

PLUMAS BANCORP  
Form 10-Q  
November 08, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

**(Mark One)**

**QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED September 30, 2006**

**TRANSITION REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_  
COMMISSION FILE NUMBER: 000-49883  
PLUMAS BANCORP  
(Exact Name of Registrant as Specified in Its Charter)**

**California**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**75-2987096**  
(I.R.S. Employer Identification No.)

**35 S. Lindan Avenue, Quincy, California**  
(Address of Principal Executive Offices)

**95971**  
(Zip Code)

Registrant's Telephone Number, Including Area Code **(530) 283-7305**

Indicated 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 requirements for the past 90 days.

Yes  No

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of November 6, 2006; 5,009,042 shares

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PART I FINANCIAL INFORMATION

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**PART I FINANCIAL INFORMATION**  
**ITEM 1. FINANCIAL STATEMENTS**  
**PLUMAS BANCORP**  
**CONDENSED CONSOLIDATED BALANCE SHEET**  
**(Unaudited)**

(In thousands, except share data)

|   | <b>September<br/>30,<br/>2006</b> | <b>December<br/>31,<br/>2005</b> |
|---|-----------------------------------|----------------------------------|
| <b>Assets</b>   |                                   |                                  |
| Cash and due from banks   | \$ 13,899                         | \$ 17,271                        |
| Federal funds sold  | 505                               | 7,325                            |
| Cash and cash equivalents   | 14,404                            | 24,596                           |
| Investment securities (fair value of \$81,108 at September 30, 2006 and \$97,712 at December 31, 2005)  | 80,968                            | 97,844                           |
| Loans, less allowance for loan losses of \$3,905 at September 30, 2006 and \$3,256 at December 31, 2005 (Notes 3 and 4)   | 346,898                           | 319,156                          |
| Premises and equipment, net   | 14,444                            | 11,404                           |
| Intangible assets, net  | 1,413                             | 1,638                            |
| Bank owned life insurance   | 9,366                             | 8,930                            |
| Accrued interest receivable and other assets  | 9,609                             | 9,235                            |
| Total assets  | \$ 477,102                        | \$ 472,803                       |
| <b>Liabilities and Shareholders Equity</b>  |                                   |                                  |
| Deposits:   |                                   |                                  |
| Non-interest bearing  | \$ 130,848                        | \$ 129,734                       |
| Interest bearing  | 287,165                           | 296,826                          |
| Total deposits  | 418,013                           | 426,560                          |
| Federal Home Loan Bank advances   | 9,500                             |                                  |
| Accrued interest payable and other liabilities  | 4,447                             | 4,796                            |
| Junior subordinated deferrable interest debentures  | 10,310                            | 10,310                           |
| Total liabilities   | 442,270                           | 441,666                          |
| Commitments and contingencies (Note 4)  |                                   |                                  |
| Shareholders equity (Notes 5, 7 and 8):   |                                   |                                  |
| Serial preferred stock, no par value; 10,000,000 shares authorized, none issued   |                                   |                                  |
| Common stock, no par value; 22,500,000 shares authorized; issued and outstanding 5,007,927 shares at September 30, 2006 and 4,976,654 shares at December 31, 2005 | 4,650                             | 4,412                            |

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|   |            |            |
|---|------------|------------|
| Retained earnings                             | 31,046     | 27,816     |
| Accumulated other comprehensive loss (Note 6) | (864)      | (1,091)    |
| Total shareholders' equity                    | 34,832     | 31,137     |
| Total liabilities and shareholders' equity    | \$ 477,102 | \$ 472,803 |

See notes to unaudited condensed consolidated financial statements.

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**PLUMAS BANCORP**  
**CONDENSED CONSOLIDATED STATEMENT OF INCOME**  
**(Unaudited)**

(In thousands, except per share data)

|  | <b>For the Three Months<br/>Ended September 30,</b> |             | <b>For the Nine Months<br/>Ended September 30,</b> |              |
|--|---|-------------|--|--------------|
|  | <b>2006</b>   | <b>2005</b> | <b>2006</b>  | <b>2005</b>  |
| <b>Interest Income:</b>  |   |             |  |              |
| Interest and fees on loans                                     | \$ 6,837  | \$ 5,862    | \$ 19,221  | \$ 16,025    |
| Interest on investment securities:                             |   |             |  |              |
| Taxable  | 608   | 640         | 1,940  | 2,030        |
| Exempt from Federal income taxes                               | 133   | 133         | 397  | 405          |
| Interest on Federal funds sold                                 | 14  | 30          | 158  | 34           |
| <br>Total interest income                                      | <br>7,592   | <br>6,665   | <br>21,716   | <br>18,494   |
| <b>Interest Expense:</b>                                       |   |             |  |              |
| Interest on deposits   | 1,561   | 1,107       | 4,342  | 2,817        |
| Interest on Federal Home Loan Bank advances                    | 69  | 44          | 108  | 210          |
| Interest on junior subordinated deferrable interest debentures | 215   | 111         | 599  | 295          |
| Other  | 6   | 4           | 15   | 9            |
| <br>Total interest expense                                     | <br>1,851   | <br>1,266   | <br>5,064  | <br>3,331    |
| <br>Net interest income before provision for loan losses       | <br>5,741   | <br>5,399   | <br>16,652   | <br>15,163   |
| <b>Provision for Loan Losses</b>                               | <b>300</b>  | <b>300</b>  | <b>900</b>   | <b>900</b>   |
| <br>Net interest income after provision for loan losses        | <br>5,441   | <br>5,099   | <br>15,752   | <br>14,263   |
| <b>Non-Interest Income:</b>                                    |   |             |  |              |
| Service charges  | 1,022   | 868         | 2,731  | 2,531        |
| Gain (loss) on sale of other real estate and vehicles, net     | 4   | 8           | 6  | (37)         |
| Earnings on Bank owned life insurance policies                 | 100   | 84          | 291  | 263          |
| Other  | 267   | 346         | 825  | 962          |
| <br>Total non-interest income                                  | <br>1,393   | <br>1,306   | <br>3,853  | <br>3,719    |
| <b>Non-Interest Expenses:</b>                                  |   |             |  |              |
| Salaries and employee benefits                                 | 2,500   | 2,405       | 7,366  | 7,071        |
| Occupancy and equipment  | 827   | 775         | 2,387  | 2,268        |
| Other  | 1,253   | 1,234       | 3,579  | 3,595        |
| <br>Total non-interest expenses                                | <br>4,580   | <br>4,414   | <br>13,332   | <br>12,934   |
| <br>Income before provision for income taxes                   | <br>2,254   | <br>1,991   | <br>6,273  | <br>5,048    |
| <b>Provision for Income Taxes</b>                              | <b>858</b>  | <b>743</b>  | <b>2,392</b>                                       | <b>1,820</b> |

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|  |          |          |          |          |
|--|----------|----------|----------|----------|
| Net income                                 | \$ 1,396 | \$ 1,248 | \$ 3,881 | \$ 3,228 |
| Basic earnings per share (Notes 5 and 7)   | \$ 0.28  | \$ 0.25  | \$ 0.78  | \$ 0.65  |
| Diluted earnings per share (Notes 5 and 7) | \$ 0.27  | \$ 0.24  | \$ 0.76  | \$ 0.64  |

See notes to unaudited condensed consolidated financial statements.

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**PLUMAS BANCORP**  
**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
**(Unaudited)**  
(In thousands)

|   | <b>For the Nine Months<br/>Ended September 30,</b> |              |
|---|--|--------------|
|   | <b>2006</b>  | <b>2005</b>  |
| <b>Cash Flows from Operating Activities:</b>  |  |              |
| Net income  | \$ 3,881   | \$ 3,228     |
| Adjustments to reconcile net income to net cash provided by operating activities:                           |  |              |
| Provision for loan losses   | 900  | 900          |
| Change in deferred loan origination costs/fees, net   | (398)  | (967)        |
| Depreciation and amortization   | 1,582  | 1,565        |
| Stock-based compensation expense  | 130  |              |
| Net loss on sale of available-for-sale investment securities  |  | 8            |
| Amortization of investment security premiums  | 312  | 541          |
| Accretion of investment security discounts  | (67)   | (52)         |
| Net loss on disposal/sale of premises and equipment   | 6  | 4            |
| Net (gain) loss on sale of other real estate and vehicles   | (6)  | 37           |
| Earnings on Bank owned life insurance policies  | (291)  | (263)        |
| Expenses on Bank owned life insurance policies  | 55   | 51           |
| Increase in accrued interest receivable and other assets  | (673)  | (1,405)      |
| (Decrease) increase in accrued interest payable and other liabilities                                       | (349)  | 1,954        |
| <br>Net cash provided by operating activities   | <br>5,082  | <br>5,601    |
| <br><b>Cash Flows from Investing Activities:</b>  |  |              |
| Proceeds from matured and called available-for-sale investment securities                                   | 14,346   | 11,000       |
| Proceeds from matured and called held-to-maturity investment securities                                     |  | 1,097        |
| Proceeds from sales of available-for-sale investment securities   |  | 1,992        |
| Purchases of held-to-maturity investment securities   | (155)  |              |
| Proceeds from principal repayments from available-for-sale government-guaranteed mortgage-backed securities | 2,782  | 2,780        |
| Proceeds from principal repayments from held-to-maturity government-guaranteed mortgage-backed securities   | 45   | 79           |
| Net increase in loans   | (28,591)   | (47,167)     |
| Proceeds from sale of other real estate and vehicles  | 124  | 183          |
| Purchase of bank owned life insurance   | (200)  | (281)        |
| Purchase of premises and equipment  | (4,035)  | (2,467)      |
| <br>Net cash used in investing activities   | <br>(15,684)                                       | <br>(32,784) |

Continued on next page.

