

COLUMBIA BANKING SYSTEM INC  
Form 10-Q  
November 07, 2007

---

---

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2007.

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number 0-20288

**COLUMBIA BANKING SYSTEM, INC.**  
(Exact name of issuer as specified in its charter)

**Washington**  
(State or other jurisdiction of  
incorporation or organization)

**91-1422237**  
(I.R.S. Employer  
Identification Number)

**1301 "A" Street**  
**Tacoma, Washington**  
(Address of principal executive offices)

**98402-2156**  
(Zip Code)

**(253) 305-1900**  
(Issuer's telephone number, including area code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing

Edgar Filing: COLUMBIA BANKING SYSTEM INC - Form 10-Q

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" in Rule 12b-2 of the Exchange Act.

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

The number of shares of common stock outstanding at October 31, 2007 was 17,894,039

---

---

---

## TABLE OF CONTENTS

|                                       | <b>Page</b>                                                                                                          |    |
|---------------------------------------|----------------------------------------------------------------------------------------------------------------------|----|
| <b>PART I — FINANCIAL INFORMATION</b> |                                                                                                                      |    |
| Item 1.                               | Financial Statements (unaudited)                                                                                     |    |
|                                       | Consolidated Condensed Statements of Income - three months and nine months ended September 30, 2007 and 2006         | 1  |
|                                       | Consolidated Condensed Balance Sheets - September 30, 2007 and December 31, 2006                                     | 2  |
|                                       | Consolidated Condensed Statements of Changes in Shareholders' Equity - nine months ended September 30, 2007 and 2006 | 3  |
|                                       | Consolidated Condensed Statements of Cash Flows - nine months ended September 30, 2007 and 2006                      | 5  |
|                                       | Notes to Unaudited Consolidated Condensed Financial Statements                                                       | 6  |
| Item 2.                               | Management's Discussion and Analysis of Financial Condition and Results of Operations                                | 13 |
| Item 3.                               | Quantitative and Qualitative Disclosures about Market Risk                                                           | 26 |
| Item 4.                               | Controls and Procedures                                                                                              | 26 |
| <b>PART II — OTHER INFORMATION</b>    |                                                                                                                      |    |
| Item 1.                               | Legal Proceedings                                                                                                    | 27 |
| Item 1A.                              | Risk Factors                                                                                                         | 27 |
| Item 2.                               | Unregistered Sales of Equity Securities and Use of Proceeds                                                          | 27 |
| Item 3.                               | Defaults Upon Senior Securities                                                                                      | 27 |
| Item 4.                               | Submission of Matters to a Vote of Security Holders                                                                  | 27 |
| Item 5.                               | Other Information                                                                                                    | 27 |
| Item 6.                               | Exhibits                                                                                                             | 27 |
|                                       | Signatures                                                                                                           | 28 |



**PART I - FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****CONSOLIDATED CONDENSED STATEMENTS OF INCOME**

*Columbia Banking System, Inc.*  
(Unaudited)

| <i>(in thousands except per share)</i>                        | <b>Three Months Ended<br/>September 30,</b> |               | <b>Nine Months Ended<br/>September 30,</b> |               |
|---------------------------------------------------------------|---------------------------------------------|---------------|--------------------------------------------|---------------|
|                                                               | <b>2007</b>                                 | <b>2006</b>   | <b>2007</b>                                | <b>2006</b>   |
| <b><i>Interest Income</i></b>                                 |                                             |               |                                            |               |
| Loans                                                         | \$ 42,353                                   | \$ 32,010     | \$ 112,607                                 | \$ 90,982     |
| Taxable securities                                            | 4,625                                       | 5,019         | 14,067                                     | 15,185        |
| Tax-exempt securities                                         | 2,005                                       | 1,944         | 5,925                                      | 5,124         |
| Federal funds sold and deposits with banks                    | 395                                         | 193           | 1,180                                      | 354           |
| Total interest income                                         | 49,378                                      | 39,166        | 133,779                                    | 111,645       |
| <b><i>Interest Expense</i></b>                                |                                             |               |                                            |               |
| Deposits                                                      | 16,841                                      | 10,868        | 42,617                                     | 28,767        |
| Federal Home Loan Bank advances                               | 2,454                                       | 3,370         | 8,117                                      | 8,344         |
| Long-term obligations                                         | 584                                         | 519           | 1,604                                      | 1,470         |
| Other borrowings                                              | 639                                         | 4             | 2,183                                      | 51            |
| Total interest expense                                        | 20,518                                      | 14,761        | 54,521                                     | 38,632        |
| <b><i>Net Interest Income</i></b>                             | <b>28,860</b>                               | <b>24,405</b> | <b>79,258</b>                              | <b>73,013</b> |
| Provision for loan and lease losses                           | 1,231                                       | 650           | 2,198                                      | 1,115         |
| Net interest income after provision for loan and lease losses | 27,629                                      | 23,755        | 77,060                                     | 71,898        |
| <b><i>Noninterest Income</i></b>                              |                                             |               |                                            |               |
| Service charges and other fees                                | 3,561                                       | 2,891         | 9,813                                      | 8,632         |
| Merchant services fees                                        | 2,251                                       | 2,154         | 6,344                                      | 6,366         |
| Gain on sale of securities available for sale, net            | —                                           | —             | —                                          | 10            |
| Bank owned life insurance ("BOLI")                            | 502                                         | 427           | 1,379                                      | 1,260         |
| Other                                                         | 1,317                                       | 636           | 3,013                                      | 2,080         |
| Total noninterest income                                      | 7,631                                       | 6,108         | 20,549                                     | 18,348        |
| <b><i>Noninterest Expense</i></b>                             |                                             |               |                                            |               |
| Compensation and employee benefits                            | 12,159                                      | 9,878         | 34,365                                     | 28,973        |
| Occupancy                                                     | 3,241                                       | 2,735         | 9,023                                      | 8,068         |
| Merchant processing                                           | 880                                         | 881           | 2,587                                      | 2,552         |
| Advertising and promotion                                     | 575                                         | 608           | 1,779                                      | 2,114         |
| Data processing                                               | 743                                         | 475           | 1,863                                      | 1,795         |
| Legal and professional services                               | 695                                         | 580           | 2,205                                      | 1,547         |
| Taxes, licenses and fees                                      | 773                                         | 637           | 2,089                                      | 1,873         |
| Gain on sale of other real estate owned, net                  | —                                           | —             | —                                          | (11)          |
| Other                                                         | 3,359                                       | 2,304         | 9,182                                      | 10,663        |
| Total noninterest expense                                     | 22,425                                      | 18,098        | 63,093                                     | 57,574        |
| Income before income taxes                                    | 12,835                                      | 11,765        | 34,516                                     | 32,672        |

