unduly reliant on alternative funding sources. The Company maintains a liquidity risk management policy to address and manage this risk. The policy identifies the primary sources of liquidity, establishes procedures for monitoring and measuring liquidity, and establishes minimum liquidity requirements, which comply with regulatory guidance. The liquidity position is continually monitored and reported on a monthly basis to the Board of Directors.

The policy also includes a contingency funding plan to address liquidity needs in the event of an institution-specific or a systemic financial market crisis. In addition to lines of credit from other banks totaling $195.7 million, the contingency plan includes steps that

may be taken in the event the total liquidity ratio falls or is projected to fall below 15% for any extended period of time. The Bank ALCO committee shall take steps to correct this condition using one or more of the following methods as needed:

1) Investments near maturity may be sold to meet temporary funding needs but may need to be replaced to maintain liquidity ratios within acceptable limits.

2) Unsecured Fed Funds lines with correspondents may be used to fund short-term peaks in loan demand or deposit run-off. Other off-balance sheet funding sources such as credit lines at FHLB or the FRB may be used for longer periods.

3) The Bank will not rely on brokered money as a primary source of funds. However, if may be prudent to utilize brokered deposits particularly at times when the interest costs are lower than could be obtained in the local market. However, the sum of all brokered deposits will not exceed 15% of the total deposits of the Bank.

4) The Bank may elect to operate a Telemarketing Money Desk for the purpose of acquiring Certificates of Deposits from both the local market and national market. The Board of Directors and management recognize that deposits acquired through money desk operations may be considered a higher cost and more volatile type of deposit than traditional bank deposits.

5) Selling whole loans or participation in loans or by increasing the amounts sold in existing participation loans are additional means for increasing liquidity.

6) The State of California Treasurer is a reliable source of deposits. The bank can typically accept CD s from this source up to 90% of equity as long as it has sufficient collateral pledged.

7) Marketing for CD s within our marketplace is another means for raising funds or through programs that post our rates on their Website, deposits from these sources should not exceed 15% of the banks total deposits for extended periods beyond 90 days without board approval.

8) Should the Bank become illiquid in spite of these steps, it will curtail its lending activities. The first step in this process will be to curtail credit marketing and tighten pricing guidelines. The second step will be to encourage loan payoffs on a selective basis where circumstances and loan documentation provide this opportunity. Only as a last resort will the Bank totally curtail lending activities to credit worthy customers.

The Company continues to utilize liability management, when needed, as part of its overall asset/liability management strategy. Through the discretionary acquisition of short term borrowings, the Company has been able to provide liquidity to fund asset growth while, at the same time, better utilizing its capital resources, and better controlling interest rate risk. The borrowings are generally short-term and more closely match the repricing characteristics of floating rate loans, which comprise approximately 67.4% of the Company s loan portfolio at December 31, 2004. This does not preclude the Company from selling assets such as investment securities to fund liquidity needs but, with favorable borrowing rates, the Company has maintained a positive yield spread between borrowed liabilities and the assets which those liabilities fund. If, at some time, rate spreads become unfavorable, the Company has the ability to utilize an asset management approach and, either control asset growth or, fund further growth with maturities or sales of investment securities.

The Company s liquid asset base which generally consists of cash and due from banks, federal funds sold, securities purchased under agreements to resell (reverse repos) and investment securities, is maintained at a level deemed sufficient to provide the cash outlay necessary to fund loan growth as well as any customer deposit runoff that may occur. Within this framework is the objective of maximizing the yield on earning assets. This is generally achieved by maintaining a high percentage of earning assets in loans, which historically have represented the Company s highest yielding asset. At December 31, 2004, the Bank had 63.8% of total assets in the loan portfolio and a loan to deposit ratio of 74.0%. Liquid assets at December 31, 2004 include cash and cash equivalents totaling $56.4 million as compared to $48.6 million at December 31, 2003.

Liabilities used to fund liquidity sources include core and non-core deposits as well as short-term borrowings. Core deposits, which comprise approximately 73.7% of total deposits at December 31, 2004, provide a significant and stable funding source for the Company. At December 31, 2004, unused lines of credit with the Federal Home Loan Bank and the Federal Reserve Bank totaling $177.7 million are collateralized in part by certain qualifying loans in the Company s loan portfolio. The carrying value of loans pledged on these unused borrowing lines totaled $201.4 million at December 31, 2004. For further discussion of the Company s borrowing lines, see Short Term Borrowings included in previously in the financial condition section of this financial review.

The liquidity of the parent company, United Security Bancshares, is primarily dependent on the payment of cash dividends by its subsidiary, United Security Bank, subject to limitations imposed by the Financial Code of the State of California. During 2004 and 2003, total dividends paid by the Bank to the parent company totaled $6.5 million and $3.3 million, respectively. As a bank holding company formed under the Bank Holding Act of 1956, United Security Bancshares is to provide a source of financial strength for its subsidiary bank(s). To help provide financial strength, United Security Bancshares trust subsidiary, United Security Bancshares Capital Trust I completed a $15 million offering in Trust Preferred Securities during 2001, the proceeds of which were used to purchase Junior Subordinated Debentures of the Company. Of the $14.5 million in net proceeds received by the Company, $13.7 million in cash was contributed as capital to United Security Bank enhancing the liquidity and capital positions of the Bank, and the remainder provided liquidity to the holding company.

Contractual Obligations, Commitments, Contingent Liabilities, and Off-Balance Sheet Arrangements

The following table presents, as of December 31, 2004, the Company s significant fixed and determinable contractual obligations by payment date. The payment amounts represent those amounts contractually due to the recipient and do not include any unamortized premiums or discounts, or other similar carrying value adjustments. Further discussion of the nature of each obligation is included in the referenced note to the consolidated financial statements.

(In thousands)	Note Reference	Payments Due In: One Year Or Less	One to Three Years	Three to Five Years	Over Five Years	Total
Deposits without a stated maturity	6	$ 336,688	$	$	$	$ 336,688
Time Deposits	6	168,355	29,016	2,004	609	199,984
Junior Subordinated Debt	8				15,464	15,464
Leveraged ESOP line of credit	7	75				75
Operating Leases	12	421	634	434	1,679	3,168

A schedule of significant commitments at December 31, 2004 follows:

(In thousands)	
Commitments to extend credit:	
Commercial and industrial	$ 38,461
Real estate mortgage	754
Real estate construction	126,761
Agricultural	10,863
Installment	2,113
Revolving home equity and credit card lines	681
Standby letters of credit	3,405

Further discussion of these commitments is included in Notes 3 and 12 to the consolidated financial statements.

Regulatory Matters

Capital Adequacy

Capital adequacy for bank holding companies and their subsidiary banks has become increasingly important in recent years. Continued deregulation of the banking industry since the 1980 s has resulted in, among other things, a broadening of business activities allowed beyond that of traditional banking products and services. Because of this volatility within the banking and financial services industry, regulatory agencies have increased their focus upon ensuring that banking institutions meet certain capital requirements as a means of protecting depositors and investors against such volatility.