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**PLUMAS BANCORP**  
**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
**(Unaudited)**  
(In thousands)  
(Continued)

|  | <b>For the Nine Months<br/>Ended September 30,</b> |                  |
|--|--|------------------|
|  | <b>2006</b>  | <b>2005</b>      |
| <b>Cash Flows from Financing Activities:</b>                                 |  |                  |
| Net (decrease) increase in demand, interest bearing and savings deposits     | \$ (1,779)   | \$ 36,718        |
| Net (decrease) increase in time deposits                                     | (6,768)  | 9,494            |
| Proceeds from issuance of junior subordinated deferrable interest debentures |  | 4,124            |
| Proceeds (payment of) from Federal Home Loan Bank advances                   | 9,500  | (1,035)          |
| Proceeds from exercise of stock options                                      | 108  | 289              |
| Payment of cash dividends  | (651)  | (536)            |
| Net cash provided by financing activities                                    | 410  | 49,054           |
| (Decrease) increase in cash and cash equivalents                             | (10,192)   | 21,871           |
| <b>Cash and Cash Equivalents at Beginning of Year</b>                        | <b>24,596</b>                                      | <b>11,444</b>    |
| <b>Cash and Cash Equivalents at End of Period</b>                            | <b>\$ 14,404</b>                                   | <b>\$ 33,315</b> |
| <b>Supplemental Disclosure of Cash Flow Information:</b>                     |  |                  |
| Cash paid during the period for:   |  |                  |
| Interest expense   | \$ 4,945   | \$ 3,075         |
| Income taxes   | \$ 2,585   | \$ 730           |
| <b>Non-Cash Investing Activities:</b>  |  |                  |
| Vehicles acquired through foreclosure  | \$ 117   | \$ 141           |
| Loan transferred to other assets   | \$ 230   | \$               |
| Net change in unrealized loss on available-for-sale securities               | \$ 227   | \$ (409)         |
| <b>Non-Cash Financing Activities:</b>  |  |                  |
| Common stock retired in connection with the exercise of stock options        | \$ 354   | \$ 80            |
| See notes to unaudited condensed consolidated financial statements.          |  |                  |

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**PLUMAS BANCORP**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. GENERAL**

Plumas Bancorp (the Company) was incorporated on January 17, 2002 and became the sole shareholder of Plumas Bank (the Bank) on June 21, 2002. The Company formed Plumas Statutory Trust I for the sole purpose of issuing trust preferred securities on September 26, 2002. The Company formed Plumas Statutory Trust II for the sole purpose of issuing trust preferred securities on September 28, 2005.

The Bank operates twelve branches in California, including branches in Alturas, Chester, Fall River Mills, Greenville, Kings Beach, Loyalton, Portola, Quincy, Susanville, Tahoe City, Truckee and Westwood. The Bank's deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to applicable legal limits. The Bank's primary source of revenue is generated from providing loans to customers who are predominately small and middle market businesses and individuals residing in the surrounding areas.

**2. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

The condensed consolidated financial statements include the accounts of the Company and the accounts of its wholly-owned subsidiary, Plumas Bank. Plumas Statutory Trust I and Plumas Statutory Trust II are not consolidated into the Company's consolidated financial statements and, accordingly, are accounted for under the equity method. In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the Company's financial position at September 30, 2006 and December 31, 2005 and its results of operations for the three-month and nine-month periods ended September 30, 2006 and 2005 and its cash flows for the nine-month periods ended September 30, 2006 and 2005. Certain reclassifications have been made to prior periods balances to conform to classifications used in 2006. The unaudited condensed consolidated financial statements of the Company have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) for interim reporting on Form 10-Q. Accordingly, certain disclosures normally presented in the notes to the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The Company believes that the disclosures are adequate to make the information not misleading. These interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2005 Annual Report to Shareholders on Form 10-K. The results of operations for the three-month and nine-month periods ended September 30, 2006 and 2005 may not necessarily be indicative of future operating results. In preparing such financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the periods reported. Actual results could differ significantly from those estimates.

Management has determined that because all of the commercial banking products and services offered by the Company are available in each branch of the Bank, all branches are located within the same economic environment and management does not allocate resources based on the performance of different lending or transaction activities, it is appropriate to aggregate the Bank branches and report them as a single operating segment. No single customer accounts for more than 10% of the revenues of the Company or the Bank.

**Table of Contents****3. LOANS**

Outstanding loans are summarized below, in thousands:

|   | <b>September<br/>30,<br/>2006</b> | <b>December<br/>31,<br/>2005</b> |
|---|-----------------------------------|----------------------------------|
| Commercial                                    | \$ 35,467                         | \$ 42,252                        |
| Agricultural                                  | 34,818                            | 31,018                           |
| Real estate mortgage                          | 114,469                           | 110,686                          |
| Real estate construction and land development | 74,987                            | 56,370                           |
| Consumer                                      | 89,898                            | 81,320                           |
|   | 349,639                           | 321,646                          |
| Deferred loan costs, net                      | 1,164                             | 766                              |
| Allowance for loan losses                     | (3,905)                           | (3,256)                          |
|   | \$ 346,898                        | \$ 319,156                       |

**4. COMMITMENTS AND CONTINGENCIES**

The Company is party to claims and legal proceedings arising in the ordinary course of business. In the opinion of the Company's management, the amount of ultimate liability with respect to such proceedings will not have a material adverse effect on the financial condition or result of operations of the Company taken as a whole.

In the normal course of business, there are various outstanding commitments to extend credit which are not reflected in the financial statements, including loan commitments of \$101,733,000 and \$107,500,000 and stand-by letters of credit of \$1,012,000 and \$1,195,000 at September 30, 2006 and December 31, 2005, respectively.

Of the loan commitments outstanding at September 30, 2006, \$32,216,000 are real estate construction loan commitments that are expected to fund within the next twelve months. The remaining commitments primarily relate to revolving lines of credit or other commercial loans, and many of these are expected to expire without being drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements. Each loan commitment and the amount and type of collateral obtained, if any, are evaluated on an individual basis. Collateral held varies, but may include real property, bank deposits, debt or equity securities or business assets.

Stand-by letters of credit are conditional commitments written to guarantee the performance of a customer to a third party. These guarantees are primarily related to the purchases of inventory by commercial customers and are typically short-term in nature. Credit risk is similar to that involved in extending loan commitments to customers and accordingly, evaluation and collateral requirements similar to those for loan commitments are used. The deferred liability related to the Company's stand-by letters of credit was not significant at September 30, 2006 or December 31, 2005.

**Table of Contents****5. EARNINGS PER SHARE**

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings of the Company. The treasury stock method has been applied to determine the dilutive effect of stock options in computing diluted earnings per share.

|   | For the Three Months<br>Ended September 30, |         | For the Nine Months<br>Ended September 30, |         |
|---|---|---------|--|---------|
|   | 2006  | 2005    | 2006                                       | 2005    |
| <b>Earnings Per Share:</b>                            |   |         |  |         |
| Basic earnings per share                              | \$ 0.28                                     | \$ 0.25 | \$ 0.78                                    | \$ 0.65 |
| Diluted earnings per share                            | \$ 0.27                                     | \$ 0.24 | \$ 0.76                                    | \$ 0.64 |
| <b>Weighted Average Number of Shares Outstanding:</b> |   |         |  |         |
| (in thousands)  |   |         |  |         |
| Basic shares  | 5,005                                       | 4,951   | 4,998                                      | 4,939   |
| Diluted shares  | 5,090                                       | 5,133   | 5,090                                      | 5,083   |

There were 10,000 stock options during the three-month and nine-month periods ended September 30, 2006, considered to be antidilutive and therefore omitted from the above calculation of diluted earnings per share. There were no stock options in the three-month and nine-month periods ended September 30, 2005 considered to be antidilutive.

**6. COMPREHENSIVE INCOME**

Total comprehensive income for the three months ended September 30, 2006 and 2005 totaled \$1,977,000 and \$1,000,000, respectively. Comprehensive income is comprised of unrealized gains (losses), net of taxes, on available-for-sale investment securities, which were \$581,000 and \$(248,000) for the three months ended September 30, 2006 and 2005, respectively, together with net income.

Total comprehensive income for the nine months ended September 30, 2006 and 2005 totaled \$4,108,000 and \$2,819,000, respectively. Comprehensive income is comprised of unrealized gains (losses), net of taxes, on available-for-sale investment securities, which were \$227,000 and \$(409,000) for the nine months ended September 30, 2006 and 2005, respectively, together with net income.

At September 30, 2006 and December 31, 2005, accumulated other comprehensive loss totaled \$864,000 and \$1,091,000, respectively, and is reflected, net of taxes, as a component of shareholders' equity.

**7. STOCK-BASED COMPENSATION**

At September 30, 2006, the Company had two stock-based compensation plans, the Plumas Bank 2001 and 1991 Stock Option Plans, which are described below. Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (R), *Share Based Payment* ( SFAS 123 (R) ), using the modified prospective application transition method, which requires recognizing expense for options granted prior to the adoption date equal to the fair value of the unvested amounts over their remaining vesting period based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 *Accounting for Stock Based Compensation* and compensation cost for all share based payments granted subsequent to January 1, 2006 based on the grant date fair values estimated in accordance with the provisions of SFAS 123 (R). There were 7,500 options granted during each of the nine-month periods ended September 30, 2006 and September 30, 2005. Results for prior periods have not been restated. Prior to January 1, 2006, the Company accounted for the Stock Option Plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. No stock-based compensation cost was recorded prior to January 1, 2006, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of the grant.

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As a result of adopting SFAS 123 (R), the Company's income before provision for income taxes and net income for the three months ended September 30, 2006 was \$43,000 and \$39,000, respectively, and for the nine months ended September 30, 2006 was \$130,000 and \$115,000, respectively, lower than if we had continued to account for share-based compensation under APB 25. Basic and diluted earnings per share for the quarter ended September 30, 2006 would have been \$0.29 and \$0.28, respectively, without the adoption of SFAS 123 (R) compared to \$0.28 and \$0.27, respectively, as reported. Basic and diluted earnings per share for the nine months ended September 30, 2006 would have been \$0.80 and \$0.78, respectively, without the adoption of SFAS 123 (R) compared to \$0.78 and \$0.76, respectively, as reported.

SFAS 123 (R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as a cash flow from financing in the statement of cash flows. These excess tax benefits were not significant for the Company.

The following table illustrates the pro forma SFAS 123 adjustment on consolidated net income and earnings per share had the Company recorded compensation expense in accordance with SFAS 123 for the three months and nine months ended September 30, 2005, dollars in thousands except per share amounts:

|  | <b>For the<br/>Three<br/>Months<br/>Ended<br/>September<br/>30,<br/>2005</b> | <b>For the Nine<br/>Months<br/>Ended<br/>September<br/>30,<br/>2005</b> |
|--|--|---|
| Net income as reported   | \$ 1,248   | \$ 3,228  |
| Deduct: Total stock-based compensation expense determined under the fair value based method for all awards, net of related tax effects | 45   | 132   |
| Pro forma net income   | \$ 1,203   | \$ 3,096  |
| Basic earnings per share as reported   | \$ 0.25  | \$ 0.65   |
| Basic earnings per share pro forma   | \$ 0.24  | \$ 0.63   |
| Diluted earnings per share as reported   | \$ 0.24  | \$ 0.64   |
| Diluted earnings per share pro forma   | \$ 0.23  | \$ 0.61   |

**8. STOCK OPTION PLANS**

In 2001 and 1991, the Company established Stock Option Plans for which 925,101 shares of common stock remain reserved for issuance to employees and directors and 615,037 shares are available for future grants under incentive and nonstatutory agreements as of September 30, 2006. The plans require that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid in full at the time the option is exercised. Payment in full for the option price must be made in cash or with Company common stock previously acquired by the optionee and held by the optionee for a period of at least six months. The options expire on dates determined by the Board of Directors, but not later than ten years from the date of grant. Upon grant, options vest ratably over a three to five year period.