Edgar Filing: COLUMBIA BANKING SYSTEM INC - Form 10-Q

|                                                     |          |          |           |           |
|-----------------------------------------------------|----------|----------|-----------|-----------|
| Provision for income taxes                          | 3,579    | 3,430    | 9,433     | 8,910     |
| <b>Net Income</b>                                   | \$ 9,256 | \$ 8,335 | \$ 25,083 | \$ 23,762 |
| Net income per common share:                        |          |          |           |           |
| Basic                                               | \$ .53   | \$ .52   | \$ 1.52   | \$ 1.49   |
| Diluted                                             | .53      | .52      | 1.51      | 1.47      |
| Dividends paid per common share                     | \$ .17   | \$ .15   | \$ .49    | \$ .42    |
| Average number of common shares outstanding         |          |          |           |           |
|                                                     | 17,339   | 15,981   | 16,472    | 15,931    |
| Average number of diluted common shares outstanding |          |          |           |           |
|                                                     | 17,533   | 16,143   | 16,636    | 16,135    |

See accompanying notes to unaudited consolidated condensed financial statements.

**CONSOLIDATED CONDENSED BALANCE SHEETS**

*Columbia Banking System, Inc.*  
*(Unaudited)*

| <i>(in thousands)</i>                                                                                 | <b>September 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|-------------------------------------------------------------------------------------------------------|-------------------------------|------------------------------|
| <b>ASSETS</b>                                                                                         |                               |                              |
| Cash and due from banks                                                                               | \$ 82,760                     | \$ 76,365                    |
| Interest-earning deposits with banks                                                                  | 6,695                         | 13,979                       |
| Federal funds sold                                                                                    | 15,000                        | 14,000                       |
| <b>Total cash and cash equivalents</b>                                                                | <b>104,455</b>                | <b>104,344</b>               |
| Securities available for sale at fair value (amortized cost of \$567,804 and \$598,703, respectively) | 564,861                       | 592,858                      |
| Securities held to maturity at cost (fair value of \$1,290 and \$1,871, respectively)                 | 1,245                         | 1,822                        |
| Federal Home Loan Bank stock at cost                                                                  | 11,606                        | 10,453                       |
| Loans held for sale                                                                                   | 2,273                         | 933                          |
| Loans, net of deferred loan fees of (\$4,277) and (\$2,940), respectively                             | 2,212,751                     | 1,708,962                    |
| Less: allowance for loan and lease losses                                                             | 25,380                        | 20,182                       |
| <b>Loans, net</b>                                                                                     | <b>2,187,371</b>              | <b>1,688,780</b>             |
| Interest receivable                                                                                   | 16,292                        | 12,549                       |
| Premises and equipment, net                                                                           | 55,745                        | 44,635                       |
| Other real estate owned                                                                               | 181                           | —                            |
| Goodwill                                                                                              | 93,737                        | 29,723                       |
| Other assets                                                                                          | 84,978                        | 67,034                       |
| <b>Total Assets</b>                                                                                   | <b>\$ 3,122,744</b>           | <b>\$ 2,553,131</b>          |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                                           |                               |                              |
| Deposits:                                                                                             |                               |                              |
| Noninterest-bearing                                                                                   | \$ 474,600                    | \$ 432,293                   |
| Interest-bearing                                                                                      | 2,003,194                     | 1,591,058                    |
| <b>Total deposits</b>                                                                                 | <b>2,477,794</b>              | <b>2,023,351</b>             |
| Short-term borrowings:                                                                                |                               |                              |
| Federal Home Loan Bank advances                                                                       | 252,275                       | 205,800                      |
| Securities sold under agreements to repurchase                                                        | —                             | 20,000                       |
| Other borrowings                                                                                      | 208                           | 198                          |
| <b>Total short-term borrowings</b>                                                                    | <b>252,483</b>                | <b>225,998</b>               |
| Long-term subordinated debt                                                                           | 25,498                        | 22,378                       |





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

*Columbia Banking System, Inc.*  
(Unaudited)

|                                                                                  | Common stock     |            | Retained Earnings | Deferred Compensation<br>(in thousands) | Accumulated Other Comprehensive Loss | Total Shareholders' Equity |
|----------------------------------------------------------------------------------|------------------|------------|-------------------|-----------------------------------------|--------------------------------------|----------------------------|
|                                                                                  | Number of Shares | Amount     |                   |                                         |                                      |                            |
| <b>Balance at December 31, 2005</b>                                              | 15,831           | \$ 163,065 | \$ 66,051         | \$ (92)                                 | \$ (2,782)                           | 226,242                    |
| Comprehensive income:                                                            |                  |            |                   |                                         |                                      |                            |
| Net income                                                                       | —                | —          | 23,762            | —                                       | —                                    | 23,762                     |
| Net unrealized loss from securities, net of reclassification adjustments and tax | —                | —          | —                 | —                                       | (2,074)                              | (2,074)                    |
| Net unrealized gain from cash flow hedging instruments                           | —                | —          | —                 | —                                       | 1,133                                | 1,133                      |
| Total comprehensive income                                                       |                  |            |                   |                                         |                                      | 22,821                     |
| Transition adjustment related to adoption of SFAS 123(R)                         | —                | (92)       | —                 | 92                                      | —                                    | —                          |
| Issuance of stock under equity compensation plan                                 | 140              | 2,158      | —                 | —                                       | —                                    | 2,158                      |
| Issuance of restricted stock under equity compensation plan                      | 76               | 407        | —                 | —                                       | —                                    | 407                        |
| Tax benefit associated with exercise of stock options                            | —                | 882        | —                 | —                                       | —                                    | 882                        |
| Cash dividends paid on common stock                                              | —                | —          | (6,709)           | —                                       | —                                    | (6,709)                    |
| <b>Balance at September 30, 2006</b>                                             | 16,047           | \$ 166,420 | \$ 83,104         | —\$                                     | \$ (3,723)                           | 245,801                    |

See accompanying notes to unaudited consolidated condensed financial statements.