During July 2001, the Company completed an offering of Trust Preferred Securities in an aggregate amount of $15.0 million to enhance its regulatory base, while providing additional liquidity. Subsequent to the completion of the offering, the Company contributed $13.7 million of that offering to the Bank to enhance its capital position. Under applicable regulatory guidelines, the Trust Preferred Securities qualify as Tier 1 capital up to a maximum of 25% of Tier 1 capital. Any additional portion will qualify as Tier 2

capital. As shareholders equity increases, the amount of Tier 1 capital that can be comprised of Trust Preferred Securities will increase.

The Board of Governors of the Federal Reserve System (Board of Governors) has adopted regulations requiring insured institutions to maintain a minimum leverage ratio of Tier 1 capital (the sum of common stockholders equity, noncumulative perpetual preferred stock and minority interests in consolidated subsidiaries, minus intangible assets, identified losses and investments in certain subsidiaries, plus unrealized losses or minus unrealized gains on available for sale securities) to total assets. Institutions which have received the highest composite regulatory rating and which are not experiencing or anticipating significant growth are required to maintain a minimum leverage capital ratio of 3% Tier 1 capital to total assets. To be considered well capitalized, the institution must maintain a leverage capital ratio of 5%. All other institutions are required to maintain a minimum leverage capital ratio of at least 100 to 200 basis points above the minimum requirements.

The Board of Governors has also adopted a statement of policy, supplementing its leverage capital ratio requirements, which provides definitions of qualifying total capital (consisting of Tier 1 capital and Tier 2 supplementary capital, including the allowance for loan losses up to a maximum of 1.25% of risk-weighted assets) and sets forth minimum risk-based capital ratios of capital to risk-weighted assets. The most highly rated insured institutions are required to maintain a minimum ratio of qualifying total capital to risk weighted assets of 8%, at least one-half (4%) of which must be in the form of Tier 1 capital. To be considered well capitalized, institutions must maintain a ratio of qualifying total capital to risk weighted assets of 10%, at least one-half (6%) of which must be in the form of Tier 1 capital.

The following table sets forth the Company s and the Bank s actual capital positions at December 31, 2004 and the regulatory minimums for the Company and the Bank to be well capitalized under the guidelines discussed above:

	Company Actual Capital Ratios	**Bank Actual Capital Ratios**	**Regulatory Minimums - Well Capitalized**
Total risk-based capital ratio	13.42%	12.96%	10.00%
Tier 1 capital to risk-weighted assets	12.29%	11.82%	6.00%
Leverage ratio	10.52%	10.09%	5.00%

Under Federal Reserve guidelines, the Company and the Bank are required to maintain a total risk-based capital ratio of 10%, tier 1 capital to risk-weighted assets of 8%, and a leverage ratio of 7%, to be considered well capitalized. As is indicated by the above table, the Company and the Bank exceeded all applicable regulatory capital guidelines at December 31, 2004. Management believes that, under the current regulations, both will continue to meet their minimum capital requirements in the foreseeable future.

Dividends

Dividends paid to shareholders by the Company are subject to restrictions set forth in the California General Corporation Law. The California General Corporation Law provides that a corporation may make a distribution to its shareholders if retained earnings immediately prior to the dividend payout are at least equal the amount of the proposed distribution. The primary source of funds with which dividends will be paid to shareholders will come from cash dividends received by the Company from the Bank. During the year ended December 31, 2004, the Company received $6.5 million in cash dividends from the Bank, from which the Company declared $3.6 million in dividends to shareholders.

The Bank as a state-chartered bank is subject to dividend restrictions set forth in California state banking law, and administered by the California Commissioner of Financial Institutions (Commissioner). Under such restrictions, the Bank may not pay cash dividends in an amount which exceeds the lesser of the retained earnings of the Bank or the Bank s net income for the last three fiscal years (less the amount of distributions to shareholders during that period of time). If the above test is not met, cash dividends may only be paid with the prior approval of the Commissioner, in an amount not exceeding the Bank s net income for its last fiscal year or the amount of its net income for the current fiscal year. Such restrictions do not apply to stock dividends, which generally require neither the satisfaction of any tests nor the approval of the Commissioner. Notwithstanding the foregoing, if the Commissioner finds that the shareholders equity is not adequate or that the declarations of a dividend would be unsafe or unsound, the Commissioner may order the state bank not to pay any dividend. The FRB may also limit dividends paid by the Bank. This is not the case with the Bank. Year-to-date dividends of $3.6 million and $6.5 million paid to shareholders and the Company, respectively, through December 31, 2004 were well within the maximum allowed under those regulatory guidelines, without approval of the Commissioner.

Stock Repurchase Plan

	For the Quarters Ended				
	March 31,	June 30,	September 30,	December 31,	YTD
Shares repurchased - 2004	9,900	54,745	22,993	1,782	89,420
Average price paid - 2004	$ 25.70	$ 22.81	$ 22.57	$ 24.22	$ 23.10
Shares repurchased - 2003	16,613	7,348	11,000	0	34,961
Average price paid - 2003	$ 17.08	$ 21.59	$ 22.63	N/A	$ 19.77
Shares repurchased - 2002	22,776	12,300	2,000	27,600	64,676
Average price paid - 2002	$ 16.74	$ 17.01	$ 17.24	$ 17.51	$ 17.13
Shares repurchased - 2001	N/A	N/A	51,534	64,252	115,786
Average price paid - 2001	N/A	N/A	$ 16.13	$ 16.38	$ 16.27

On August 30, 2001 the Company announced that its Board of Directors approved a plan to repurchase, as conditions warrant, up to 280,000 shares of the Company s common stock on the open market or in privately negotiated transactions. The duration of the program was open-ended and the timing of purchases was dependent on market conditions. A total of 215,423 shares had been repurchased under that plan as of December 31, 2003, at a total cost of $3.7 million, and an average per share price of $17.10.

Then, on February 25, 2004 the Company announced another stock repurchase plan under which the Board of Directors approved a plan to repurchase, as conditions warrant, up to 276,500 shares of the Company s common stock on the open market or in privately negotiated transactions. As with the first plan, the duration of the new program is open-ended and the timing of purchases will depend on market conditions.

Concurrent with the approval of the new repurchase plan, the Board terminated the 2001 repurchase plan and canceled the remaining 64,577 shares yet to be purchased under the earlier plan.

Reserve Balances

The Bank is required to maintain average reserve balances with the Federal Reserve Bank. At December 31, 2004 the Bank s qualifying balance with the Federal Reserve was approximately $11.1 million, consisting of vault cash and balances.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Sensitivity and Market Risk

An interest rate-sensitive asset or liability is one that, within a defined time period, either matures or is subject to interest rate adjustments as market rates of interest change. Interest rate sensitivity is the measure of the volatility of earnings from movements in market rates of interest, which is generally reflected in interest rate spread. As interest rates change in the market place, yields earned on assets do not necessarily move in tandem with interest rates paid on liabilities. Interest rate sensitivity is related to liquidity in that each is affected by maturing assets and sources of funds. Interest rate sensitivity is also affected by assets and liabilities with interest rates that are subject to change prior to maturity.