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A summary of the option activity during the nine months ended September 30, 2006 within the Stock Options Plans follows:

|   | Shares  | Weighted<br>Average<br>Exercise Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term | Intrinsic<br>Value<br>(in<br>thousands) |
|---|---------|---------------------------------------|---|---|
| <b>Incentive:</b>                         |         |                                       |   |   |
| Options outstanding at January 1, 2006    | 242,845 | 11.05                                 |   |   |
| Options granted                           | 5,000   | 16.89                                 |   |   |
| Options exercised                         | 48,656  | 8.94                                  |   |   |
| Options cancelled                         | 4,756   | 12.68                                 |   |   |
| Options outstanding at September 30, 2006 | 194,433 | 11.68                                 | 6.7   | \$ 926                                  |
| Options exercisable at September 30, 2006 | 92,895  | 9.92                                  | 5.9   | \$ 606                                  |
| <b>Nonstatutory:</b>                      |         |                                       |   |   |
| Options outstanding at January 1, 2006    | 113,131 | 10.59                                 |   |   |
| Options granted                           | 2,500   | 18.79                                 |   |   |
| Options exercised                         |         |                                       |   |   |
| Options cancelled                         |         |                                       |   |   |
| Options outstanding at September 30, 2006 | 115,631 | 10.77                                 | 6.0   | \$ 656                                  |
| Options exercisable at September 30, 2006 | 70,386  | 9.15                                  | 5.0   | \$ 513                                  |

The intrinsic value represents the value of the Company's closing stock price on September 29, 2006 in excess of the exercise price multiplied by the number of options outstanding or exercisable.

There were a total of 7,500 options granted during each of the nine-month periods ended September 30, 2006 and September 30, 2005. The fair value of each option grant is estimated on the date of grant using a Black-Scholes option-pricing model that uses assumptions based on expected option life, expected stock volatility, risk free interest rate, and dividend yield. The Company uses historical data to estimate expected option life and pre-vesting option forfeitures. Stock volatility is based on the historical volatility of the Company's stock. The risk-free rate is based on the U. S. Treasury yield curve for the periods within the contractual life of the options in effect at the time of grant. A summary of the weighted average assumptions and results for options granted during the periods presented is as follows:

|  | <b>For the Three Months Ended</b> |                               |
|--|-----------------------------------|-------------------------------|
|  | <b>September<br/>30, 2006</b>     | <b>September 30,<br/>2005</b> |
| Weighted average fair value of options granted | \$ 4.54                           | \$ 4.77                       |
| Dividend yield                                 | 1.5%                              | 1.4%                          |
| Expected volatility                            | 23.7%                             | 13.7%                         |
| Risk-free interest rate                        | 4.7%                              | 4.1%                          |
| Expected option life in years                  | 5.0                               | 5.0                           |

|  | <b>For the Nine Months Ended</b> |                               |
|--|----------------------------------|-------------------------------|
|  | <b>September<br/>30, 2006</b>    | <b>September 30,<br/>2005</b> |
| Weighted average fair value of options granted | \$ 4.56                          | \$ 4.77                       |
| Dividend yield                                 | 1.4%                             | 1.4%                          |
| Expected volatility                            | 21.4%                            | 13.7%                         |
| Risk-free interest rate                        | 4.7%                             | 4.1%                          |
| Expected option life in years                  | 5.0                              | 5.0                           |

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As of September 30, 2006, there was \$405,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the 1991 Plan and 2001 Plan. That cost is expected to be recognized over a weighted average period of 2.7 years. The total intrinsic value of options exercised during the nine months ended September 30, 2006 and 2005 was \$528,000 and \$692,000 respectively. The total fair value of shares vested during the quarter ended September 30, 2006 and 2005 was \$6,000 and \$0 respectively. The total fair value of shares vested during the nine months ended September 30, 2006 and 2005 was \$12,000 and \$9,000 respectively.

**9. RECENT ACCOUNTING DEVELOPMENTS***Accounting for Servicing of Financial Assets*

In March 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 156 (SFAS 156), *Accounting for Servicing of Financial Assets – An Amendment of FASB Statement No. 140*. SFAS 156 requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable, and permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. Under SFAS 156, an entity can elect subsequent fair value measurement of its servicing assets and servicing liabilities by class. An entity should apply the requirements for recognition and initial measurement of servicing assets and servicing liabilities prospectively to all transactions after the effective date. SFAS 156 permits an entity to reclassify certain available-for-sale securities to trading securities provided that they are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities subsequently measured at fair value. The provisions of SFAS 156 are effective for an entity as of the beginning of its first fiscal year that begins after September 15, 2006. Management does not expect the adoption of SFAS 156 to have a material impact on the Company's financial position or results of operations.

*Accounting for Uncertainty in Income Taxes*

In July 2006, the FASB issued Financial Accounting Standards Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. FIN 48 is effective for fiscal years beginning after December 15, 2006. Management does not expect the adoption of FIN 48 to have a material impact on the Company's financial position or results of operations.

*Accounting for Purchases of Life Insurance*

In September 2006, the FASB ratified the consensus reached by the Emerging Issues Task Force (EITF) on Issue No. 06-5, *Accounting for Purchases of Life Insurance – Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance*. FASB Technical Bulletin No. 85-4 requires that the amount that could be realized under the insurance contract as of the date of the statement of financial position should be reported as an asset. Since the issuance of FASB Technical Bulletin No. 85-4, questions arose regarding whether the amount that could be realized should consider 1) any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value and 2) the contractual ability to surrender all of the individual-life policies (or certificates in a group policy) at the same time. EITF 06-5 determined that the amount that could be realized should 1) consider any additional amounts included in the contractual terms of the policy and 2) assume the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). Any amount that is ultimately realized by the policy holder upon the assumed surrender of the final policy (or final certificate in a group policy) shall be included in the amount that could be realized. An entity should apply the provisions of EITF 06-5 through either a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or a change in accounting principle through retrospective application to all prior periods. The provisions of EITF 06-5 are effective for fiscal years beginning after December 15, 2006. Management has not yet completed its evaluation of the impact that EITF 06-5 will have.

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*Fair Value Measurements*

In September 2006, the FASB issued Statement No. 157 (SFAS 157), *Fair Value Measurements*. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. In this standard, the FASB clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, SFAS 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The provisions of SFAS 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The provisions should be applied prospectively, except for certain specifically identified financial instruments. Management does not expect the adoption of SFAS 157 to have a material impact to the Company's financial position or result of operations.

*Consideration of the Effects of Prior Year Misstatements*

In September 2006, the Securities and Exchange Commission published Staff Accounting Bulletin No. 108 (SAB 108) *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. The interpretations in this Staff Accounting Bulletin were issued to address diversity in practice in quantifying financial statement misstatements and the potential under current practice to build up improper amounts on the balance sheet. This guidance will apply to the first fiscal year ending after November 15, 2006 and early application in interim periods is encouraged. Management does not believe the adoption of SAB 108 will have a material impact on the Company's financial position, results of operations or cash flows.

**PART I FINANCIAL INFORMATION**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Certain matters discussed in this Quarterly Report 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, among others, (1) significant increases in competitive pressures in the financial services industry; (2) changes in the interest rate environment resulting in reduced margins; (3) general economic conditions, either nationally or regionally, maybe less favorable than expected, resulting in, among other things, a deterioration in credit quality; (4) changes in regulatory environment; (5) loss of key personnel; (6) fluctuations in the real estate market; (7) changes in business conditions and inflation; (8) operational risks including data processing systems failures or fraud; and (9) changes in securities markets. Therefore, the information set forth herein should be carefully considered when evaluating the business prospects of Plumas Bancorp.

When the Company uses in this Quarterly Report the words anticipate, estimate, expect, project, intend, committed, believe and similar expressions, the Company intends to identify forward-looking statements. Such statements are not guarantees of performance and are subject to certain risks, uncertainties and assumptions, including those described in this Quarterly Report. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, expected, projected, intended, committed or believed. The future results and stockholder values of the Company may differ materially from those expressed in these forward-looking statements. Many of the factors that will determine these results and values are beyond the Company's ability to control or predict. For those statements, the Company claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

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**INTRODUCTION**

On May 18, 2005, Plumas Bancorp (the Company) began trading on The NASDAQ Capital Market under the ticker symbol PLBC. Prior to May 18, 2005, the Company was traded on the Over-The-Counter Bulletin Board (OTC BB) also under the ticker symbol PLBC.

The following discussion and analysis sets forth certain statistical information relating to the Company as of September 30, 2006 and December 31, 2005 and for the three and nine month periods ended September 30, 2006 and 2005. This discussion should be read in conjunction with the condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and the consolidated financial statements and notes thereto included in Plumas Bancorp's Annual Report filed on Form 10-K for the year ended December 31, 2005.

**CASH DIVIDEND**

On October 20, 2006, the Company declared a common stock cash dividend of \$0.13 per share. The dividend is payable on November 24, 2006 to its shareholders of record on November 10, 2006.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (R), *Share Based Payment* (SFAS 123(R)) using the modified prospective transition method. Prior to adoption of this statement, the Company accounted for its share-based employee compensation plans under the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock-Based Compensation*. See Note 7 and 8 to the Condensed Consolidated Financial Statements for additional information related to implementation of SFAS 123(R). There have been no other changes to the Company's critical accounting policies from those disclosed in the Company's 2005 Annual Report to Shareholders on Form 10-K.

This discussion should be read in conjunction with our unaudited condensed consolidated financial statements, including the notes thereto, appearing elsewhere in this report.

**RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006**

**OVERVIEW**

The Company's net income increased \$653 thousand, or 20%, to \$3.88 million for the nine months ended September 30, 2006 from \$3.23 million for the same period in 2005. The primary contributor to the increase in net income for the first nine months of 2006 was a \$1.49 million increase in net interest income. In addition non-interest income increased by \$134 thousand primarily as a result of an increase in service charge income of \$200 thousand. Partially offsetting these revenue gains was an increase in non-interest expenses of \$398 thousand which included increases of \$295 thousand in salaries and benefits and \$119 thousand in occupancy and equipment costs. The provision for income taxes increased by \$572 thousand.

Total assets increased \$4.3 million from \$472.8 million at December 31, 2005 to \$477.1 million at September 30, 2006. Net loans increased by \$27.7 million, or 9% from \$319.2 million at December 31, 2005 to \$346.9 million at September 30, 2006. Funding for the increase in loans was provided by a decrease in cash and cash equivalents of \$10.2 million, a decrease in investment securities of \$16.9 million, and an increase in Federal Home Loan Bank (FHLB) advances of \$9.5 million as deposits declined \$8.6 million, or 2% from \$426.6 million at December 31, 2005 to \$418.0 million at September 30, 2006.

The annualized return on average assets was 1.11% for the nine months ended September 30, 2006 up from 0.97% for the same period in 2005. The annualized return on average equity was 15.7% for the nine months ended September 30, 2006 up from 14.9% for the same period in 2005.