3

---

**CONSOLIDATED CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
(continued)**

*Columbia Banking System, Inc.  
(Unaudited)*

|                                                                          | Common stock |            | Retained  | Deferred       | Accumulated   | Total         |
|--------------------------------------------------------------------------|--------------|------------|-----------|----------------|---------------|---------------|
|                                                                          | Number of    | Amount     | Earnings  | Compensation   | Other         | Shareholders' |
|                                                                          | Shares       |            |           | (in thousands) | Comprehensive | Equity        |
|                                                                          |              |            |           |                | Loss          |               |
| <b>Balance at December 31, 2006</b>                                      | 16,060       | \$ 166,763 | \$ 89,037 | \$ —           | (3,453)       | \$ 252,347    |
| Comprehensive income:                                                    |              |            |           |                |               |               |
| Net income                                                               | —            | —          | 25,083    | —              | —             | 25,083        |
| Other comprehensive income, net of tax:                                  |              |            |           |                |               |               |
| Net unrealized gain from securities, net of reclassification adjustments | —            | —          | —         | —              | 1,911         | 1,911         |
| Net unrealized gain from cash flow hedging instruments                   | —            | —          | —         | —              | 794           | 794           |
| Total comprehensive income                                               |              |            |           |                |               | 27,788        |
| Purchase and retirement of common stock                                  | (65)         | (2,121)    | —         | —              | —             | (2,121)       |
| Acquisitions:                                                            |              |            |           |                |               |               |
| Shares issued to the shareholders of Mountain Bank Holding Company       | 993          | 30,327     |           |                |               | 30,327        |
| Converted Mountain Bank Holding Company stock options                    |              | 1,325      |           |                |               | 1,325         |
| Shares issued to the shareholders of Town Center Bancorp                 | 705          | 23,869     |           |                |               | 23,869        |
|                                                                          |              | 1,598      |           |                |               | 1,598         |

Converted Town  
Center Bancorp  
stock options

|                                                                |        |            |            |      |       |            |
|----------------------------------------------------------------|--------|------------|------------|------|-------|------------|
| Stock award<br>compensation<br>expense                         | 50     | 573        | —          | —    | —     | 573        |
| Issuance of stock<br>under stock option<br>and other plans     | 139    | 2,098      | —          | —    | —     | 2,098      |
| Stock option<br>compensation<br>expense                        | —      | 137        | —          | —    | —     | 137        |
| Tax benefit<br>associated with<br>exercise of stock<br>options | —      | 235        | —          | —    | —     | 235        |
| Cash dividends<br>paid on common<br>stock                      | —      | —          | (8,207)    | —    | —     | (8,207)    |
| <b>Balance at<br/>September 30,<br/>2007</b>                   | 17,882 | \$ 224,804 | \$ 105,913 | \$ — | (748) | \$ 329,969 |

See accompanying notes to unaudited consolidated condensed financial statements.

**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**

*Columbia Banking System, Inc.*  
*(Unaudited)*

| <i>(in thousands)</i>                                                              | <b>Nine Months Ended</b> |                      |
|------------------------------------------------------------------------------------|--------------------------|----------------------|
|                                                                                    | <b>2007</b>              | <b>September 30,</b> |
|                                                                                    |                          | <b>2006</b>          |
| <b>Operating Activities</b>                                                        |                          |                      |
| Net income                                                                         | \$ 25,083                | \$ 23,762            |
| Adjustments to reconcile net income to net cash provided by operating activities:  |                          |                      |
| Provision for loan and lease losses                                                | 2,198                    | 1,115                |
| Deferred income tax benefit                                                        | (1,194)                  | (796)                |
| Excess tax benefit from stock-based compensation                                   | (80)                     | (102)                |
| Stock-based compensation expense                                                   | 710                      | 576                  |
| Gain on sale of investment securities                                              | —                        | (10)                 |
| Gain on sale of other real estate owned and other personal property owned          | —                        | (11)                 |
| Depreciation, amortization and accretion                                           | 4,607                    | 5,787                |
| Net realized gains on sale of assets                                               | (8)                      | (42)                 |
| Net change in:                                                                     |                          |                      |
| Loans held for sale                                                                | (875)                    | 690                  |
| Interest receivable                                                                | (2,074)                  | (2,013)              |
| Interest payable                                                                   | 4,606                    | 481                  |
| Other assets                                                                       | 3,109                    | (3,784)              |
| Other liabilities                                                                  | (6,994)                  | 724                  |
| Net cash provided by operating activities                                          | 29,088                   | 26,377               |
| <b>Investing Activities</b>                                                        |                          |                      |
| Purchases of securities available for sale                                         | (2,888)                  | (137,549)            |
| Proceeds from sales of securities available for sale                               | 28,467                   | 3,865                |
| Proceeds from principal repayments and maturities of securities available for sale | 39,033                   | 101,932              |
| Proceeds from maturities of securities held to maturity                            | 578                      | 328                  |
| Loans originated and acquired, net of principal collected                          | (218,350)                | (91,902)             |
| Purchases of premises and equipment                                                | (4,003)                  | (3,797)              |
| Proceeds from disposal of premises and equipment                                   | 212                      | 206                  |
| Acquisition of Mt. Rainier and Town Center, net of cash acquired                   | (32,429)                 | —                    |
| Proceeds from sales of Federal Reserve Bank stock                                  | 310                      | —                    |
| Proceeds from sales of other real estate and other personal property owned         | —                        | 29                   |
| Net cash used in investing activities                                              | (189,070)                | (126,888)            |
| <b>Financing Activities</b>                                                        |                          |                      |
| Net increase in deposits                                                           | 149,758                  | 14,576               |
| Proceeds from Federal Home Loan Bank advances                                      | 2,353,626                | 2,024,720            |
| Repayment of Federal Home Loan Bank advances                                       | (2,315,151)              | (1,927,220)          |
| Net decrease in repurchase agreement borrowings                                    | (20,000)                 | —                    |
| Net increase (decrease) in other borrowings                                        | 10                       | (1,873)              |

Edgar Filing: COLUMBIA BANKING SYSTEM INC - Form 10-Q

|                                                    |            |            |
|----------------------------------------------------|------------|------------|
| Cash dividends paid on common stock                | (8,207)    | (6,709)    |
| Proceeds from issuance of common stock, net        | 2,098      | 1,989      |
| Repurchase of common stock                         | (2,121)    | —          |
| Excess tax benefit from stock-based compensation   | 80         | 102        |
| Net cash provided by financing activities          | 160,093    | 105,585    |
| Net increase in cash and cash equivalents          | 111        | 5,074      |
| Cash and cash equivalents at beginning of period   | 104,344    | 100,406    |
| Cash and cash equivalents at end of period         | \$ 104,455 | \$ 105,480 |
| Supplemental disclosures of cash flow information: |            |            |
| Cash paid for interest                             | \$ 49,915  | \$ 38,470  |
| Cash paid for income taxes                         | 10,490     | 10,505     |
| Share-based consideration issued for acquisitions  | 57,119     | —          |

See accompanying notes to unaudited consolidated condensed financial statements.

## NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

*Columbia Banking System, Inc.*

### **1. Basis of Presentation and Significant Accounting Policies**

#### *(a) Basis of Presentation*

The interim unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for condensed interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain financial information and footnotes have been omitted or condensed. The consolidated condensed financial statements include the accounts of the Company, and its wholly owned banking subsidiaries Columbia Bank and Bank of Astoria (“Astoria”). All intercompany transactions and accounts have been eliminated in consolidation. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of the results for the interim periods presented have been included. The results of operations for the nine months ended September 30, 2007 are not necessarily indicative of results to be anticipated for the year ending December 31, 2007. The accompanying interim unaudited consolidated condensed financial statements should be read in conjunction with the financial statements and related notes contained in the Company’s 2006 Annual Report on Form 10-K.