The object of interest rate sensitivity management is to minimize the impact on earnings from interest rate changes in the marketplace. In recent years, deregulation, causing liabilities to become more interest rate sensitive, combined with interest rate volatility in the capital markets, has placed additional emphasis on this principal. When management decides to maintain repricing imbalances, it usually does so on the basis of a well- conceived strategy designed to ensure that the risk is not excessive and that liquidity is properly maintained. The Company s interest rate risk management is the responsibility of the Asset/Liability Management Committee (ALCO), which reports to the Board of Directors on a periodic basis, pursuant to established operating policies and procedures.

As part of its overall risk management, the Company pursues various asset and liability management strategies, which may include obtaining derivative financial instruments to mitigate the impact of interest fluctuations on the Company s net interest margin. During the second quarter of 2003, the Company entered into an interest rate swap agreement with the purpose of minimizing interest rate fluctuations on its interest rate margin and equity.

Under the interest rate swap agreement, the Company receives a fixed rate and pays a variable rate based on the Prime Rate (Prime). The swap qualifies as a cash flow hedge under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , as

amended, and is designated as a hedge of the variability of cash flows the Company receives from certain variable-rate loans indexed to Prime. In accordance with SFAS No. 133, the swap agreement is measured at fair value and reported as an asset or liability on the consolidated balance sheet. The portion of the change in the fair value of the swap that is deemed effective in hedging the cash flows of the designated assets are recorded in accumulated other comprehensive income and reclassified into interest income when such cash flow occurs in the future. Any ineffectiveness resulting from the hedge is recorded as a gain or loss in the consolidated statement of income as part of noninterest income. The amortizing hedge has a remaining notional value of $20.1 million and duration of approximately 3.0 years. As of December 31, 2004, the maximum length of time over which the Company is hedging its exposure to the variability of future cash flows is approximately three and one-half years. As of December 31, 2004, the loss amounts in accumulated other comprehensive income associated with these cash flows totaled $626,000 (net of tax benefit of $252,000). During the year ended December 31, 2004, $125,000 was reclassified from other accumulated comprehensive income into earnings.

Interest rate risk can be measured through various methods including gap, duration and market value analysis as well as income simulation models, which provides a dynamic view of interest rate sensitivity based on the assumptions of the Company s Management. The Company employs each of these methods and refines these processes to make the most accurate measurements possible. The information provided by these calculations is the basis for management decisions in managing interest rate risk.

From the Gap report below, the Company is apparently subject to interest rate risk to the extent that its liabilities have the potential to reprice more quickly than its assets within the next year. At December 31, 2004, the Company had a cumulative 12-month Gap of -$29.4 million or 5.6% of total earning assets. Management believes the Gap analysis shown below is not entirely indicative of the Company s actual interest rate sensitivity, because certain interest-sensitive liabilities would not reprice to the same degree as interest-sensitive assets. For example, if the prime rate were to change by 50 basis points, the floating rate loans included in the $247.2 million immediately adjustable category would change by the full 50 basis points. Interest bearing checking and savings accounts which are also included in the immediately adjustable column probably would move only a portion of the 50 basis point rate change and, in fact, might not even move at all. In addition, many of the floating rate time deposits are at their floors, or have repricing rates below their current floors, which means that they might act as fixed-rate instruments in either a rising or a declining rate environment (although there are only about $4.2 million of these floating-rate time deposits at December 31, 2004). The effects of market value risk have been mitigated to some degree by the makeup of the Bank s balance sheet. Loans are generally short-term or are floating-rate instruments. At December 31, 2004, $310.7 million or 81.3% of the loan portfolio matures or reprices within one year, and only 1.8% of the portfolio matures or reprices in more than 5 years.

Total investment securities including call options and prepayment assumptions, have a combined duration of approximately 2.4 years. Nearly $392.0 million or 92.8% of interest-bearing liabilities mature or can be repriced within the next 12 months, even though the rate elasticity of deposits with no defined maturities may not necessarily be the same as interest-earning assets.

The following table sets forth the Company s gap, or estimated interest rate sensitivity profile based on ending balances as of December 31, 2004, representing the interval of time before earning assets and interest-bearing liabilities may respond to changes in market rates of interest. Assets and liabilities are categorized by remaining interest rate maturities rather than by principal maturities of obligations.

Maturities and Interest Rate Sensitivity

	December 31, 2004					
(In thousands)	**Immediately**	**Next Day But Within Three Months**	**After Three Months Within 12 Months**	**After One Year But Within Five Years**	**After Five Years**	**Total**

Interest Rate Sensitivity Gap:						
Loans (1)	$ 247,207	$ 26,349	$ 37,134	$ 64,538	$ 6,774	$ 382,002
Investment securities		17,863	7,849	55,026	31,512	112,250
Interest bearing deposits in other banks			198	5,391	1,840	7,429
Federal funds sold and reverse repos	26,040					26,040
Total earning assets	$ 273,247	$ 44,212	$ 45,181	$ 124,955	$ 40,126	$ 527,721
Interest-bearing transaction accounts	173,943					173,943
Savings accounts	32,775					32,775
Time deposits (2)	4,201	60,052	105,516	29,606	609	199,984
Federal funds purchased/other borrowings	75					75
Trust Preferred securities		15,464				15,464
Total interest-bearing liabilities	$ 210,994	$ 75,516	$ 105,516	$ 29,606	$ 609	$ 422,241
Interest rate sensitivity gap	$ 62,253	$ (31,304)	$ (60,335)	$ 95,349	$ 39,517	$ 105,480
Cumulative gap	$ 62,253	$ 30,949	$ (29,386)	$ 65,963	$ 105,480	
Cumulative gap percentage to Total earning assets	11.8%	5.9%	-5.6%	12.5%	20.0%	

(1) Loan balance does not include nonaccrual loans of $16.682 million.

(2) See above for discussion of the impact of floating rate CD s.

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The Company utilizes a vendor-purchased simulation model to analyze net interest income sensitivity to movements in interest rates. The simulation model projects net interest income based on both a 100 and 200 basis point rise and a 100 and 200 basis point fall in interest rates ramped over a twelve-month period, with net interest impacts projected out as far as twenty-four months. The model is based on the actual maturity and repricing characteristics of the Company s interest-sensitive assets and liabilities. The model incorporates assumptions regarding the impact of changing interest rates on the prepayment of certain assets and liabilities. Projected net interest income is calculated assuming customers will reinvest maturing deposit accounts and the Company will originate new loans. The balance sheet growth assumptions utilized correspond closely to the Company s strategic growth plans and annual budget. Excess cash is invested in overnight funds or other short-term investments such as U.S. Treasuries. Cash shortfalls are covered through additional borrowing of overnight or short-term funds. The Board of Directors has adopted an interest rate risk policy which establishes maximum decreases in net interest income of 12% and 15% in the event of a 100 BP and 200 BP increase or decrease in market interest rates over a twelve month period. Based on the information and assumptions utilized in the simulation model at December 31, 2004, the resultant projected impact on net interest income falls within policy limits set by the Board of Directors for all rate scenarios simulated.