**Net interest income before provision for loan losses.** Net interest income, on a nontax-equivalent basis, was \$16.7 million for the nine months ended September 30, 2006, an increase of \$1.5 million, or 10%, from \$15.2 million for the same period in 2005. The increase in net interest income was primarily attributed to volume and rate increases in the Company's average loan balances partially offset by increases in the rates paid on interest bearing deposit account balances and in the level of and rates paid on the junior subordinated debentures.

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Interest income increased \$3.2 million, or 17%, to \$21.7 million for the nine months ended September 30, 2006. Interest and fees on loans increased by \$3.2 million from \$16.0 million for the nine months ended September 30, 2005 to \$19.2 million during the current nine month period. The Company's average loan balances were \$330.2 million for the nine months ended September 30, 2006, up \$32.7 million, or 11%, from the \$297.5 million during the same period in 2005. The average rate earned on the Company's loan balances increased 58 basis points to 7.78% during the first nine months of 2006 versus 7.20% during the first nine months of 2005. The increase in yield is consistent with market conditions in the Company's service area.

Interest on investment securities decreased by \$98 thousand, as an increase in yield of 38 basis points was offset by a decline in average investment securities of \$14.4 million. Interest earned on federal funds sold increased by \$124 thousand. This item benefited both from an increase in yield of 92 basis points and an increase in average balances outstanding of \$3.4 million.

Interest expense increased \$1.8 million to \$5.1 million for the nine months ended September 30, 2006, up from \$3.3 million for the same period in 2005. The increase in interest expense was primarily attributed to rate increases on time deposits and other interest-bearing deposits and the increase in the level of and rates paid on the junior subordinated debentures. Partially offsetting these increases in interest expense was a decrease of \$102 thousand in interest from FHLB borrowings, resulting from a reduction in the level of these borrowings during the 2006 period. For the nine months ended September 30, 2006 compared to the same period in 2005, the Company's average rate paid on time deposits increased 84 basis points to 3.44% from 2.60%. The average rate paid on all other interest-bearing deposits increased 62 basis points to 1.31% for the first nine months of 2006 versus 0.69% for the first nine months of 2005 primarily as a result of the introduction of the Money Fund Plu\$ account in September 2005.

Money Fund Plu\$ is a high interest bearing checking account designed to pay rates comparable to those available on a typical brokerage account. Since its introduction, there has been significant growth in the total Money Fund Plu\$ balances with an average balance of \$38.9 million for the nine months ended September 30, 2006 and total balances as of September 30, 2006 of \$47.1 million. The average rate paid on Money Fund Plu\$ accounts during the nine months ending September 30, 2006 was 3.54%.

Adding to interest expense was an increase in the average balance of the junior subordinated debentures of \$4.1 million to \$10.3 million and in the average rate paid of 144 basis points from 6.33% to 7.77%.

As a result of the changes noted above, the net interest margin for the nine months ended September 30, 2006 increased 22 basis points, or 4%, to 5.28%, up from 5.06% for the same period in 2005.

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The following table presents for the nine-month periods indicated the distribution of consolidated average assets, liabilities and shareholders' equity. It also presents the amounts of interest income from interest-earning assets and the resultant annualized yields expressed in both dollars and annualized yield percentages, as well as the amounts of interest expense on interest-bearing liabilities and the resultant cost expressed in both dollars and annualized rate percentages. Average balances are based on daily averages. Nonaccrual loans are included in the calculation of average loans while nonaccrued interest thereon is excluded from the computation of yields earned:

|  | For the Nine Months Ended<br>September 30,<br>2006 |                               |                | For the Nine Months Ended<br>September 30,<br>2005 |                               |                |
|--|--|-------------------------------|----------------|--|-------------------------------|----------------|
|  | Average<br>Balance<br>(in<br>thousands)            | Interest<br>(in<br>thousands) | Yield/<br>Rate | Average<br>Balance<br>(in<br>thousands)            | Interest<br>(in<br>thousands) | Yield/<br>Rate |
| <b>Interest-earning assets:</b>          |  |                               |                |  |                               |                |
| Loans (1) (2)                            | \$ 330,153   | \$ 19,221                     | 7.78%          | \$ 297,526   | \$ 16,025                     | 7.20%          |
| Investment securities (1)                | 87,142   | 2,337                         | 3.59%          | 101,545  | 2,435                         | 3.21%          |
| Federal funds sold                       | 4,679  | 158                           | 4.51%          | 1,267  | 34                            | 3.59%          |
| Total interest earning<br>assets         | 421,974  | 21,716                        | 6.88%          | 400,338  | 18,494                        | 6.18%          |
| Cash and due from banks                  | 13,489   |                               |                | 16,276   |                               |                |
| Other assets                             | 31,425   |                               |                | 26,580   |                               |                |
| Total assets                             | \$ 466,888   |                               |                | \$ 443,194   |                               |                |
| <b>Interest-bearing liabilities:</b>     |  |                               |                |  |                               |                |
| NOW, money market, &<br>savings deposits | \$ 199,261   | 1,947                         | 1.31%          | \$ 176,195   | 910                           | 0.69%          |
| Time deposits                            | 93,100   | 2,395                         | 3.44%          | 98,044   | 1,907                         | 2.60%          |
| FHLB advances                            | 2,743  | 108                           | 5.26%          | 9,254  | 210                           | 3.03%          |
| Other interest-bearing<br>liabilities    | 281  | 15                            | 7.14%          | 237  | 9                             | 5.08%          |
| Junior subordinated<br>debentures        | 10,310   | 599                           | 7.77%          | 6,231  | 295                           | 6.32%          |
| Total interest-bearing<br>liabilities    | 305,695  | 5,064                         | 2.21%          | 289,961  | 3,331                         | 1.54%          |
| Non-interest bearing<br>deposits         | 123,677  |                               |                | 120,256  |                               |                |
| Other liabilities                        | 4,466  |                               |                | 4,094  |                               |                |
| Shareholders' equity                     | 33,050   |                               |                | 28,883   |                               |                |
| Total liabilities & equity               | \$ 466,888   |                               |                | \$ 443,194   |                               |                |
|  |  |                               | 1.60%          |  |                               | 1.12%          |

Cost of funding  
interest-earning assets (3)  
Net interest income and  
margin (4)

|    |        |       |    |        |       |
|----|--------|-------|----|--------|-------|
| \$ | 16,652 | 5.28% | \$ | 15,163 | 5.06% |
|----|--------|-------|----|--------|-------|

- (1) Not computed on a tax-equivalent basis.
- (2) Loan (costs) fees included in loan interest income for the nine-month periods ended September 30, 2006 and 2005 were \$(251,000) and \$148,000, respectively.
- (3) Total annualized interest expense divided by the average balance of total earning assets.
- (4) Annualized net interest income divided by the average balance of total earning assets.

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The following table sets forth changes in interest income and interest expense for the nine-month periods indicated and the amount of change attributable to variances in volume, rates and the combination of volume and rates based on the relative changes of volume and rates:

|                                      | <b>2006 over 2005 change in net interest income<br/>for the nine months ended September 30<br/>(in thousands)</b> |                 |                |              |
|--------------------------------------|---|-----------------|----------------|--------------|
|                                      | <b>Volume<br/>(1)</b>   | <b>Rate (2)</b> | <b>Mix (3)</b> | <b>Total</b> |
| <b>Interest-earning assets:</b>      |   |                 |                |              |
| Loans                                | \$ 1,757  | \$ 1,297        | \$ 142         | \$ 3,196     |
| Investment securities                | (345)   | 288             | (41)           | (98)         |
| Federal funds sold                   | 91  | 9               | 24             | 124          |
| Total interest income                | 1,503   | 1,594           | 125            | 3,222        |
| <b>Interest-bearing liabilities:</b> |   |                 |                |              |
| NOW, money market & savings          | 119   | 812             | 106            | 1,037        |
| Time deposits                        | (96)  | 615             | (31)           | 488          |
| FHLB advances                        | (148)   | 155             | (109)          | (102)        |
| Other interest-bearing liabilities   | 1   | 4               | 1              | 6            |
| Junior subordinated debentures       | 193   | 67              | 44             | 304          |
| Total interest expense               | 69  | 1,653           | 11             | 1,733        |
| Net interest income                  | \$ 1,434  | \$ (59)         | \$ 114         | \$ 1,489     |

(1) The volume change in net interest income represents the change in average balance divided by the previous period's rate.

(2) The rate change in net interest income represents the change in rate multiplied by the previous period's average balance.

(3)

The mix change  
in net interest  
income  
represents the  
change in  
average balance  
multiplied by  
the change in  
rate.

**Provision for loan losses.** The Company recorded \$900,000 in provision for loan losses for each of the nine months ended September 30, 2006 and 2005. Management assesses its loan quality monthly to maintain an adequate allowance for loan losses. Based on information currently available, management believes that the allowance for loan losses is adequate to absorb potential risks in the portfolio. However, no assurance can be given that the Company may not sustain charge-offs which are in excess of the allowance in any given period. The Company's loan portfolio composition and non-performing assets are further discussed under the financial condition section below.

**Non-interest income.** During the nine months ended September 30, 2006, total non-interest income increased \$134 thousand, or 4%, to \$3.9 million, up from \$3.7 million from the comparable period in 2005. This increase was primarily related to an increase in service charges on deposit accounts of \$200 thousand from the previous nine month period. This increase primarily relates to fees from increased customer usage of deposit account overdrafts privileges, the collection of fees resulting from those overdrafts and from an increase in the rate charged.

Loan commissions and servicing fees declined by \$94 thousand from the 2005 nine month period. This decline primarily relates to an increase in the amortization of servicing assets and I/O strips receivable. Declines of \$70 thousand in investment services income and \$58 thousand related to a tax refund recorded in 2005 were mostly offset by increases of \$28 thousand in earnings on life insurance policies, \$48 thousand in official check fees and \$43 thousand related to sales of repossessed vehicles and other real estate owned.