#### *(b) Significant Accounting Policies*

The significant accounting policies used in preparation of our consolidated financial statements are disclosed in our 2006 Annual Report on Form 10-K. There have not been any other material changes in our significant accounting policies compared to those contained in our 2006 10-K disclosure for the year ended December 31, 2006.

### **2. Recent Developments**

*Adoption of FIN 48:* Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainties in Income Taxes, an Interpretation of FASB Statement No. 109* (“FIN 48”). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return. As of September 30, 2007 and January 1, 2007, we had no unrecognized tax benefits. Our policy is to recognize interest and penalties on unrecognized tax benefits in “Provision for income taxes” in the Consolidated Statements of Income. There were no amounts related to interest and penalties recognized for the nine months ended September 30, 2007. The tax years subject to examination by federal and state taxing authorities are the years ending December 31, 2006, 2005 and 2004.

*SFAS 157:* Effective January 1, 2008, the Company will adopt Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (“SFAS 157”). This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies whenever assets or liabilities are required or permitted to be measured at fair value under currently existing standards. No additional fair value measurements are required under this Statement. The Company plans to apply the disclosure provisions of SFAS 157 to all fair value measurements and is assessing the impact of adoption of SFAS 157 on our consolidated financial position and results of operations.

*EITF 06-4:* Effective January 1, 2008, the Company will apply the consensus reached by the Emerging Issues Task Force in Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* (“EITF 06-4”). EITF 06-4 provides recognition guidance regarding liabilities and related compensation costs for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods. The Company will recognize the effects of applying the consensus

through a change in accounting principle with a cumulative-effect adjustment to retained earnings of approximately \$2.2 million as of January 1, 2008. We do not expect application of this consensus to have a material effect on our results of operations; however, compensation expense will be higher when compared to prior periods and net income will be lower.

***3. Acquisitions of Mountain Bank Holding Company and Town Center Bancorp***

On July 23, 2007, the Company acquired all of the outstanding common stock of Mountain Bank Holding Company (“Mt. Rainier”), the parent company of Mt. Rainier National Bank, Enumclaw, Washington. Mt. Rainier was merged into Columbia and Mt. Rainier National Bank was merged into Columbia State Bank doing business as Mt. Rainier Bank. The results of Mt. Rainier Bank’s operations are included in those of Columbia State Bank starting in the quarter ended September 30, 2007. The acquisition of Mt. Rainier was consistent with our expansion strategy and with its 7 branches in King and Pierce counties, expanded Columbia’s geographic footprint into adjacent markets.



The aggregate purchase price was \$58.4 million and included \$26.4 million of cash, 993,000 common shares valued at \$30.3 million, options to purchase 97,000 shares of common stock valued at \$1.3 million and \$369,000 of direct merger costs. The value of the common shares issued was determined based on the \$30.53 average closing market price of the Company's common stock for the two trading days before and after the measurement date of May 2, 2007 when the number of shares to be issued was determined. Outstanding Mt. Rainier options were converted at a weighted average fair value of \$13.66 per option.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition.

| <i>(in thousands)</i>                              | <b>July 23,<br/>2007</b> |
|----------------------------------------------------|--------------------------|
| Cash                                               | \$ 12,451                |
| Securities available for sale                      | 21,412                   |
| Federal funds sold                                 | 3,716                    |
| Loans, net of allowance for loan losses of \$1,978 | 175,533                  |
| Premises and equipment, net                        | 9,065                    |
| Other assets                                       | 7,510                    |
| Core deposit intangible                            | 4,244                    |
| Goodwill                                           | 31,490                   |
| <b>Total assets acquired</b>                       | <b>265,421</b>           |
| Deposits                                           | (202,644)                |
| Other liabilities                                  | (4,311)                  |
| <b>Total liabilities assumed</b>                   | <b>(206,955)</b>         |
| <b>Net assets acquired</b>                         | <b>\$ 58,466</b>         |

Additional adjustments to the purchase price allocation may occur as certain items are based on estimates at the time of acquisition, including income taxes and direct costs. The core deposit intangible asset shown in the table above represents the value ascribed to the long-term deposit relationships acquired. This intangible asset is being amortized on an accelerated basis over an estimated useful life of ten years. The core deposit intangible asset is not estimated to have a significant residual value. Goodwill represents the excess of the total purchase price paid for Mt. Rainier over the fair value of the assets acquired, net of the fair values of the liabilities assumed. None of the goodwill is deductible for tax purposes. Goodwill is not amortized, but is evaluated for possible impairment at least annually and more frequently if events and circumstances indicate that the asset might be impaired. No impairment losses were recognized in connection with core deposit intangible or goodwill assets during the period from acquisition on July 23, 2007 to the end of the current reporting period.

On July 23, 2007, the Company also acquired all of the outstanding common stock of Town Center Bancorp ("Town Center"), the parent company of Town Center Bank, Portland, Oregon. Town Center was merged into Columbia and Town Center Bank was merged into Columbia State Bank. The results of Town Center Bank's operations are included in those of Columbia State Bank starting in the quarter ended September 30, 2007. The acquisition of Town Center, with its 5 Oregon locations in the North Clackamas and Southeast Portland area, expanded Columbia's geographic footprint into the Portland metropolitan market and was consistent with our expansion strategy.

The aggregate purchase price was \$45.6 million and included \$19.5 million in cash, 705,000 common shares valued at \$23.9 million, options to purchase 90,000 shares of common stock valued at \$1.6 million and \$667,000 of direct merger costs. The value of the common shares issued was determined based on the \$33.87 average closing market price of the Company's common stock for the two trading days before and after the measurement date of March 28, 2007 when the number of shares to be issued was determined. Outstanding Town Center options were converted at a weighted average fair value of \$17.71 per option.