The Company also utilizes the same vendor-purchased simulation model to project the impact of changes in interest rates on the underlying market value of all the Company s assets, liabilities, and off-balance sheet accounts under alternative interest rate scenarios. The resultant net value, as impacted under each projected interest rate scenario, is referred to as the market value of equity (MV of Equity). This technique captures the interest rate risk of the Company s business mix across all maturities. The market analysis is performed using an immediate rate shock of 200 basis points up and down calculating the present value of expected cash flows under each rate environment at applicable discount rates. The market value of loans is calculated by discounting the expected future cash flows over either the term to maturity for fixed rate loans or scheduled repricing for floating rate loans using the current rate at which similar loans would be made to borrowers with similar credit ratings. The market value of investment securities is based on quoted market prices obtained from reliable independent brokers. The market value of time deposits is calculated by discounting the expected cash flows using current rates for similar instruments of comparable maturities. The market value of deposits with no defined maturities, including interest-bearing checking, money market and savings accounts is calculated by discounting the expected cash flows at a rate equal to the difference between the cost of these deposits and the alternate use of the funds, federal funds in this case. Assumed maturities for these deposits are estimated using decay analysis and are generally assumed to have implied maturities of less than five years. For noninterest sensitive assets and liabilities, the market value is equal to their carrying value amounts at the reporting date. The Company s interest rate risk policy establishes maximum decreases in the Company s market value of equity of 12% and 15% in the event of an immediate and sustained 100 BP and 200 BP increase or decrease in market interest rates. As shown in the table below, the percentage changes in the net market value of the Company s equity are within policy limits for both rising and falling rate scenarios.

The following sets forth the analysis of the Company s market value risk inherent in its interest-sensitive financial instruments as they relate to the entire balance sheet at December 31, 2004 and December 31, 2003 ($ in thousands). Fair value estimates are subjective in nature and involve uncertainties and significant judgment and, therefore, cannot be determined with absolute precision. Assumptions have been made as to the appropriate discount rates, prepayment speeds, expected cash flows and other variables. Changes in these assumptions significantly affect the estimates and as such, the obtained fair value may not be indicative of the value negotiated in the actual sale or liquidation of such financial instruments, nor comparable to that reported by other financial institutions. In addition, fair value estimates are based on existing financial instruments without attempting to estimate future business.

	December 31, 2004			December 31, 2003		
Change in Rates	**Estimated MV of Equity**	**Change in MV of Equity $**	**Change in MV Of Equity %**	**Estimated MV of Equity**	**Change in MV of Equity $**	**Change in MV Of Equity %**
+ 200 BP	$ 59,707	$ (1,405)	-2.30%	$ 45,919	$ (2,301)	-4.77%
+ 100 BP	60,775	(337)	-0.55%	47,563	(657)	-1.36%
0 BP	61,112	0	0.00%	48,220	0	0.00%
- 100 BP	60,216	(896)	-1.47%	48,430	210	0.43%
- 200 BP	58,338	(2,774)	-4.54%	52,694	4,474	9.28%

Item 8 - Financial Statements and Supplementary Data

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Years Ended December 31, 2004, 2003 and 2002

Notes to Consolidated Financial Statements

Moss Adams LLP

Certified Public Accountants

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To The Board of Directors and Shareholders

United Security Bancshares

We have audited the accompanying consolidated balance sheets of United Security Bancshares and Subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of income and comprehensive income, shareholders equity, and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of United Security Bancshares and Subsidiaries at December 31, 2004 and 2003, and the consolidated results of their operations and their consolidated cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

/s/ Moss Adams LLP

Stockton, California
February 28, 2005

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United Security Bancshares and Subsidiaries

Consolidated Statements of Condition - Balance Sheets

December 31, 2004 and 2003

(in thousands except shares)	December 31, 2004	December 31, 2003
Assets		
Cash and due from banks	$ 30,366	$ 22,480
Federal funds sold and securities purchased under agreements to resell	26,040	26,110
Cash and cash equivalents	56,406	48,590
Interest-bearing deposits in other banks	7,429	7,212
Investment securities available for sale	112,250	83,735
Loans and leases	398,684	345,662
Unearned fees	(1,099)	(865)
Allowance for credit losses	(7,251)	(6,081)
Net loans	390,334	338,716
Accrued interest receivable	2,523	2,110
Premises and equipment - net	8,102	4,567
Other real estate owned	1,615	2,718
Intangible assets	3,338	1,947
Goodwill	750	0
Cash surrender value of life insurance	12,571	2,621
Investment in limited partnership	4,295	4,689
Deferred income taxes	4,547	3,135
Other assets	7,536	6,548
Total assets	$ 611,696	$ 506,588
Liabilities & Shareholders Equity		
Liabilities		
Deposits		
Noninterest bearing	$ 129,970	$ 94,597
Interest bearing	406,702	345,847
Total deposits	536,672	440,444
Other borrowings	75	345
Accrued interest payable	1,166	800
Accounts payable and other liabilities	5,083	4,963
Trust Preferred securities	0	15,000
Junior subordinated debt	15,464	0
Total liabilities	558,460	461,552
Commitments and Contingent Liabilities		
Shareholders Equity		
Common stock, no par value 10,000,000 shares authorized, 5,683,794 and 5,512,538 issued and outstanding, in 2004 and 2003, respectively	22,322	18,227
Retained earnings	31,879	27,093
Unearned ESOP shares	(67)	(313)
Accumulated other comprehensive (loss) income	(898)	29
Total shareholders equity	53,236	45,036
Total liabilities and shareholders equity	$ 611,696	$ 506,588

See notes to financial statements

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United Security Bancshares and Sudsidiaries

Consolidated Statements of Income and Comprehensive Income

Years Ended December 31, 2004, 2003 and 2002

(in thousands except shares and EPS)	2004	2003	2002
Interest Income			
Loans, including fees	$ 26,558	$ 23,134	$ 24,521
Investment securities - AFS taxable	3,442	3,169	3,617
Investment securities - AFS nontaxable	123	132	139
Federal funds sold and securities purchased under agreements to resell	315	147	301
Interest on deposits in other banks	310	345	138
Total interest income	30,748	26,927	28,716
Interest Expense			
Interest on deposits	5,588	5,936	9,190
Interest on other borrowed funds	845	1,324	2,326
Total interest expense	6,433	7,260	11,516
Net Interest Income Before Provision for Credit Losses	24,315	19,667	17,200
Provision for Credit Losses	1,145	1,713	1,963
Net Interest Income	23,170	17,954	15,237
Noninterest Income			
Customer service fees	4,438	3,789	3,895
Gain (loss) on sale of securities	35	(58)	485
Gain on sale of loans	0	21	103
(Loss) gain on sale of other real estate owned	(98)	80	4
Gain on sale of interest-bearing deposits in other banks	0	186	0
Shared appreciation income	8	1,813	267
Other	485	440	614
Total noninterest income	4,868	6,271	5,368
Noninterest Expense			
Salaries and employee benefits	6,663	5,089	4,895
Occupancy expense	2,197	1,658	1,730
Data processing	659	515	553
Professional fees	1,209	991	965
Director fees	192	184	201
Amortization of intangibles	470	353	360
Correspondent bank service charges	318	281	289
Writedown on OREO	35	403	132
Loss on tax credit partnership	395	276	210
Other	2,529	2,105	1,525
Total noninterest expense	14,667	11,855	10,860
Income Before Provision for Taxes on Income	13,371	12,370	9,745
Provision for Taxes on Income	4,966	4,664	2,912
Net Income	$ 8,405	$ 7,706	$ 6,833
Other comprehensive income, net of tax			
Unrealized (loss) gain on available for sale securities and interest rate swaps - net income tax expense (benefit) of $(535), $(593), and $620	(928)	(1,012)	931
Comprehensive Income	$ 7,477	$ 6,694	$ 7,764
Net Income per common share			
Basic	$ 1.49	$ 1.41	$ 1.27
Diluted	$ 1.48	$ 1.40	$ 1.25
Weighted shares on which net income per common share were based			
Basic	5,630,256	5,459,926	5,400,751
Diluted	5,667,243	5,511,670	5,487,038