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The following table describes the components of non-interest income for the nine-month periods ending September 30, 2006 and 2005, in thousands:

|   | For the Nine Months<br>Ended September<br>30, |          | Dollar<br>Change | Percentage<br>Change |
|---|---|----------|------------------|----------------------|
|   | 2006  | 2005     |                  |                      |
| Service charges on deposit accounts             | \$ 2,731                                      | \$ 2,531 | \$ 200           | 7.9%                 |
| Earnings on life insurance policies             | 291   | 263      | 28               | 10.6%                |
| Merchant processing income                      | 242   | 252      | (10)             | -4.0%                |
| Official check fees                             | 126   | 78       | 48               | 61.5%                |
| Customer service fees                           | 83  | 82       | 1                | 1.2%                 |
| Investment services income                      | 78  | 148      | (70)             | -47.3%               |
| Federal Home Loan Bank dividends                | 76  | 59       | 17               | 28.8%                |
| Safe deposit box and night depository income    | 51  | 51       |                  | %                    |
| Other deposit account fees                      | 40  | 25       | 15               | 60.0%                |
| Printed check fee income                        | 38  | 31       | 7                | 22.6%                |
| Loan commission and servicing fees              | 36  | 130      | (94)             | -72.3%               |
| Gain (loss) on sale of real estate and vehicles | 6   | (37)     | 43               | 116.2%               |
| Loss on sale of securities                      |   | (8)      | 8                | 100.0%               |
| Loss on sale of loans                           | (4)   |          | (4)              | -100.0%              |
| Tax refunds                                     |   | 58       | (58)             | -100.0%              |
| Other   | 59  | 56       | 3                | 5.4%                 |
| Total non-interest income                       | \$ 3,853                                      | \$ 3,719 | \$ 134           | 3.6%                 |

**Non-interest expenses.** During the nine months ended September 30, 2006, total non-interest expense increased \$398 thousand, or 3%, to \$13.3 million, up from \$12.9 million for the comparable period in 2005. The increase in non-interest expense was primarily the result of increases in salaries and employee benefits, occupancy and equipment costs and other expenses.

Salaries and other employee benefits increased \$295 thousand, or 4%, over the same nine-month period last year. Salaries increased \$330 thousand as a result of staffing additions related to branch administration and the establishment of a customer call and resource center as well as general salary merit increases. An increase of \$165 thousand in employee bonuses and \$94 thousand in employee stock based compensation expense was offset by reductions in workers' compensation costs of \$61 thousand, salary continuation costs of \$172 thousand and an increase in capitalized salary costs of \$85 thousand related to increased loan origination activities. The decrease in salary continuation expense relates to non-recurring accruals for the Company's former President and Chief Executive Officer who retired in December 2005.

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (R), *Share Based Payment* (SFAS 123 (R)), using the modified prospective application transition method to record stock based compensation. As a result of adopting SFAS 123 (R), the Company recorded \$94,000 of employee stock based compensation expense and \$36,000 of director stock based compensation expense during the first nine months of 2006. As of September 30, 2006, there was \$295,000 of unrecognized employee compensation costs and \$110,000 of unrecognized director compensation cost related to non-vested share-based compensation arrangements. These costs are expected to be recognized over a weighted average period of 2.7 years.

Occupancy and equipment expense increased by \$119 thousand to \$2.39 million during the nine months ended September 30, 2006 from \$2.27 million during the first nine months of 2005. This increase included \$32 thousand in utilities and \$66 thousand in premises depreciation and amortization. The increase in other expenses was related to an increase in other losses of \$54 thousand, from \$30 thousand during the 2005 nine month period to \$84 thousand for

the nine months ended September 30, 2006. These losses primarily relate to a higher level of charge-offs related to overdrafts on deposit accounts.

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Armored car and courier costs decreased \$68 thousand, or 25%, as compared to the nine months ended September 30, 2005. Courier savings were realized as a result of the Bank's implementation of Check 21. Check 21 is a federal law promoting the transmission of checks electronically between institutions rather than physically transporting the items. The following table describes the components of non-interest expense for the nine-month periods ending September 30, 2006 and 2005.

|                                       | <b>For the Nine Months<br/>Ended September 30,</b> |                  | <b>Dollar<br/>Change</b> | <b>Percentage<br/>Change</b> |
|---------------------------------------|--|------------------|--------------------------|------------------------------|
|                                       | <b>2006</b>  | <b>2005</b>      |                          |                              |
| Salaries and employee benefits        | \$ 7,366   | \$ 7,071         | \$ 295                   | 4.2%                         |
| Occupancy and equipment               | 2,387  | 2,268            | 119                      | 5.2%                         |
| Professional fees                     | 533  | 542              | (9)                      | -1.7%                        |
| Outside service fees                  | 443  | 509              | (66)                     | -13.0%                       |
| Business development                  | 405  | 364              | 41                       | 11.3%                        |
| Advertising and shareholder relations | 364  | 340              | 24                       | 7.1%                         |
| Telephone and data communication      | 286  | 265              | 21                       | 7.9%                         |
| Director compensation                 | 279  | 237              | 42                       | 17.7%                        |
| Deposit premium amortization          | 226  | 226              |                          |                              |
| Stationery and supplies               | 205  | 253              | (48)                     | -19.0%                       |
| Armored car and courier               | 202  | 270              | (68)                     | -25.2%                       |
| Postage                               | 181  | 182              | (1)                      | -0.5%                        |
| Insurance                             | 129  | 177              | (48)                     | -27.1%                       |
| Loan and collection expenses          | 111  | 79               | 32                       | 40.5%                        |
| Other                                 | 215  | 151              | 64                       | 42.4%                        |
| <b>Total non-interest expense</b>     | <b>\$ 13,332</b>                                   | <b>\$ 12,934</b> | <b>\$ 398</b>            | <b>3.1%</b>                  |

**Provision for income taxes.** The provision for income taxes was \$2.4 million, or 38.1% of income before provision for income taxes for the nine months ended September 30, 2006. This compares to \$1.8 million or 36.1% of pre-tax income during the first nine months of 2005. The increase in provision as a percentage of income before provision for income taxes during 2006 includes the effect of employee stock based compensation expense which is included in expense during 2006, but excluded from the calculation of the provision for income taxes and a reduction in the percentage of tax exempt income as a percentage of income before tax.

**RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006****OVERVIEW**

The Company's net income increased \$148 thousand, or 12%, to \$1.4 million for the three months ended September 30, 2006 from \$1.25 million for the same period in 2005. The primary contributor to the increase in net income for the third quarter of 2006 was a \$342 thousand increase in net interest income. In addition non-interest income increased by \$87 thousand primarily as a result of an increase in service charge income of \$154 thousand. Partially offsetting these revenue gains were increases of \$95 thousand in salaries and benefits, \$52 thousand in occupancy and equipment costs, \$19 thousand in all other non-interest expense categories and \$115 thousand in the provision for income taxes.

The annualized return on average assets was 1.17% for the three months ended September 30, 2006 up from 1.07% for the same period in 2005. The annualized return on average equity was 16.2% for the three months ended September 30, 2006 down from 16.5% for the same period in 2005.

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**Net interest income before provision for loan losses.** Net interest income, on a nontax-equivalent basis, was \$5.7 million for the three months ended September 30, 2006, an increase of \$342 thousand, or 6%, from \$5.4 million for the same period in 2005. The increase in net interest income was attributed to volume and rate increases in the Company's average loan portfolio partially offset by increases in rates paid on interest bearing deposits, an increase in the rates paid on FHLB advances and in the increases in the level of and rates paid on the junior subordinated debentures.

Interest income increased \$927 thousand, or 14%, to \$7.6 million for the three months ended September 30, 2006. Interest and fees on loans increased by \$975 thousand from \$5.9 million for the three months ended September 30, 2005 to \$6.8 million during the 2006 third quarter. The increase in interest income was primarily attributed to volume and rate increases in the loan portfolio. The Company's average loan balances were \$344 million for the three months ended September 30, 2006, up \$26 million, or 8%, from the \$318 million for the same period in 2005. The average yield earned on loans increased by 57 basis points from 7.32% during the third quarter of 2005 to 7.89% during the 2006 quarter.

A positive yield variance of 42 basis points on investment securities was offset by a decrease in the average balance outstanding of \$14.6 million, resulting in a decrease of \$32 thousand in interest earned on investment securities.

Interest expense increased \$585 thousand, or 46%, to \$1.9 million for the three months ended September 30, 2006, up from \$1.3 million for the same period in 2005. The increase in interest expense was primarily attributed to the increase in the level of and rates paid on interest bearing transaction accounts and the increase in rates paid on time deposits, partially offset by the decrease in the level of average time deposits. The Company also experienced an increase in the rates paid on FHLB advances of 179 basis points and rate and volume increases on junior subordinated debentures. Rates on these debentures increased 130 basis points while the level of average amounts outstanding increased \$4.0 million.

The rate and volume increases in interest expense on deposit accounts, excluding time deposits, primarily relates to the introduction of the Company's Money Fund Plu\$ product in September 2005. Money Fund Plu\$ deposits averaged \$48.9 million during the third quarter of 2006 with an average rate paid of 3.59%. The average rate paid on time deposits increased from 2.92% during the 2005 third quarter to 3.64% during the quarter ended September 30, 2006. As a result of the changes noted above, the net interest margin for the three months ended September 30, 2006 increased 20 basis points, or 4%, to 5.34%, up from 5.14% for the same period in 2005.

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The following table presents for the three-month periods indicated the distribution of consolidated average assets, liabilities and shareholders' equity. It also presents the amounts of interest income from interest-earning assets and the resultant annualized yields expressed in both dollars and annualized yield percentages, as well as, the amounts of interest expense on interest-bearing liabilities and the resultant cost expressed in both dollars and annualized rate percentages. Average balances are based on daily averages. Nonaccrual loans are included in the calculation of average loans while nonaccrued interest thereon is excluded from the computation of yields earned:

|  | For the Three Months Ended<br>September 30,<br>2006 |                               |                | For the Three Months Ended<br>September 30,<br>2005 |                               |                |
|--|---|-------------------------------|----------------|---|-------------------------------|----------------|
|  | Average<br>Balance<br>(in<br>thousands)             | Interest<br>(in<br>thousands) | Yield/<br>Rate | Average<br>Balance<br>(in<br>thousands)             | Interest<br>(in<br>thousands) | Yield/<br>Rate |
| <b>Interest-earning assets:</b>          |   |                               |                |   |                               |                |
| Loans (1) (2)                            | \$ 343,622  | \$ 6,837                      | 7.89%          | \$ 317,730  | \$ 5,862                      | 7.32%          |
| Investment securities (1)                | 81,513  | 741                           | 3.61%          | 96,071  | 773                           | 3.19%          |
| Federal funds sold                       | 1,113   | 14                            | 4.99%          | 3,207   | 30                            | 3.71%          |
| Total interest earning<br>assets         | 426,248   | 7,592                         | 7.07%          | 417,008   | 6,665                         | 6.34%          |
| Cash and due from banks                  | 13,119  |                               |                | 17,675  |                               |                |
| Other assets                             | 33,114  |                               |                | 27,467  |                               |                |
| Total assets                             | \$ 472,481  |                               |                | \$ 462,150  |                               |                |
| <b>Interest-bearing liabilities:</b>     |   |                               |                |   |                               |                |
| NOW, money market, &<br>savings deposits | \$ 200,529  | 730                           | 1.44%          | \$ 178,964  | 354                           | 0.78%          |
| Time deposits                            | 90,585  | 831                           | 3.64%          | 102,308   | 753                           | 2.92%          |
| Federal Home Loan<br>Bank advances       | 5,137   | 69                            | 5.33%          | 4,935   | 44                            | 3.54%          |
| Other interest-bearing<br>liabilities    | 289   | 6                             | 8.24%          | 251   | 4                             | 6.32%          |
| Junior subordinated<br>debentures        | 10,310  | 215                           | 8.27%          | 6,320   | 111                           | 6.97%          |
| Total interest-bearing<br>liabilities    | 306,850   | 1,851                         | 2.39%          | 292,778   | 1,266                         | 1.72%          |
| Non-interest bearing<br>deposits         | 127,145   |                               |                | 134,678   |                               |                |
| Other liabilities                        | 4,350   |                               |                | 4,670   |                               |                |
| Shareholders' equity                     | 34,136  |                               |                | 30,024  |                               |                |
| Total liabilities & equity               | \$ 472,481  |                               |                | \$ 462,150  |                               |                |

|   |          |       |          |       |
|---|----------|-------|----------|-------|
| Cost of funding interest-earning assets (3) |          | 1.73% |          | 1.20% |
| Net interest income and margin (4)          | \$ 5,741 | 5.34% | \$ 5,399 | 5.14% |

(1) Not computed on a tax-equivalent basis.