The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition.

| <i>(in thousands)</i>                              | <b>July 23,<br/>2007</b> |
|----------------------------------------------------|--------------------------|
| Cash                                               | \$ 2,104                 |
| Securities available for sale                      | 13,184                   |
| Federal funds sold                                 | 2,000                    |
| Loans, net of allowance for loan losses of \$1,213 | 107,976                  |
| Premises and equipment, net                        | 1,596                    |
| Bank-owned life insurance                          | 2,312                    |
| Other assets                                       | 2,750                    |
| Core deposit intangible                            | 581                      |
| Goodwill                                           | 32,524                   |
| Total assets acquired                              | 165,027                  |
| Deposits                                           | (102,041)                |
| Advances from Federal Home Loan Bank               | (8,000)                  |
| Other borrowings                                   | (4,087)                  |
| Other liabilities                                  | (5,261)                  |
| Total liabilities assumed                          | (119,389)                |
| Net assets acquired                                | \$ 45,638                |

Additional adjustments to the purchase price allocation may occur as certain items are based on estimates at the time of acquisition, including income taxes and direct costs. The core deposit intangible asset shown in the table above represents the value ascribed to the long-term deposit relationships acquired. This intangible asset is being amortized on an accelerated basis over an estimated useful life of ten years. The core deposit intangible asset is not estimated to have a significant residual value. Goodwill represents the excess of the total purchase price paid for Town Center over the fair value of the assets acquired, net of the fair values of the liabilities assumed. None of the goodwill is deductible for tax purposes. Goodwill is not amortized, but is evaluated for possible impairment at least annually and more frequently if events and circumstances indicate that the asset might be impaired. No impairment losses were recognized in connection with core deposit intangible or goodwill assets during the period from acquisition on July 23, 2007 to the end of the current reporting period.

The following tables present unaudited pro forma consolidated condensed results of operations for the three and nine months ended September 30, 2007 and 2006 prepared as if the acquisitions of Mt. Rainier and Town Center had occurred on January 1, 2006. Any cost savings realized as a result of the acquisitions are not reflected in the pro forma condensed statements of income as no assurance can be given with respect to the final amount of such cost savings. The pro forma results have been prepared for comparison purposes only and are not necessarily indicative of the results that would have been obtained had the acquisitions actually occurred on January 1, 2006.

| <i>(in thousands, except per<br/>common share information)</i> | <b>For The Three<br/>Months Ended<br/>9/30/2007</b> | <b>For The Three<br/>Months Ended<br/>9/30/2006</b> | <b>For The Nine<br/>Months Ended<br/>9/30/2007</b> | <b>For The Nine<br/>Months Ended<br/>9/30/2006</b> |
|----------------------------------------------------------------|-----------------------------------------------------|-----------------------------------------------------|----------------------------------------------------|----------------------------------------------------|
| Net interest income                                            | \$ 29,875                                           | \$ 28,630                                           | \$ 88,723                                          | \$ 85,039                                          |
| Provision for loan and lease losses                            | \$ 1,231                                            | \$ 784                                              | \$ 2,376                                           | \$ 1,587                                           |
| Noninterest income                                             | \$ 7,726                                            | \$ 6,865                                            | \$ 21,876                                          | \$ 20,205                                          |
| Noninterest expense                                            | \$ 23,488(A)                                        | \$ 21,148(B)                                        | \$ 70,590(C)                                       | \$ 66,587(D)                                       |
| Net income                                                     | \$ 9,303                                            | \$ 9,510                                            | \$ 27,225                                          | \$ 26,655                                          |
| Earnings per common share - basic                              | \$ 0.52                                             | \$ 0.54                                             | \$ 1.54                                            | \$ 1.51                                            |
|                                                                | \$ 0.52                                             | \$ 0.53                                             | \$ 1.52                                            | \$ 1.49                                            |

Earnings per common share -  
diluted

(A) Includes reversal of merger related expenses of \$2.6 million, offset by additional core deposit amortization of \$175,000 assuming acquired January 1, 2006.

(B) Includes additional core deposit amortization of \$201,000 assuming acquired January 1, 2006.

(C) Includes reversal of merger related expenses of \$3.1 million, offset by additional core deposit amortization of \$527,000 assuming acquired January 1, 2006.

(D) Includes additional core deposit amortization of \$604,000 assuming acquired January 1, 2006.

#### 4. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share for the three and nine month periods ended September 30, 2007 and 2006 (in thousands, except for per share data):

|                                                                                                  | <b>For The Three<br/>Months Ended<br/>9/30/2007</b> | <b>For The Three<br/>Months Ended<br/>9/30/2006</b> | <b>For The Nine<br/>Months Ended<br/>9/30/2007</b> | <b>For The Nine<br/>Months Ended<br/>9/30/2006</b> |
|--------------------------------------------------------------------------------------------------|-----------------------------------------------------|-----------------------------------------------------|----------------------------------------------------|----------------------------------------------------|
| Net income                                                                                       | \$ 9,256                                            | \$ 8,335                                            | \$ 25,083                                          | \$ 23,762                                          |
| Weighted average common shares outstanding (for basic calculation)                               | 17,339                                              | 15,981                                              | 16,472                                             | 15,931                                             |
| Dilutive effect of outstanding common stock options and nonvested stock awards                   | 194                                                 | 162                                                 | 164                                                | 204                                                |
| Weighted average common stock and common equivalent shares outstanding (for diluted calculation) | 17,533                                              | 16,143                                              | 16,636                                             | 16,135                                             |
| Earnings per common share - basic                                                                | \$ 0.53                                             | \$ 0.52                                             | \$ 1.52                                            | \$ 1.49                                            |
| Earnings per common share - diluted                                                              | \$ 0.53                                             | \$ 0.52                                             | \$ 1.51                                            | \$ 1.47                                            |

Potential dilutive shares are excluded from the computation of earnings per share if their effect is anti-dilutive. For the three and nine month periods ended September 30, 2007 anti-dilutive shares outstanding related to options to acquire common stock were 5,671 and 0, respectively. There were no anti-dilutive shares outstanding for the same periods in 2006.

#### 5. Dividends

On January 25, 2007, the Company declared a quarterly cash dividend of \$0.15 per share, payable on February 21, 2007 to shareholders of record as of the close of business on February 7, 2007. On April 25, 2007, the Company declared a quarterly cash dividend of \$0.17 per share, payable on May 23, 2007, to shareholders of record at the close of business May 9, 2007. On July 26, 2007, the Company declared a quarterly cash dividend of \$0.17 per share, payable on August 22, 2007, to shareholders of record at the close of business August 8, 2007. Subsequent to quarter-end, on October 25, 2007, the Company declared a quarterly cash dividend of \$0.17 per share, payable on November 21, 2007, to shareholders of records at the close of business November 7, 2007. The payment of cash dividends is subject to Federal regulatory requirements for capital levels and other restrictions. In addition, the cash dividends paid by Columbia Bank and Bank of Astoria to the Company are subject to both Federal and State regulatory requirements.

#### 6. Business Segment Information

The Company is managed along two major lines of business within the Columbia Bank banking subsidiary: commercial banking and retail banking. The treasury function of the Company, included in the "Other" category, although not considered a line of business, is responsible for the management of investments and interest rate risk. The Bank of Astoria banking subsidiary operates as a stand-alone segment of the Company.