See notes to financial statements

United Security Bancshares and Subsidiaries

Consolidated Statements of Changes in Shareholders Equity

Periods Ended December 31, 2004

(in thousands except shares)	Common stock Number of Shares	Common stock Amount	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income (Loss)	Total
Balance January 1, 2002	5,397,298	$ 18,239	$ 18,582	$ (873)	$ 111	$ 36,059
Director/Employee stock options exercised	58,800	416				416
Tax benefit of stock options exercised		7				7
Net changes in unrealized gain on available for sale securities (net of income tax benefit of $620)					930	930
Dividends on common stock ($0.52 per share)			(2,839)			(2,839)
Repurchase and cancellation of common shares	(64,676)	(1,107)				(1,107)
Release of unearned ESOP shares	15,244	(2)		264		262
Net Income			6,833			6,833
Balance December 31, 2002	5,406,666	17,553	22,576	(609)	1,041	40,561
Director/Employee stock options exercised	123,800	1,293				1,293
Tax benefit of stock options exercised		63				63
Net changes in unrealized gain on available for sale securities (net of income tax benefit of $392)					(588)	(588)
Net changes in unrealized loss on interest rate swaps (net of income tax benefit of $201)					(424)	(424)
Dividends on common stock ($0.58 per share)			(3,189)			(3,189)
Repurchase and cancellation of common shares	(34,961)	(691)				(691)
Release of unearned ESOP shares	17,033	9		296		305
Net Income			7,706			7,706
Balance December 31, 2003	5,512,538	18,227	27,093	(313)	29	45,036
Director/Employee stock options exercised	5,000	86				86
Tax benefit of stock options exercised		11				11
Net changes in unrealized gain on available for sale securities (net of income tax benefit of					(726)	(726)

$484)						
Net changes in unrealized loss on interest rate swaps (net of income tax benefit of $51)					(201)	(201)
Dividends on common stock ($0.64 per share)			(3,619)			(3,619)
Issuance of shares for business combination	241,447	6,033				6,033
Repurchase and cancellation of common shares	(89,420)	(2,058)				(2,058)
Release of unearned ESOP shares	14,229	23		246		269
Net Income			8,405			8,405
Balance December 31, 2004	5,683,794	$ 22,322	$ 31,879	$ (67)	$ (898)	$ 53,236

See notes to financial statements

United Security Bancshares and Subsidiaires

Consolidated Statements of Cash Flows

Periods Ended December 31, 2004, 2003 and 2002

(in thousands)	2004	2003	2002
Cash Flows From Operating Activities:			
Net income	$ 8,405	$ 7,706	$ 6,833
Adjustments to reconcile net earnings to cash provided by operating activities:			
Provision for credit losses	1,145	1,713	1,963
Depreciation and amortization	1,297	980	1,199
Amortization of investment securities	37	265	369
Loss (gain) on sale of securities	(35)	58	(485)
(Increase) decrease in accrued interest receivable	(185)	327	1,314
Increase (decrease) in accrued interest payable	358	(403)	(67)
Increase (decrease) in unearned fees	327	409	(211)
(Decrease) increase in income taxes payable	(1,647)	1,489	197
Deferred income taxes	(877)	(904)	(527)
Decrease (increase) in accounts payable and accrued liabilities	149	(119)	704
Write-down of other investments	0	0	40
Write-down of other real estate owned	35	403	132
Loss (gain) on sale of other real estate owned	98	(80)	(4)
Gain on sale of loans	0	(21)	(103)
Gain on sale of interest-bearing deposits with banks	0	(186)	0
(Loss) gain on sale of assets	(7)	14	(10)
Increase in surrender value of life insurance	(252)	(103)	(107)
Loss in limited partnership interest	395	276	210
Net decrease (increase) in other assets	357	293	(198)
Net cash provided by operating activities	9,600	12,117	11,249
Cash Flows From Investing Activities:			
Net decrease (increase) in interest-bearing deposits with banks	975	2,237	(9,449)
Purchases of available-for-sale securities	(55,552)	(68,763)	(107,172)
Net (purchase) redemption of FHLB/FRB and other bank stock	(1,038)	1,026	(718)
Maturities, calls, and principal payments on available-for-sale securities	24,126	55,292	51,563
Maturities, calls, and principal payments on held-to-maturity securities	0	0	(1)
Proceeds from sales of available-for-sale securities	10,923	33,000	16,074
Investment in limited partnership	0	(2,381)	23
Premiums paid on life insurance	(9,000)	0	0
Net increase in loans	(28,238)	(532)	(20,465)
Cash proceeds from sales of loans	0	5,529	1,602
Cash and equivalents received in bank acquisitions	15,383	0	0
Cash proceeds from sales of foreclosed leased assets	192	643	95
Cash proceeds from sales of other real estate owned	970	391	325
Capital expenditures for premises and equipment	(2,779)	(744)	(431)
Cash proceeds from sales of premises and equipment	26	1,034	15
Net cash (used in) provided by investing activities	(44,012)	26,732	(68,539)
Cash Flows From Financing Activities:			
Net increase in demand deposit and savings accounts	54,736	28,326	34,724
Net (decrease) increase in certificates of deposit	(6,757)	(11,869)	20,611
Net (decrease) increase in repurchase agreements	0	(35,400)	7,900
Director/Employee stock options exercised	86	1,293	416
Repurchase and retirement of common stock	(2,058)	(691)	(1,107)
Repayment of ESOP borrowings	(269)	(305)	(269)

Payment of dividends on common stock	(3,510)	(3,098)	(2,755)
Net cash provided by (used in) financing activities	42,228	(21,744)	59,520
Net increase in cash and cash equivalents	7,816	17,105	2,230
Cash and cash equivalents at beginning of period	48,590	31,485	29,255
Cash and cash equivalents at end of period	$ 56,406	$ 48,590	$ 31,485

See notes to financial statements

Notes to Consolidated Financial Statements

Years Ended December 31, 2004, 2003, and 2002

1. Organization and Summary of Significant Accounting and Reporting Policies

Basis of Presentation The consolidated financial statements include the accounts of United Security Bancshares, and its wholly owned subsidiaries, United Security Bank and subsidiary (the Bank), as well as United Security Bancshares Capital Trust I (the Trust) which was deconsolidated in 2004 pursuant to FIN46, (collectively the Company or USB). Intercompany accounts and transactions have been eliminated in consolidation. In the following notes, references to the Bank are references to United Security Bank. References to the Company are references to United Security Bancshares, (including the Bank), except for periods prior to June 12, 2001, in which case, references to the Company are references to the Bank. United Security Bancshares operates as one business segment providing banking services to commercial establishments and individuals primarily in the San Joaquin Valley of California.