(2) Loan (costs) fees included in loan interest income for the three-month periods ended September 30, 2006 and 2005 were \$(177,000) and \$48,000, respectively.

(3) Total interest expense divided by the average balance of total earning assets.

(4) Net interest income divided by the average balance of total earning assets.

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The following table sets forth changes in interest income and interest expense for the three-month periods indicated and the amount of change attributable to variances in volume, rates and the combination of volume and rates based on the relative changes of volume and rates:

|                                      | <b>2006 over 2005 change in net interest income<br/>for the three months ended September 30<br/>(in thousands)</b> |                 |                |              |
|--------------------------------------|--|-----------------|----------------|--------------|
|                                      | <b>Volume<br/>(1)</b>  | <b>Rate (2)</b> | <b>Mix (3)</b> | <b>Total</b> |
| <b>Interest-earning assets:</b>      |  |                 |                |              |
| Loans                                | \$ 478   | \$ 460          | \$ 37          | \$ 975       |
| Investment securities                | (117)  | 100             | (15)           | (32)         |
| Federal funds sold                   | (19)   | 10              | (7)            | (16)         |
| Total interest income                | 342  | 570             | 15             | 927          |
| <b>Interest-bearing liabilities:</b> |  |                 |                |              |
| NOW, money market, & savings         | 43   | 297             | 36             | 376          |
| Time deposits                        | (86)   | 185             | (21)           | 78           |
| FHLB advances                        | 2  | 22              | 1              | 25           |
| Other interest-bearing liabilities   | 1  | 1               |                | 2            |
| Junior subordinated debentures       | 70   | 21              | 13             | 104          |
| Total interest expense               | 30   | 526             | 29             | 585          |
| Net interest income                  | \$ 312   | \$ 44           | \$ (14)        | \$ 342       |

(1) The volume change in net interest income represents the change in average balance divided by the previous period's rate.

(2) The rate change in net interest income represents the change in rate divided by the previous period's average balance.

(3) The mix change in net interest

income  
represents the  
change in  
average balance  
multiplied by  
the change in  
rate.

**Provision for loan losses.** The Company recorded \$300,000 in provision for loan losses for each of the three months ended September 30, 2006 and 2005. Management assesses its loan quality monthly to maintain an adequate allowance for loan losses. The Company's loan portfolio composition and non-performing assets are further discussed under the financial condition section below.

**Non-interest income.** During the three months ended September 30, 2006, total non-interest income increased by \$87 thousand. This increase resulted from a \$154 thousand increase in service charges on deposit accounts. Partially offsetting the increase in service charge income was a \$70 thousand decline in loan commission and servicing fees primarily related to an increase in the amortization of servicing assets and I/O strips receivable.

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The following table describes the components of non-interest income for the three-month periods ending September 30, 2006 and 2005, in thousands:

|   | <b>For the Three<br/>Months<br/>Ended September<br/>30,</b> |                 | <b>Dollar<br/>Change</b> | <b>Percentage<br/>Change</b> |
|---|---|-----------------|--------------------------|------------------------------|
|   | <b>2006</b>   | <b>2005</b>     |                          |                              |
| Service charges on deposit accounts             | \$ 1,022  | \$ 868          | \$ 154                   | 17.7%                        |
| Merchant processing income                      | 111   | 120             | (9)                      | -7.5%                        |
| Earnings on life insurance policies             | 100   | 84              | 16                       | 19.0%                        |
| Official check fees                             | 46  | 32              | 14                       | 43.8%                        |
| Federal Home Loan Bank dividends                | 28  | 21              | 7                        | 33.3%                        |
| Customer service fees                           | 23  | 30              | (7)                      | -23.3%                       |
| Investment services income                      | 23  | 46              | (23)                     | -50.0%                       |
| Safe deposit box and night depository income    | 15  | 16              | (1)                      | -6.3%                        |
| Other deposit account fees                      | 12  | 11              | 1                        | 9.1%                         |
| Printed check fee income                        | 7   | 10              | (3)                      | -30.0%                       |
| Gain (loss) on sale of real estate and vehicles | 4   | 8               | (4)                      | -50.0%                       |
| Loan commission and servicing fees              | (29)  | 41              | (70)                     | -170.7%                      |
| Other   | 31  | 19              | 12                       | 63.2%                        |
| <b>Total non-interest income</b>                | <b>\$ 1,393</b>   | <b>\$ 1,306</b> | <b>\$ 87</b>             | <b>6.7%</b>                  |

**Non-interest expenses.** Non-interest expense increased by \$166 thousand from \$4.4 million during the third quarter of 2005 to \$4.6 million during the current quarter. This increase is primarily related to an increase of \$95 thousand in salaries and employee benefits. In addition occupancy and equipment expense increased by \$52 thousand related to increased occupancy costs and outside service fees increased by \$52 thousand.

The increase in salaries and employee benefits included an increase in salary expense of \$64 thousand related to higher staffing levels and merit increases, an increase in bonus expense of \$81 thousand, a decrease in capitalized loan origination costs of \$46 thousand and employee stock based compensation expense of \$31 thousand. These increases in expense were partially offset by a decrease in salary continuation expense of \$104 thousand related to non-recurring accruals for the Company's former President and Chief Executive Officer who retired in December 2005.

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The following table describes the components of non-interest expense for the three-month periods ending September 30, 2006 and 2005.

|                                       | <b>For the Three<br/>Months<br/>Ended September<br/>30</b> |             | <b>Dollar<br/>Change</b> | <b>Percentage<br/>Change</b> |
|---------------------------------------|--|-------------|--------------------------|------------------------------|
|                                       | <b>2006</b>  | <b>2005</b> |                          |                              |
| Salaries and employee benefits        | \$ 2,500   | \$ 2,405    | \$ 95                    | 4.0%                         |
| Occupancy and equipment               | 827  | 775         | 52                       | 6.7%                         |
| Outside service fees                  | 224  | 172         | 52                       | 30.2%                        |
| Professional fees                     | 188  | 180         | 8                        | 4.4%                         |
| Business development                  | 123  | 126         | (3)                      | -2.4%                        |
| Advertising and shareholder relations | 122  | 116         | 6                        | 5.2%                         |
| Director compensation                 | 104  | 78          | 26                       | 33.3%                        |
| Telephone and data communication      | 89   | 108         | (19)                     | -17.6%                       |
| Deposit premium amortization          | 76   | 76          |                          | %                            |
| Armored car and courier               | 70   | 82          | (12)                     | -14.6%                       |
| Stationery and supplies               | 65   | 93          | (28)                     | -30.1%                       |
| Postage                               | 58   | 58          |                          | %                            |
| Insurance                             | 45   | 60          | (15)                     | -25.0%                       |
| Loan and collection expense           | 31   | 34          | (3)                      | -8.8%                        |
| Other                                 | 58   | 51          | 7                        | 13.7%                        |
| Total non-interest expense            | \$ 4,580   | \$ 4,414    | \$ 166                   | 3.8%                         |

**Provision for income taxes.** The provision for income taxes was \$858 thousand, or 38.1% of income before provision for income taxes for the three months ended September 30, 2006. This compares to \$743 thousand or 37.3% of pre-tax income during the third quarter of 2005. The increase in provision as a percentage of income before provision for income taxes during 2006 includes the effect of employee stock based compensation expense which is included in expense during 2006, but excluded from the calculation of the provision for income taxes and a reduction in the percentage of tax exempt income as a percentage of income before tax.

**FINANCIAL CONDITION**

**Loan portfolio composition.** The Company continues to manage the mix of its loan portfolio consistent with its identity as a community bank serving the financing needs of all sectors of Northeastern California. Although the Company offers a broad array of financing options, it continues to concentrate its focus on small- to medium-sized commercial businesses. These commercial loans are diversified as to the industries and types of businesses, thus limiting material exposure from any one industry concentration. The Company offers both fixed and floating rate loans and obtains collateral in the form of real property, business assets and deposit accounts, but looks to business and personal cash flows as the primary source of repayment. As of September 30, 2006, agricultural loans increased as a percentage of total loan balances to 10.0% from 9.7% at December 31, 2005 and real estate construction and land development loans increased to 21.4% of total loan balances from 17.5% at December 31, 2005. This increase is consistent with the seasonality of these loans. Consumer loan balances as a percentage of total loans increased slightly to 25.7% from 25.3% at December 31, 2005. The increased percentages in agricultural, real construction and land development and consumer loan balances were offset with a decline in the relative percentage of commercial loan balances which were 10.1% at September 30, 2006, down from 13.1% at December 31, 2005 and a decline in the relative percentage of real estate mortgage loans from 34.4% at December 31, 2005 to 32.7% at September 30, 2006.

**Nonperforming assets.** Nonperforming loans at September 30, 2006 were \$1.0 million, a decrease of \$651 thousand, or 39%, over the \$1.7 million balance at December 31, 2005. Nonperforming assets (which is comprised of

nonperforming loans plus vehicle holdings) at September 30, 2006 were \$1.1 million, a decrease of \$653 thousand, or 38%, over the \$1.7 million balance at December 31, 2005.

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The decrease in both nonperforming loans and assets at September 30, 2006 from December 31, 2005 relates to the reduction in the balance of two nonaccrual SBA loans totaling \$704,000. This reduction includes charge-offs totaling \$77,000 with the remaining balance having been collected through sales of assets or payments from the SBA.

As a result of the above, nonperforming loans as a percentage of total loans decreased to 0.29% at September 30, 2006 from 0.52% at December 31, 2005. In addition, nonperforming assets as a percentage of total assets also decreased to 0.22% at September 30, 2006 from 0.36% at December 31, 2005.