The Company generates segment results that include balances directly attributable to business line activities. The financial results of each segment are derived from the Company's general ledger system. Overhead, including sales and back office support functions and other indirect expenses are not allocated to the major lines of business. Since the Company is not specifically organized around lines of business, most reportable segments comprise more than one operating activity.

The principal activities conducted by commercial banking are the origination of commercial business loans, private banking services and real estate lending. Retail banking includes all deposit products, with their related fee income, and all consumer loan products as well as commercial loan products offered in the Company's branch offices.

9

---

The organizational structure of the Company and its business line financial results are not necessarily comparable with information from other financial institutions. Financial highlights by lines of business are as follows:

**Condensed Statements of Income:**

| <b>Three Months Ended September 30, 2007</b>                |                            |                               |                           |              |              |
|-------------------------------------------------------------|----------------------------|-------------------------------|---------------------------|--------------|--------------|
| <b>Columbia Bank</b>                                        |                            |                               |                           |              |              |
| <i>(in thousands)</i>                                       | <b>Bank of<br/>Astoria</b> | <b>Commercial<br/>Banking</b> | <b>Retail<br/>Banking</b> | <b>Other</b> | <b>Total</b> |
| Net interest income after provision for loan and lease loss | \$ 2,280                   | \$ 11,893                     | \$ 15,184                 | \$ (1,728)   | \$ 27,629    |
| Other income                                                | 391                        | 1,067                         | 1,962                     | 4,211        | 7,631        |
| Other expense                                               | (1,607)                    | (3,341)                       | (5,755)                   | (11,722)     | (22,425)     |
| Net income before taxes                                     | 1,064                      | 9,619                         | 11,391                    | (9,239)      | 12,835       |
| Income taxes                                                |                            |                               |                           |              | (3,579)      |
| Net income                                                  |                            |                               |                           |              | \$ 9,256     |
| Total assets                                                | \$ 227,784                 | \$ 1,399,262                  | \$ 776,163                | \$ 719,535   | \$ 3,122,744 |

| <b>Three Months Ended September 30, 2006</b>                |                            |                               |                           |              |              |
|-------------------------------------------------------------|----------------------------|-------------------------------|---------------------------|--------------|--------------|
| <b>Columbia Bank</b>                                        |                            |                               |                           |              |              |
| <i>(in thousands)</i>                                       | <b>Bank of<br/>Astoria</b> | <b>Commercial<br/>Banking</b> | <b>Retail<br/>Banking</b> | <b>Other</b> | <b>Total</b> |
| Net interest income after provision for loan and lease loss | \$ 2,213                   | \$ 5,567                      | \$ 18,093                 | \$ (2,118)   | \$ 23,755    |
| Other income                                                | 351                        | 438                           | 1,553                     | 3,766        | 6,108        |
| Other expense                                               | (1,505)                    | (2,865)                       | (4,471)                   | (9,257)      | (18,098)     |
| Net income before taxes                                     | 1,059                      | 3,140                         | 15,175                    | (7,609)      | 11,765       |
| Income taxes                                                |                            |                               |                           |              | (3,430)      |
| Net income                                                  |                            |                               |                           |              | \$ 8,335     |
| Total assets                                                | \$ 222,168                 | \$ 1,151,340                  | \$ 449,355                | \$ 684,587   | \$ 2,507,450 |

| <b>Nine Months Ended September 30, 2007</b>                 |                            |                               |                           |              |              |
|-------------------------------------------------------------|----------------------------|-------------------------------|---------------------------|--------------|--------------|
| <b>Columbia Bank</b>                                        |                            |                               |                           |              |              |
| <i>(in thousands)</i>                                       | <b>Bank of<br/>Astoria</b> | <b>Commercial<br/>Banking</b> | <b>Retail<br/>Banking</b> | <b>Other</b> | <b>Total</b> |
| Net interest income after provision for loan and lease loss | \$ 6,550                   | \$ 21,055                     | \$ 52,987                 | \$ (3,532)   | \$ 77,060    |
| Other income                                                | 1,161                      | 2,427                         | 5,088                     | 11,873       | 20,549       |
| Other expense                                               | (4,629)                    | (8,719)                       | (15,429)                  | (34,316)     | (63,093)     |
| Net income before taxes                                     | 3,082                      | 14,763                        | 42,646                    | (25,975)     | 34,516       |
| Income taxes                                                |                            |                               |                           |              | (9,433)      |
| Net income                                                  |                            |                               |                           |              | \$ 25,083    |
| Total assets                                                | \$ 227,784                 | \$ 1,399,262                  | \$ 776,163                | \$ 719,535   | \$ 3,122,744 |

**Nine Months Ended September 30, 2006**  
**Columbia Bank**

| <i>(in thousands)</i>                                       | <b>Bank of<br/>Astoria</b> | <b>Commercial<br/>Banking</b> | <b>Retail<br/>Banking</b> | <b>Other</b> | <b>Total</b> |
|-------------------------------------------------------------|----------------------------|-------------------------------|---------------------------|--------------|--------------|
| Net interest income after provision for loan and lease loss | \$ 6,355                   | \$ 16,971                     | \$ 53,084                 | \$ (4,512)   | \$ 71,898    |
| Other income                                                | 1,127                      | 1,371                         | 4,645                     | 11,205       | 18,348       |
| Other expense                                               | (4,394)                    | (7,721)                       | (13,426)                  | (32,033)     | (57,574)     |
| Net income before taxes                                     | 3,088                      | 10,621                        | 44,303                    | (25,340)     | 32,672       |
| Income taxes                                                |                            |                               |                           |              | (8,910)      |
| Net income                                                  |                            |                               |                           |              | \$ 23,762    |
| Total assets                                                | \$ 222,168                 | \$ 1,151,340                  | \$ 449,355                | \$ 684,587   | \$ 2,507,450 |

**7. Comprehensive Income**

The components of comprehensive income are as follows:

| <i>(in thousands)</i>                                                                                               | <b>Three Months Ended<br/>September 30,</b> |             |
|---------------------------------------------------------------------------------------------------------------------|---------------------------------------------|-------------|
|                                                                                                                     | <b>2007</b>                                 | <b>2006</b> |
| Net income as reported                                                                                              | \$ 9,256                                    | \$ 8,335    |
| Unrealized gain from securities:                                                                                    |                                             |             |
| Net unrealized gain from available for sale securities arising during the period, net of tax of \$3,259 and \$3,063 | 5,974                                       | 5,542       |
| Unrealized gain from cash flow hedging instruments:                                                                 |                                             |             |
| Net unrealized gain arising during the period, net of tax of \$863 and \$0                                          | 1,583                                       | 1,133       |
| Reclassification adjustment of losses included in income, net of tax of \$13 and \$0                                | 24                                          | —           |
| Net unrealized gain from cash flow hedging instruments                                                              | 1,607                                       | 1,133       |
| Total comprehensive income                                                                                          | \$ 16,837                                   | \$ 15,010   |