Nature of Operations United Security Bancshares is a bank holding company, incorporated in the state of California for the purpose of acquiring all the capital stock of the Bank through a holding company reorganization (the Reorganization) of the Bank. The Reorganization, which was accounted for in a manner similar to a pooling of interests, was completed on June 12, 2001. Management believes the Reorganization has provided the Company greater operating and financial flexibility and has permitted expansion into a broader range of financial services and other business activities.

United Security Bancshares Capital Trust I, a subsidiary of United Security Bancshares, is a Delaware statutory business trust formed for the exclusive purpose of issuing and selling Trust Preferred Securities. The Trust was formed on June 28, 2001 (See Note 8. Trust Preferred Securities and Junior Subordinated Debt).

USB Investment Trust Inc was incorporated effective December 31, 2001as a special purpose real estate investment trust (REIT) under Maryland law. The REIT is a subsidiary of the Bank and was funded with $133.0 million in real estate-secured loans contributed by the Bank. USB Investment Trust was originally formed to give the Bank flexibility in raising capital, and reduce the expenses associated with holding the assets contributed to USB Investment Trust (See Note 9. Income Taxes).

The Bank was founded in 1987 and currently operates ten branches and one construction lending office in an area from eastern Madera County to western Fresno County, as well as Taft and Bakersfield in Kern County. The Bank s primary source of revenue is providing loans to customers, who are predominantly small and middle-market businesses and individuals. The Bank engages in a full compliment of lending activities, including real estate mortgage, commercial and industrial, real estate construction, agricultural and consumer loans, with particular emphasis on short and medium term obligations.

The Bank offers a wide range of deposit instruments. These include personal and business checking accounts and savings accounts, interest-bearing negotiable order of withdrawal (NOW) accounts, money market accounts and time certificates of deposit. Most of the Bank s deposits are attracted from individuals and from small and medium-sized business-related sources.

The Bank also offers a wide range of specialized services designed to attract and service the needs of commercial customers and account holders. These services include cashiers checks, travelers checks, money orders, and foreign drafts. In addition, the Bank recently began to offer Internet banking services to its commercial and retail customers. The Bank does not operate a trust department, however it makes arrangements with its correspondent bank to offer trust services to its customers upon request.

Neither the Company s business or liquidity is seasonal, and there has been no material effect upon the Company s capital expenditures, earnings or competitive position as a result of federal, state or local environmental regulation.

Use of Estimates in the Preparation of Financial Statements - The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change, relate to the determination of the allowance for loan losses, determination of fair market values, and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowance for loan losses and the valuation of foreclosed assets held for sale, management obtains independent appraisals for significant properties.

Significant Accounting Policies - The accounting and reporting policies of the Company conform to generally accepted accounting principles and to prevailing practices within the banking industry. The following is a summary of significant policies:

a. *Cash and cash equivalents* Cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and repurchase agreements. At times throughout the year, balances can exceed FDIC insurance limits. Generally, federal funds sold and repurchase agreements are sold for one-day periods. Repurchase agreements are with a registered broker-dealer affiliated with a correspondent bank and work much like federal funds sold, except that the transaction is collateralized by various investment securities. The securities collateralizing such transactions generally consist of U.S. Treasuries, U.S. Government and U.S. Government-sponsored agencies. The Bank did not have any repurchase agreements during 2004, nor at December 31, 2003 or December 31, 2002. All cash and cash equivalents have maturities of three months or less.

b. *Securities* - Debt and equity securities classified as available for sale are reported at fair value, with unrealized gains and losses excluded from net income and reported, net of tax, as a separate component of comprehensive income and shareholders equity. Debt securities classified as held to maturity are carried at amortized cost. Gains and losses on disposition are reported using the identified certificate method for the adjusted basis of the securities sold.

The Company classifies its securities as available for sale or held to maturity, and periodically reviews its investment portfolio on an individual security basis. Securities that are to be held for indefinite periods of time (including, but not limited to, those that management intends to use as part of its asset/liability management strategy, those which may be sold in response to changes in interest rates, changes in prepayments or any such other factors) are classified as securities available for sale. Securities which the Company has the ability and intent to hold to maturity are classified as held to maturity.

Declines in fair value of individual held-to-maturity and available-for-sale securities below their cost that are other than temporary are recognized by write-downs of the individual securities to their fair value. Such write-downs would be included in earnings as realized losses. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

Investments with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed interest rate investments, from rising interest rates. At each financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other-than-temporary based upon the positive and negative evidence available. Evidence evaluated includes, but is not limited to, industry analyst reports, credit market conditions, and interest rate trends. If negative evidence outweighs positive evidence that the carrying amount is recoverable within a reasonable period of time, the impairment is deemed to be other-than-temporary and the security is written down in the period in which such determination is made.

c. *Loans* - Interest income on loans is credited to income as earned and is calculated by using the simple interest method on the daily balance of the principal amounts outstanding. Loans are placed on non-accrual status when principal or interest is past due for 90 days and/or when management believes the collection of amounts due is doubtful. For loans placed on nonaccrual status, the accrued and unpaid interest receivable may be reversed at management s discretion based upon management s assessment of collectibility, and interest is thereafter credited to principal to the extent necessary to eliminate doubt as to the collectibility of the net carrying amount of the loan.

Nonrefundable fees and related direct costs associated with the origination or purchase of loans are deferred and netted against outstanding loan balances. The net deferred fees and costs are generally amortized into interest income over the loan term using a method, which approximates the interest method. Other credit-related fees, such as standby letter of credit fees, loan placement fees and annual credit card fees are recognized as noninterest income during the period the related service is performed.

Impaired loans are measured based on the present value of expected future cash flows discounted at the loan s effective interest rate or as a practical expedient at the loan s observable market rate or the fair value of the collateral if the loan is collateral dependent.

d. *Allowance for Credit Losses* - The allowance for credit losses is maintained to provide for losses that can reasonably be anticipated. The allowance is based on ongoing quarterly assessments of the probable losses inherent in the loan portfolio, and to a lesser extent, unfunded loan commitments.

The allowance for credit losses is increased by provisions charged to operations during the current period and reduced by loan charge-offs net of recoveries. Loans are charged against the allowance when management believes that the collection of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing loans, based on evaluations of the probability of collection. In evaluating the probability of collection, management is required to make estimates and assumptions that affect the reported amounts of loans, allowance for credit losses and the provision for credit losses charged to operations. Actual results could differ significantly from those estimates. These evaluations take into consideration such factors as the composition of the portfolio, overall portfolio quality, loan concentrations, specific problem loans, and current economic conditions that may affect the borrowers ability to pay. The Company s methodology for assessing the adequacy of the allowance for credit losses consists of several key elements, which include the formula allowance, specific allowances, and the unallocated allowance.