**Analysis of allowance for loan losses.** Net charge-offs during the nine months ended September 30, 2006 totaled \$251 thousand, or 0.08% of average loans during the period, compared to \$333 thousand, or 0.11% of average loans, for the comparable period in 2005. Net charge-offs during the first nine months of 2006 were comprised of \$475 thousand of charge-offs offset by \$224 thousand in recoveries, compared to \$480 thousand of charge-offs offset by \$147 thousand in recoveries for the same period in 2005. The provision for loan losses was \$900 thousand for each of the nine month periods. The allowance for loan losses stood at 1.12% of total loans as of September 30, 2006 up from 1.01% as of December 31, 2005. Based on an evaluation of the credit quality of the loan portfolio and delinquency trends and charge-offs, management believes the allowance for loan losses to be adequate. However, no prediction of the ultimate level of loans charged off in future years can be made with any certainty.

The following table provides certain information for the nine-month period indicated with respect to the Company's allowance for loan losses as well as charge-off and recovery activity.

|   | <b>For the Nine Months<br/>Ended September 30,<br/>(in thousands)</b> |             |
|---|---|-------------|
|   | <b>2006</b>   | <b>2005</b> |
| Balance at January 1,   | \$ 3,256  | \$ 2,762    |
| Charge-offs:  |   |             |
| Commercial and agricultural                                   | (126)   | (141)       |
| Real estate mortgage  |   |             |
| Real estate construction                                      |   |             |
| Consumer  | (349)   | (339)       |
| Total charge-offs   | (475)   | (480)       |
| Recoveries:   |   |             |
| Commercial and agricultural                                   | 45  | 19          |
| Real estate mortgage  |   |             |
| Real estate construction                                      |   |             |
| Consumer  | 179   | 128         |
| Total recoveries  | 224   | 147         |
| Net charge-offs   | (251)   | (333)       |
| Provision for loan losses                                     | 900   | 900         |
| Balance at September 30,                                      | \$ 3,905  | \$ 3,329    |
| Net charge-offs during the nine-month period to average loans | 0.08%   | 0.11%       |
| Allowance for loan losses to total loans                      | 1.12%   | 1.06%       |

**Investment securities.** Investment securities decreased \$17 million to \$81 million at September 30, 2006, down from \$98 million at December 31, 2005. The Company's investment in U.S. Treasury securities as a percentage of the total investment portfolio was 8% at September 30, 2006, down from 10% at December

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31, 2005. The Company's investment in obligations of U.S. agencies remained relatively unchanged at 64% of the investment portfolio at September 30, 2006 and 66% at December 31, 2005. Municipal obligations increased to 18% of the investment portfolio at September 30, 2006, up from 14% at December 31, 2005. Corporate bonds were 10% of the investment portfolio at both September 30, 2006 and December 31, 2005. The decrease in the overall investment portfolio resulted from maturities, calls and pay downs that were used to provide funding for loan growth and liquidity and, to a lesser extent, additional unrealized losses on available for sale securities.

**Premises and equipment.** Premises and equipment increased \$3.0 million, or 27%, to \$14.4 million at September 30, 2006, from \$11.4 million at December 31, 2005. This increase primarily relates to a \$1.2 million purchase of land and a building in Quincy, California to be utilized as a future administrative office location and costs of \$1.5 million for a new branch office in Truckee, California. As of September 30, 2006 land and construction costs for the Truckee branch have amounted to \$3.8 million. The new branch in Truckee, California was opened during October, 2006.

**Deposits.** Total deposits were \$418 million as of September 30, 2006, a decrease of \$9 million, or 2%, from the December 31, 2005 balance of \$427 million. The decrease in deposits resulted from a decline of \$7 million in time deposits and \$3 million in other interest bearing deposits partially offset by a \$1 million increase in non-interest bearing deposits. The Company continues to manage the mix of its deposits consistent with its identity as a community bank serving the financial needs of its customers. As of September 30, 2006, non-interest bearing deposits increased to 31% of total deposits compared to 30% of total deposits as of December 31, 2005. Time deposits decreased to 22% of total deposits as of September 30, 2006 versus 23% as of December 31, 2005 and other interest bearing deposits were 47% of total deposits at both September 30, 2006 and December 31, 2005. While the Company has experienced an overall decline in deposits, its Money Fund Plus checking account, introduced in September 2005, has been very successful in generating interest bearing checking deposits. This account is intended to pay rates comparable to those available on a typical brokerage account. Since its introduction, there has been significant growth in the total Money Fund Plus balances with an increase of \$25.8 million in the first nine months of 2006 and balances at September 30, 2006 of \$47.1 million.

**Federal Home Loan Bank advances.** FHLB advances were \$9.5 million as of September 30, 2006. There were no outstanding advances at December 31, 2005. During the first nine months of 2006 the Company utilized portions of an established line of credit with the Federal Home Loan Bank to meet its short-term liquidity needs. See Liquidity below for a further discussion on available lines of credit.

**CAPITAL RESOURCES**

Shareholders' equity as of September 30, 2006 increased \$3.7 million, or 12%, to \$34.8 million up from \$31.1 million as of December 31, 2005. This increase was the result of earnings during the first nine months of 2006 of \$3.9 million and a decrease in accumulated other comprehensive loss of \$227 thousand partially offset by dividends paid of \$651 thousand. Other less significant changes affecting total shareholders' equity during the first nine months of 2006 included exercise of stock options and stock based compensation expense.

The Company and the Bank are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (FDIC). Failure to meet these minimum capital requirements can initiate certain mandatory and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Each of these components is defined in the regulations. Management believes that the Company met all its capital adequacy requirements and that the Bank met the requirements to be considered well capitalized under the regulatory framework for prompt corrective action as of September 30, 2006.



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The following table presents the Company's and the Bank's capital ratios as of September 30, 2006 and December 31, 2005, dollars in thousands:

|  | September 30, 2006 |              | December 31, 2005 |              |
|--|--------------------|--------------|-------------------|--------------|
|  | Amount             | Ratio        | Amount            | Ratio        |
| <b>Tier 1 Leverage Ratio</b>                         |                    |              |                   |              |
| <b>Plumas Bancorp and Subsidiary</b>                 | <b>\$44,283</b>    | <b>9.4%</b>  | <b>\$40,589</b>   | <b>8.5%</b>  |
| Minimum regulatory requirement                       | 18,893             | 4.0%         | 19,013            | 4.0%         |
| <b>Plumas Bank</b>                                   | <b>42,461</b>      | <b>9.0%</b>  | <b>37,611</b>     | <b>7.8%</b>  |
| Minimum requirement for Well-Capitalized institution | 23,587             | 5.0%         | 24,060            | 5.0%         |
| Minimum regulatory requirement                       | 18,870             | 4.0%         | 19,248            | 4.0%         |
| <b>Tier 1 Risk-Based Capital Ratio</b>               |                    |              |                   |              |
| <b>Plumas Bancorp and Subsidiary</b>                 | <b>44,283</b>      | <b>10.7%</b> | <b>40,589</b>     | <b>10.3%</b> |
| Minimum regulatory requirement                       | 16,579             | 4.0%         | 15,780            | 4.0%         |
| <b>Plumas Bank</b>                                   | <b>42,461</b>      | <b>10.3%</b> | <b>37,611</b>     | <b>9.6%</b>  |
| Minimum requirement for Well-Capitalized institution | 24,834             | 6.0%         | 23,635            | 6.0%         |
| Minimum regulatory requirement                       | 16,556             | 4.0%         | 15,757            | 4.0%         |
| <b>Total Risk-Based Capital Ratio</b>                |                    |              |                   |              |
| <b>Plumas Bancorp and Subsidiary</b>                 | <b>48,242</b>      | <b>11.6%</b> | <b>43,845</b>     | <b>11.1%</b> |
| Minimum regulatory requirement                       | 33,157             | 8.0%         | 31,560            | 8.0%         |
| <b>Plumas Bank</b>                                   | <b>46,365</b>      | <b>11.2%</b> | <b>40,867</b>     | <b>10.4%</b> |
| Minimum requirement for Well-Capitalized institution | 41,391             | 10.0%        | 39,392            | 10.0%        |
| Minimum regulatory requirement                       | 33,112             | 8.0%         | 31,514            | 8.0%         |

**LIQUIDITY**

The Company manages its liquidity to provide the ability to generate funds to support asset growth, meet deposit withdrawals (both anticipated and unanticipated), fund customers' borrowing needs, satisfy maturity of short-term borrowings and maintain reserve requirements. The Company's liquidity needs are managed using assets or liabilities, or both. On the asset side the Company maintains cash and due from banks along with an investment portfolio containing U.S. government securities and agency securities that are classified as available-for-sale. On the liability side, liquidity needs are managed by charging competitive offering rates on deposit products and the use of established lines of credit from correspondent financial institutions and the Federal Home Loan Bank.

The Company has unsecured short-term borrowing agreements with two of its correspondent banks in the amounts of \$10 million and \$5 million. In addition, the Company can borrow up to \$92 million from the Federal Home Loan Bank secured by commercial and residential mortgage loans. At September 30, 2006 the Company had outstanding advances from the Federal Home Loan Bank which totaled \$9.5 million. There were no outstanding advances at December 31, 2005.

Customer deposits are the Company's primary source of funds. Those funds are held in various types of accounts with varying maturities. The Company does not accept brokered deposits. During the first nine months of 2006, deposits decreased \$9 million, or 2%, from the December 31, 2005 balance of \$427 million. The Company has historically experienced a seasonal trend in regards to deposits; whereas the majority of the Company's annual deposit growth has historically occurred in the late spring, summer and fall months.

The Company's available-for-sale securities portfolio, cash and due from banks and short-term borrowings from correspondent banks and the Federal Home Loan Bank serve as the primary sources of liquidity, providing adequate funding for loans during periods of high loan demand. During periods of decreased lending activity, proceeds from the maturity or sale of investment securities, loan payments, and new

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deposits are invested in short-term earning assets, such as Federal funds sold and investment securities, to serve as a source of funding for future loan growth. Management believes that the Company's available sources of funds, including short-term borrowings, will provide adequate liquidity for its operations in the foreseeable future.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is the risk of loss in a financial instrument arising from adverse changes in market rates and prices such as interest rates, commodity prices and equity prices. As a financial institution, the Company's market risk arises primarily from interest rate risk exposure. Fluctuation in interest rates will ultimately impact both the level of income and expense recorded on a large portion of the Company's assets and liabilities, and the market value of all interest earning assets and interest bearing liabilities, dependent upon the stated or estimated maturity date. Since virtually all of the Company's interest earning assets and all of the Company's interest bearing liabilities, with the exception of the junior subordinated debentures, are located at the Bank level, virtually all of the Company's interest rate risk exposure lies at the Bank level. As a result, all significant interest rate risk management procedures are performed at the Bank level. Based upon the nature of its operations, the Bank is not subject to foreign currency exchange or commodity price risk. The Bank's real estate loan portfolio, concentrated primarily within northeastern California, is subject to risks associated with the local economies.