| <i>(in thousands)</i>                                                                                                       | <b>Nine Months Ended<br/>September 30,</b> |             |
|-----------------------------------------------------------------------------------------------------------------------------|--------------------------------------------|-------------|
|                                                                                                                             | <b>2007</b>                                | <b>2006</b> |
| Net income as reported                                                                                                      | \$ 25,083                                  | \$ 23,762   |
| Unrealized gain (loss) from securities:                                                                                     |                                            |             |
| Net unrealized gain (loss) from available for sale securities arising during the period, net of tax of \$992 and \$(1,128)  | 1,911                                      | (2,068)     |
| Reclassification of net gain from sale of available for sale securities included in net income, net of tax of \$0 and \$(4) | —                                          | (6)         |
| Net unrealized gain (loss) from securities, net of reclassification adjustments                                             | 1,911                                      | (2,074)     |
| Unrealized gain from cash flow hedging instruments:                                                                         |                                            |             |
| Net unrealized gain arising during the period, net of tax of \$413 and \$0                                                  | 756                                        | 1,133       |
| Reclassification adjustment of losses included in income, net of tax of \$20 and \$0                                        | 38                                         | —           |
| Net unrealized gain from cash flow hedging instruments                                                                      | 794                                        | 1,133       |
| Total comprehensive income                                                                                                  | \$ 27,788                                  | \$ 22,821   |





### 8. Allowance for Loan and Lease Losses and Unfunded Loan Commitments and Letters of Credit

The Company maintains an allowance for loan and lease losses to absorb losses inherent in the loan portfolio. The size of the allowance is determined through quarterly assessments of the estimated probable losses in the loan portfolio. The Company's methodology for making such assessments and determining the adequacy of the allowance includes a general valuation allowance consistent with SFAS No. 5, "Accounting for Contingencies" and criticized/classified loss reserves on specific relationships. Specific allowances for identified problem loans are determined in accordance with SFAS No. 114, "Accounting by Creditors for Impairment of a Loan".

On a quarterly basis the Chief Credit Officer of the Company reviews with Executive Management and the Board of Directors the various additional factors that management considers when determining the adequacy of the allowance, including economic and business condition reviews. These factors include general economic and business conditions affecting the Company's market place, credit quality trends, including trends in nonperforming loans, collateral values, seasoning of the loan portfolio, bank regulatory examination results, findings of internal credit examiners and the duration of current business cycles. The allowance is increased by provisions charged to income, and is reduced by loans charged-off, net of recoveries. While management believes it uses the best information available to determine the allowance for loan losses, unforeseen market conditions could result in adjustments to the allowance, and net income could be affected, if circumstances differ from the assumptions used in determining the allowance.

The following table presents activity in the allowance for loan and lease losses for the three and nine months ended September 30, 2007 and 2006:

| <i>(in thousands)</i>                         | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|-----------------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                               | 2007                                | 2006      | 2007                               | 2006      |
| Beginning balance                             | \$ 21,339                           | \$ 20,990 | \$ 20,182                          | \$ 20,829 |
| Allowance added through business combinations | 3,192                               | —         | 3,192                              | —         |
| Provision charged to expense                  | 1,231                               | 650       | 2,198                              | 1,115     |
| Loans charged-off                             | (528)                               | (843)     | (854)                              | (1,423)   |
| Recoveries                                    | 146                                 | 129       | 662                                | 405       |
| Ending balance                                | \$ 25,380                           | \$ 20,926 | \$ 25,380                          | \$ 20,926 |

Changes in the allowance for unfunded loan commitments and letters of credit are summarized as follows:

| <i>(in thousands)</i>                                                            | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|----------------------------------------------------------------------------------|-------------------------------------|--------|------------------------------------|--------|
|                                                                                  | 2007                                | 2006   | 2007                               | 2006   |
| Beginning balance                                                                | \$ 339                              | \$ 339 | \$ 339                             | \$ 339 |
| Net changes in the allowance for unfunded loan commitments and letters of credit | 10                                  | —      | 10                                 | —      |
| Ending balance                                                                   | \$ 349                              | \$ 339 | \$ 349                             | \$ 339 |

### 9. Goodwill and Intangible Assets

The Company had \$93.7 million in goodwill at September 30, 2007 and \$29.7 million at December 31, 2006. At September 30, 2007 and December 31, 2006, the Company had a core deposit intangible ("CDI") asset of \$7.5 million and \$2.9 million, respectively. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets", goodwill is not amortized but is reviewed for potential impairment during the third quarter on an annual basis, or if events or

circumstances indicate a potential impairment, at the reporting unit level. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. The CDI is evaluated for impairment if events and circumstances indicate a possible impairment based on undiscounted cash flow projections. The CDI is amortized on an accelerated basis over an estimated life of approximately 10 years. Amortization expense related to the CDI was \$95,000 and \$287,000 for the three and nine months ended September 30, 2007, respectively, and \$113,000 and \$339,000 for the three and nine months ended September 30, 2006, respectively. Amortization expense related to the CDI is included in other noninterest expense on the consolidated condensed statements of income.

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

*Columbia Banking System, Inc.*

*This discussion should be read in conjunction with the unaudited consolidated condensed financial statements of Columbia Banking System, Inc. (referred to in this report as "we", "our", and "the Company") and notes thereto presented elsewhere in this report and with the December 31, 2006 audited consolidated financial statements and its accompanying notes included in our recent Annual Report on Form 10-K. In the following discussion, unless otherwise noted, references to increases or decreases in average balances in items of income and expense for a particular period and balances at a particular date refer to the comparison with corresponding amounts for the period or date one year earlier.*

### **NOTE REGARDING FORWARD LOOKING STATEMENTS**

**This Quarterly Report on Form 10-Q may be deemed to include forward looking statements, which management believes to be a benefit to shareholders. These forward looking statements describe management's expectations regarding future events and developments such as future operating results, growth in loans and deposits, continued success of our style of banking and the strength of the local economy. The words "will," "believe," "expect," "should," and "anticipate" and words of similar construction are intended in part to help identify forward looking statements. Future events are difficult to predict, and the expectations described above are necessarily subject to risk and uncertainty that may cause actual results to differ materially and adversely. In addition to discussions about risks and uncertainties set forth from time to time in our filings with the SEC, factors that may cause actual results to differ materially from those contemplated by such forward looking statements include, among others, the following possibilities: (1) local, national, and international economic conditions are less favorable than expected or have a more direct and pronounced effect on us than expected and adversely affect our ability to continue internal growth at historical rates and maintain the quality of our earning assets; (2) changes in interest rates reduce interest margins more than expected and negatively affect funding sources; (3) projected business increases following strategic expansion or opening or acquiring new branches are lower than expected; (4) costs or difficulties related to the integration of acquisitions are greater than expected; (5) competitive pressure among financial institutions increases significantly; (6) legislation or regulatory requirements or changes adversely affect the businesses in which we're engaged; and (7) our ability to realize the efficiencies we expect to receive from our investments in personnel and infrastructure.**

### **CRITICAL ACCOUNTING POLICIES**

Management has identified the accounting policies related to the allowance for loan and lease losses as critical to an understanding of our financial statements. These policies and related estimates are discussed in "Item 7. Management Discussion and Analysis of Financial Condition and Results of Operation" under the heading "Allowance for Loan and Lease Losses and Unfunded Loan Commitments and Letters of Credit" in our 2006 Annual Report on Form 10-K. There have not been any material changes in our critical accounting policies relating to the allowance for loan and lease losses as compared to those disclosed in our 2006 Annual Report on Form 10-K.