The formula allowance is calculated by applying loss factors to outstanding loans and certain unfunded loan commitments. Loss factors are based on the Company s historical loss experience and may be adjusted for significant factors that, in management s judgment, affect the collectibility of the portfolio as of the evaluation date. The Company determines the loss factors for problem-graded loans (substandard, doubtful, and loss), special mention loans, and pass graded loans, based on a loss migration model. The migration analysis incorporates the Company s losses over the past twelve quarters (three years) and loss factors are adjusted to recognize and quantify the loss exposure from changes in market conditions and trends in the loan portfolio. For purposes of this analysis, loans are grouped by internal risk classifications, which are pass , special mention , substandard , doubtful , and loss . Certain loans are homogenous in nature and are therefore pooled by risk gr These homogenous loans include consumer installment and home equity loans. Special mention loans are currently performing but are potentially weak, as the borrower has begun to exhibit deteriorating trends, which if not corrected, could jeopardize repayment of the loan and result in further downgrade. Substandard loans have well-defined weaknesses which, if not corrected, could jeopardize the full satisfaction of the debt. A loan classified as doubtful has critical weaknesses that make full collection of the obligation improbable. Classified loans, as defined by the Company, include loans categorized as substandard, doubtful, and loss.

Specific allowances are established based on management s periodic evaluation of loss exposure inherent in classified loans, impaired loans, and other loans in which management believes there is a probability that a loss has been incurred in excess of the amount determined by the application of the formula allowance.

The unallocated portion of the allowance is based upon management s evaluation of various conditions that are not directly measured in the determination of the formula and specific allowances. The conditions may include, but are not limited to, general economic and business conditions affecting the key lending areas of the Company, credit quality trends, collateral values, loan volumes and concentration, and other business conditions.

The allowance analysis also incorporates the results of measuring impaired loans as provided in Statement of Financial Accounting Standards (SFAS) No. 114, Accounting by Creditors for Impairment of a Loan and SFAS 118, Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures . A loan is considered impaired when management determines that it is probable that the Company will be unable to collect all amounts due according to the original contractual terms of the loan agreement. Impairment is measured by the difference between the original recorded investment in the loan and the estimated present value of the total expected cash flows, discounted at the loan s effective rate, or the fair value of the collateral, if the loan is collateral dependent. Any differences in the specific allowance amounts calculated in the impaired loan analysis and the migration analysis are reconciled by management and changes are made to the allowance as deemed necessary.

e. *Loans held-for-sale* - Loans originated and designated as held-for-sale are carried at the lower of cost or estimated fair value, as determined by quoted market prices, in aggregate. Net unrealized losses are recognized in a valuation allowance by charges to income. Gains or losses on the sale of such loans are based on the specific identification method. The Company held no loans for sale at December 31, 2004 or 2003.

f. *Premises and Equipment* - Premises and equipment are carried at cost less accumulated depreciation. Depreciation expense is computed principally on the straight-line method over the estimated useful lives of the assets. Estimated useful lives are as follows:

Buildings	31 Years	Furniture and equipment	3-7 Years

g. *Other Real Estate Owned* - Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at the lower of the book value of the loan, or fair value of the property, less estimated costs to sell. The excess, if any,

of the loan amount over the fair value is charged to the allowance for credit losses. Subsequent declines in the fair value of other real estate owned, along with related revenue and expenses from operations, are charged to noninterest expense.

h. *Intangible Assets and Goodwill* - Intangible assets are comprised of core deposit intangibles, residual identifiable intangibles (previously called goodwill), and goodwill acquired in branch acquisitions in which the fair value of the liabilities assumed exceeded the fair value of the assets acquired. Core deposit intangibles of $2,276,000 and $748,000 (net of accumulated amortization of $1,720,000 and $1,386,000) at December 31, 2004 and 2003 are amortized over the estimated useful lives of the existing deposit bases (7 years) using a method which approximates the interest method. Residual identifiable intangibles (previously called goodwill), resulting from the purchase of certain bank branches in years prior to 2004, of $1.1 million and $1.2 million (net accumulated amortization of $1.1 million and $948,000) at December 31, 2004 and 2003 is being accounted for under the provisions of SFAS No. 72 Accounting for Acquisitions of Certain Financial Institutions , and is being amortized using a method which approximates the interest method over a period of 15 years.

In October 2002, the Financial Accounting Standards Board issued SFAS No. 147, Accounting for Acquisitions of Certain Financial Institutions . This statement is effective October 1, 2002 and amends FASB Statements No. 72 and 144 and FASB Interpretation No. 9. SFAS No. 147 stipulates that the acquisition of all or part of a financial institution will now be accounted for under SFAS No. 141 and 142 if that transaction was a business combination as defined. SFAS No. 147 also stipulated that under a business combination, the core deposit intangible assets related to the acquisition of financial institutions, will now be subjected to the impairment testing requirements of SFAS No. 144. The Company has reviewed the guidelines under SFAS No. 147 and has determined that the branch purchases consummated during 1997 did not constitute a business combination because the purchased branches were not self-sustaining and thus were not a business as defined. As a result, the Company continues to amortize the intangible assets resulting from those branch acquisitions under SFAS No. 72. The provisions of SFAS No. 147 did not have a material impact on results of operations, financial position, or liquidity.

Goodwill resulting from the acquisition of Taft National Bank during April 2004 is considered to have an indefinite life and is not amortized pursuant to SFAS No. 141, *Business Combinations*. At December 31, 2004 goodwill totaled $750,000. Pursuant to SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill is evaluated annually for impairment. Impairment testing of goodwill is performed during April of each year at a reporting unit level.

i. *Income Taxes* - Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company s assets and liabilities using the liability method, and are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled.

j. *Net Income per Share* - Basic income per common share is computed based on the weighted average number of common shares outstanding. Diluted income per share includes the effect of stock options and other potentially dilutive securities using the treasury stock method. ESOP shares are only considered outstanding for earnings per share calculations when they are committed to be released (Note 16).

k. *Cash Flow Reporting* - For purposes of reporting cash flows, cash and cash equivalents include cash on hand, noninterest-bearing amounts due from banks, federal funds sold and securities purchased under agreements to resell. Federal funds and securities purchased under agreements to resell are generally sold for one-day periods.

l. *Transfers of Financial Assets* - Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

m. *Advertising Costs* - The Company expenses marketing costs as they are incurred. Advertising expense was $74,000, $66,000 and $48,000 for the years ended December 31, 2004, 2003 and 2002, respectively.

n. *Stock Based Compensation* - At December 31, 2004, the Company has a stock-based employee compensation plan, which is described more fully in Note 10. The Company accounts for stock-based awards to employees using the intrinsic value method in accordance with APB No. 25, Accounting for Stock Issued to Employees , and related interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income

and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123 .