The fundamental objective of the Bank's management of its assets and liabilities is to maximize the economic value of the Company while maintaining adequate liquidity and an exposure to interest rate risk deemed by management to be acceptable. Management believes an acceptable degree of exposure to interest rate risk results from the management of assets and liabilities through maturities, pricing and mix to attempt to neutralize the potential impact of changes in market interest rates. The Bank's profitability is dependent to a large extent upon its net interest income which is the difference between its interest income on interest-earning assets, such as loans and securities, and its interest expense on interest-bearing liabilities, such as deposits and borrowings. The Bank, like other financial institutions, is subject to interest rate risk to the degree that its interest-earning assets reprice differently than its interest-bearing liabilities. The Bank manages its mix of assets and liabilities with the goals of limiting its exposure to interest rate risk, ensuring adequate liquidity, and coordinating its sources and uses of funds.

The Bank seeks to control its interest rate risk exposure in a manner that will allow for adequate levels of earnings and capital over a range of possible interest rate environments. The Bank has adopted formal policies and practices to monitor and manage interest rate risk exposure. As part of this effort, the Bank measures interest rate risk utilizing an internal asset liability management system and employs independent third party reviews to confirm the reasonableness of the assumptions used to measure and report the Bank's interest rate risk, enabling management to make any adjustments necessary.

Interest rate risk is managed by the Bank's Asset Liability Committee (ALCO), which is comprised of members of senior management. The ALCO monitors interest rate risk by analyzing the potential impact on the net interest income from potential changes in interest rates and considers the impact of alternative strategies or changes in balance sheet structure. The ALCO manages the Bank's balance sheet in part to maintain the potential impact on net interest income within acceptable ranges despite changes in interest rates. The Bank's exposure to interest rate risk is reviewed on at least a quarterly basis by ALCO.

In management's opinion there has not been a material change in the Company's market risk or interest rate risk profile for the nine months ended September 30, 2006 compared to December 31, 2005 as discussed in the Company's 2005 annual report on Form 10-K.

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**ITEM 4. CONTROLS AND PROCEDURES**

The Company's Chief Executive Officer and Chief Financial Officer, based on their evaluation of the Company's disclosure controls and procedures as of the end of the Company's fiscal quarter ended September 30, 2006 (as defined in Exchange Act Rule 13a-15(e)), have concluded that the Company's disclosure controls and procedures are adequate and effective for purposes of Rule 13a-15(e) in timely alerting them to material information relating to the Company required to be included in the Company's filings with the SEC under the Securities Exchange Act of 1934.

There were no significant changes in the Company's internal controls over financial reporting or in other factors that could significantly affect internal controls that occurred during the Company's fiscal quarter ended September 30, 2006.

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**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

From time to time, the Company and/or its subsidiaries are a party to claims and legal proceedings arising in the ordinary course of business. In the opinion of the Company's management, the amount of ultimate liability with respect to such proceedings will not have a material adverse effect on the financial condition or results of operations of the Company taken as a whole.

**ITEM 1A RISK FACTORS**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2005, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**ITEM 2. UNREGISTERD SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

The following documents are included or incorporated by reference in this Quarterly Report on Form 10Q:

- 3.1 Articles of Incorporation as amended of Registrant included as exhibit 3.1 to the Registrant's Form S-4, File No. 333-84534, which is incorporated by reference herein.
- 3.2 Bylaws of Registrant included as exhibit 3.2 to the Registrant's Form S-4, File No. 333-84534, which is incorporated by reference herein.
- 3.3 Amendment of the Articles of Incorporation of Registrant dated November 1, 2002.
- 3.4 Amendment of the Articles of Incorporation of Registrant dated August 17, 2005.
- 4 Specimen form of certificate for Plumas Bancorp included as exhibit 4 to the Registrant's Form S-4, File No. 333-84534, which is incorporated by reference herein.
- 10.1 Executive Salary Continuation Agreement of Andrew J. Ryback dated August 23, 2005, is included as Exhibit 10.1 to the Registrant's 8-K filed on October 17, 2005, which is incorporated by this reference herein.
- 10.2 Split Dollar Agreement of Andrew J. Ryback dated August 23, 2005, is included as Exhibit 10.2 to the Registrant's 8-K filed on October 17, 2005, which is incorporated by this reference herein.

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- 10.3 Executive Salary Continuation Agreement as amended of William E. Elliott dated October 13, 1993, is included as Exhibit 10.3 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.4 Split Dollar Agreements of William E. Elliott dated January 23, 2002, is included as Exhibit 10.4 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.5 Employment Agreement of Douglas N. Biddle dated January 1, 2006 is included as Exhibit 10.5 to the Registrant's 8-K filed on March 15, 2006, which is incorporated by this reference herein.
- 10.6 Executive Salary Continuation Agreement as amended of Douglas N. Biddle dated June 2, 1994, is included as Exhibit 10.6 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.7 Split Dollar Agreements of Douglas N. Biddle dated January 24, 2002, is included as Exhibit 10.7 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.9 Executive Salary Continuation Agreement as amended of Dennis C. Irvine dated June 2, 1994, is included as Exhibit 10.9 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.10 Split Dollar Agreements of Dennis C. Irvine dated January 24, 2002, is included as Exhibit 10.10 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.11 First Amendment to Executive Salary Continuation Agreement of Robert T. Herr dated September 15, 2004, is included as Exhibit 10.11 to the Registrant's 8-K filed on September 17, 2004, which is incorporated by this reference herein.
- 10.13 Deferred Fee Agreement as amended of Jerry V. Kehr dated August 19, 1998, is included as Exhibit 10.13 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.14 Amended and Restated Director Retirement Agreement of Jerry V. Kehr dated April 28, 2000, is included as Exhibit 10.14 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.15 Consulting Agreement of Jerry V. Kehr dated May 10, 2000, is included as Exhibit 10.15 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.16 Deferred Fee Agreement of Jerry V. Kehr dated December 21, 2005 is included as Exhibit 10.16 to the Registrant's 8-K filed on March 15, 2006, which is incorporated by this reference herein.
- 10.18 Amended and Restated Director Retirement Agreement of Daniel E. West dated May 10, 2000, is included as Exhibit 10.18 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.19 Consulting Agreement of Daniel E. West dated May 10, 2000, is included as Exhibit 10.19 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.20 Split Dollar Agreements of Robert T. Herr dated September 15, 2004, is included as Exhibit 10.20 to the Registrant's 8-K filed on September 17, 2004, which is incorporated by this reference herein.
- 10.21 Amended and Restated Director Retirement Agreement of Alvin G. Blickenstaff dated April 19, 2000, is included as Exhibit 10.21 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference

herein.

10.22 Consulting Agreement of Alvin G. Blickenstaff dated May 8, 2000, is included as Exhibit 10.22 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.

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- 10.24 Amended and Restated Director Retirement Agreement of Gerald W. Fletcher dated May 10, 2000, is included as Exhibit 10.24 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.25 Consulting Agreement of Gerald W. Fletcher dated May 10, 2000, is included as Exhibit 10.25 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.27 Amended and Restated Director Retirement Agreement of Arthur C. Grohs dated May 9, 2000, is included as Exhibit 10.27 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.28 Consulting Agreement of Arthur C. Grohs dated May 9, 2000, is included as Exhibit 10.28 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.30 Amended and Restated Director Retirement Agreement of Christine McArthur dated May 12, 2000, is included as Exhibit 10.30 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.31 Consulting Agreement of Christine McArthur dated May 12, 2000, is included as Exhibit 10.31 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.33 Amended and Restated Director Retirement Agreement of Terrance J. Reeson dated April 19, 2000, is included as Exhibit 10.33 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.34 Consulting Agreement of Terrance J. Reeson dated May 10, 2000, is included as Exhibit 10.34 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.39 Deferred Fee Agreement of Thomas Watson dated March 3, 2001, is included as Exhibit 10.39 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.40 Form of Indemnification Agreement, is included as Exhibit 10.41 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.41 2001 Stock Option Plan as amended is included as exhibit 99.1 of the Form S-8 filed July 23, 2002, File No. 333-96957.
- 10.42 1991 Stock Option Plan on Form S-8 filed August 19, 2002, File No. 333-98319.
- 10.43 Plumas Bank 401(k) Profit Sharing Plan as amended is included as exhibit 99.1 of the Form S-8 filed February 14, 2003, File No. 333-103229.
- 10.44 Executive Salary Continuation Agreement of Robert T. Herr dated June 4, 2002, is included as Exhibit 10.44 to the Registrant's 10-Q for March 31, 2003, which is incorporated by this reference herein.
- 10.46 1991 Stock Option Plan as amended is included as Exhibit 10.46 to the Registrant's 10-Q for September 30, 2004, which is incorporated by this reference herein.
- 10.47 Specimen form of Incentive Stock Option Agreement under the 1991 Stock Option Plan is included as Exhibit 10.47 to the Registrant's 10-Q for September 30, 2004, which is incorporated by this reference herein.
- 10.48 Specimen form of Non-Qualified Stock Option Agreement under the 1991 Stock Option Plan is included as Exhibit 10.48 to the Registrant's 10-Q for September 30, 2004, which is incorporated by this reference herein.

10.49 Amended and Restated Plumas Bancorp 2001 Stock Option Plan  
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- 10.59 Director Retirement Agreement of Thomas Watson dated May 1, 2003, is included as Exhibit 10.59 to the Registrant's 10-Q for June 30, 2003, which is incorporated by this reference herein.
- 10.60 Consulting Agreement of Thomas Watson dated May 1, 2003, is included as Exhibit 10.60 to the Registrant's 10-Q for June 30, 2003, which is incorporated by this reference herein.
- 10.62 Deferred Fee Agreement of Thomas Watson dated December 23, 2004, is included as Exhibit 10.62 to the Registrant's 8-K filed on January 6, 2005, which is incorporated by this reference herein.
- 10.63 Deferred Fee Agreement of Jerry V. Kehr dated December 24, 2004, is included as Exhibit 10.63 to the Registrant's 8-K filed on January 6, 2005, which is incorporated by this reference herein.
- 11 Computation of per share earnings appears in the attached 10-Q under Plumas Bancorp and Subsidiary Notes to Consolidated Financial Statements as Footnote 5 Earnings Per Share Computation.
- 31.1 Rule 13a-14(a) [Section 302] Certification of Principal Financial Officer dated November 8, 2006
- 31.2 Rule 13a-14(a) [Section 302] Certification of Principal Executive Officer dated November 8, 2006.
- 32.1 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated November 8, 2006.
- 32.2 Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated November 8, 2006.

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**SIGNATURES**

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

**PLUMAS BANCORP**

(Registrant)

Date: November 8, 2006

/s/ Andrew J. Ryback

Andrew J. Ryback

*Executive Vice President Chief Financial  
Officer*

/s/ Douglas N. Biddle

Douglas N. Biddle

*President and Chief Executive Officer*