	Years Ended December 31,		
(In thousands except earnings per share)	**2004**	**2003**	**2002**
Net income, as reported	$ 8,405	$ 7,706	$ 6,833
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(40)	(12)	(27)
Pro forma net income	$ 8,365	$ 7,694	$ 6,806
Earnings per share:			
Basic as reported	$ 1.49	$ 1.41	$ 1.27
Basic pro forma	$ 1.49	$ 1.41	$ 1.26
Diluted as reported	$ 1.48	$ 1.40	$ 1.25
Diluted pro forma	$ 1.48	$ 1.40	$ 1.24

In December 2004, the FASB issued SFAS No. 123 (revised 2004) (SFAS 123(R)), Share-Based Payment , which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123(R) eliminates the ability to account for share-based compensation transactions using Accounting Principles Board Opinion No. 25 and requires that such transactions be accounted for using a fair value-based method. The Company will adopt the requirements of SFAS No. 123R using the modified-prospective method during the second quarter of 2005. SFAS No. 123R will require the Company to recognize as compensation expense, the fair value of stock options granted to employees and Directors of the Company beginning with the effective date (a) based on the requirements of Statement 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123 for all awards granted to employees prior to the effective date of Statement 123(R) that remain unvested on the effective date. Exclusive of options that can still be issued, the estimated additional pretax compensation expense expected to be recognized during 2005 is approximately $41,000.

o. *Long-Lived Assets* - The Company periodically evaluates the carrying value of long-lived assets to be held and used, including residual intangible assets (previously called goodwill) and other intangible assets in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets . Pursuant to SFAS No. 147, core deposit intangibles are also evaluated for impairment in accordance with the guidelines of SFAS No. 144. It does not apply to financial instruments, mortgage and other servicing rights, or deferred tax assets. Based on such evaluation, the Bank determined that there is no impairment loss to be recognized in 2004, 2003 or 2002.

p. *Employee Stock Ownership Plan (ESOP)* - The Bank accounts for shares acquired by its ESOP in accordance with the guidelines established by the American Institute of Certified Public Accounts Statement of Position 93-6, Employers Accounting for Employee Stock Ownership Plans (SOP 93-6). Under SOP 93-6, the Bank recognizes compensation cost equal to the fair value of the ESOP shares during the periods in which they become committed to be released. To the extent that the fair value of the Bank s ESOP shares committed to be released differ from the cost of those shares, the differential is charged or credited to equity. The ESOP is externally leveraged and, as such, the ESOP debt is recorded as a liability and interest expense is recorded on that debt. The ESOP shares not yet committed to be released are accounted for as a reduction of shareholders equity.

q. *Derivative Financial Instruments* - All derivative instruments (including certain derivative instrument s

embedded in other contracts) are recognized in the consolidated balance sheet at fair value. The Company s policy is that the accounting treatment for gains or losses from changes in the derivative instrument s fair value is contingent on whether the derivative instrument qualifies as a hedge. On the date the Company enters into a derivative contract, the Company designates the derivative instruments as (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), (2) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge) or (3), a hedge for trading, customer accommodation or not qualifying for hedge accounting (free-standing derivative instruments). For a fair value hedge, changes in the fair value of the derivative instrument and changes in the fair value of the hedged asset or liability or of an unrecognized firm commitment attributable to the hedged risk are recorded in current period net income. For a cash flow hedge, changes in the fair value of the derivative instrument to the extent that it is effective are recorded in other comprehensive income, net of tax, within shareholders equity and subsequently

reclassified to net income in the same period(s) that the hedged transaction impacts net income. For freestanding derivative instruments, changes in the fair values are reported in current period net income. The Company formally documents the relationship between hedging instruments and hedged items, as well as the risk management objective and strategy for undertaking any hedge transaction. This process includes relating all derivative instruments that are designated as fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific forecasted transactions. The Company also formally assesses both at the inception of the hedge and on an ongoing basis, whether the derivative instruments used are highly effective in offsetting changes in fair values or cash flows of hedged items. If it is determined that the derivative instrument is not highly effective as a hedge, hedge accounting is discontinued.

r. *Federal Home Loan Bank stock and Federal Reserve Stock* **-** As a member of the Federal Home Loan Bank (FHLB), the Company is required to maintain an investment in capital stock of the FHLB. In addition, as a member of the Federal Reserve Bank (FRB), the Company is required to maintain an investment in capital stock of the FRB. The investments in both the FHLB and the FRB are carried at cost in the accompanying consolidated statements of condition under other assets and are subject to certain redemption requirements by the FHLB and FRB.

s. *Comprehensive Income* -Comprehensive income is comprised of net income and other comprehensive income. Other comprehensive income includes items previously recorded directly to equity, such as unrealized gains and losses on securities available-for-sale and certain derivative instruments. Comprehensive income is presented in the consolidated statement of shareholders equity.

t. *Segment Reporting* - The Company s operations are solely in the financial services industry and include providing to its customers traditional banking and other financial services. The Company operates primarily in the San Joaquin Valley region of California. Management makes operating decisions and assesses performance based on an ongoing review of the Company s consolidated financial results. Therefore, the Company has a single operating segment for financial reporting purposes.

u. *New Accounting Standards:*

In March 2004, the Financial Accounting Standards Board (FASB) ratified the consensuses reached by the Emerging Issues Task Force (EITF) regarding Issue 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* . Issue 03-1 provides guidance on recognition and measurement of other-than-temporary impairment and its application to certain investments, including all debt securities and equity securities that are subject to the scope of SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities .

On September 30, 2004, FASB issued a proposed Board-directed Staff Position, FSP EITF Issue 03-1-a, Implementation Guidance for the Application of Paragraph 16 of EITF issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.* The proposed FSP will provide implementation guidance with respect to debt securities that are impaired solely due to interest rates and/or sector spreads and analyzed for other-than-temporary impairment under paragraph 16 of Issue 03-1. The Board has delayed the effective date to provide further implementation guidance. This delay does not suspend the requirement to recognize other-than-temporary impairments as required by existing authoritative literature. The delay of the effective date for paragraphs 10-20 of Issue 03-1 will be superseded concurrent with the final issuance of FSB EITF Issue 03-1-a.

On March 9, 2004, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 105 *Application of Accounting Principles to Loan Commitments* (SAB 105), which specifies that servicing assets embedded in commitments for loans to be held for sale should be recognized only when the servicing asset has been contractually separated from the associated loans by sale or securitization. SAB 105 is effective for commitments entered into after March 31, 2004. SAB 105 has had no effect on the Corporation s results of operations or financial condition.

In December 2004 the FASB revised SFAS No. 123, *Accounting for Stock Based Compensation.* This statement supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees,* and its related implementation guidance. The Statement requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The cost will be recognized over the period during which an employee is required to provide service in exchange for the award the requisite service period (usually the vesting period). This Statement is effective for public entities that do not file as small business users as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. Exclusive of options that can still be issued, Management estimates that the effective of adopting this Statement will result in approximately $41,000 in additional compensation expense during 2005.

v. *Reclassifications* - Certain reclassifications have been made to the 2003 and 2002 financial statements to conform to the classifications used in 2004.

2. Investment Securities

Following is a comparison of the amortized cost and approximate fair value of investment securities for the years ended December 31, 2004 and December 31, 2003:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
December 31, 2004:				
Securities available for sale:				