### **RESULTS OF OPERATIONS**

Our results of operations are dependent to a large degree on our net interest income. We also generate noninterest income through service charges and fees, merchant services fees, and bank owned life insurance. Our operating expenses consist primarily of compensation and employee benefits, occupancy, merchant card processing, data processing and legal and professional fees. Like most financial institutions, our interest income and cost of funds are affected significantly by general economic conditions, particularly changes in market interest rates, and by

government policies and actions of regulatory authorities.

### **Business Combinations**

In July, 2007, the Company acquired all of the outstanding common stock of both Mountain Bank Holding Company (“Mt. Rainier”), the parent company of Mt. Rainier National Bank, Enumclaw, Washington and Town Center Bancorp (“Town Center”), the parent company of Town Center Bank, Portland, Oregon. The acquisitions were consistent with our expansion strategy and added 7 branches in King and Pierce counties and 5 Oregon branches in the North Clackamas and Southeast Portland area.

The operating results of Mt. Rainier and Town Center were included in the Company’s operating results beginning July 23, 2007; consequently, 2007 quarter-end and year-to-date operating results are not directly comparable to the 2006 results for the same periods. For comparison purposes to prior periods, Mt. Rainier and Town Center combined contributed \$360 million in assets, \$287 million in loans and \$305 million in deposits (as of July 23, 2007).

## Net Interest Income

For the three months ended September 30, 2007, net interest income increased \$4.4 million, or 18%, compared to the third quarter 2006. The increase is due to increased loans outstanding from new originations as well as loans derived from acquisitions. For the three and nine month periods ended September 30, 2007 funding costs have increased as our mix of core deposits has shifted within our existing portfolio toward higher cost core and non-core funding products. In addition, deposits derived from our recent acquisitions were comprised of a greater percentage of non-core deposit products. However, we have maintained a stable net interest margin because we were able to offset the increased funding costs with higher yielding assets. The net interest margin was 4.40% for the third quarter of 2007, compared to 4.41% for the third quarter of 2006. On a linked quarterly basis, the net interest margin was 4.37% and 4.36%, respectively, for the first and second quarters of 2007.

During the third quarter of 2007, the target Federal Funds rate decreased 50 basis points to 4.75%; the Company subsequently reduced its CB Prime Rate to 7.75%. The Company utilizes prime-based interest rate floor derivative instruments to assist in adding stability to interest income and to manage our exposure to such reductions in interest rates. Utilizing these derivative instruments, we have hedged against the variability of cash flows for \$200.0 million of principal on our prime-based loans. Should the prime rate fall below the instruments' strike rates of 7.25% - 7.75%, these interest rate floor derivatives, in conjunction with additional, prudent asset/liability management, should assist us in minimizing the compression to our net interest margin in the event further prime rate reductions occur.

The following tables set forth the average balances of all major categories of interest-earning assets and interest-bearing liabilities, the total dollar amounts of interest income on interest-earning assets and interest expense on interest-bearing liabilities, the average yield earned on interest-earning assets and average rate paid on interest-bearing liabilities by category and in total, net interest income and net interest margin.

| <i>(in thousands)</i>                                             | Three months ending<br>September 30,<br>2007 |                              |                 | Three months ending<br>September 30,<br>2006 |                              |                 |
|-------------------------------------------------------------------|----------------------------------------------|------------------------------|-----------------|----------------------------------------------|------------------------------|-----------------|
|                                                                   | Average<br>Balances (1)                      | Interest<br>Earned /<br>Paid | Average<br>Rate | Average<br>Balances (1)                      | Interest<br>Earned /<br>Paid | Average<br>Rate |
| <b>ASSETS</b>                                                     |                                              |                              |                 |                                              |                              |                 |
| Loans, net                                                        | \$ 2,102,281                                 | \$ 42,353                    | 7.99%           | \$ 1,647,471                                 | \$ 32,010                    | 7.71%           |
| Securities (2)                                                    | 572,124                                      | 7,727                        | 5.36%           | 627,821                                      | 8,031                        | 5.08%           |
| Interest-earning deposits<br>with banks and federal funds<br>sold | 28,082                                       | 395                          | 5.58%           | 15,059                                       | 193                          | 5.10%           |
| Total interest-earning assets                                     | 2,702,487                                    | \$ 50,475                    | 7.41%           | 2,290,351                                    | \$ 40,234                    | 6.97%           |
| Other earning assets                                              | 44,595                                       |                              |                 | 37,927                                       |                              |                 |
| Noninterest-earning assets                                        | 222,115                                      |                              |                 | 176,093                                      |                              |                 |
| Total assets                                                      | \$ 2,969,197                                 |                              |                 | \$ 2,504,371                                 |                              |                 |
| <b>LIABILITIES AND<br/>SHAREHOLDERS'<br/>EQUITY</b>               |                                              |                              |                 |                                              |                              |                 |
| Certificates of deposit                                           | \$ 772,358                                   | \$ 8,976                     | 4.61%           | \$ 541,462                                   | \$ 5,475                     | 4.01%           |
| Savings accounts                                                  | 116,640                                      | 131                          | 0.45%           | 114,769                                      | 105                          | 0.36%           |
| Interest-bearing demand and<br>money market accounts              | 1,038,571                                    | 7,734                        | 2.95%           | 878,638                                      | 5,288                        | 2.39%           |
| Total interest-bearing<br>deposits                                | 1,927,569                                    | 16,841                       | 3.47%           | 1,534,869                                    | 10,868                       | 2.81%           |
| Federal Home Loan Bank<br>advances                                | 178,303                                      | 2,454                        | 5.46%           | 243,513                                      | 3,370                        | 5.49%           |
| Securities sold under<br>agreements to repurchase                 | 44,457                                       | 637                          | 5.68%           | —                                            | —                            | —               |
| Other borrowings and<br>interest-bearing liabilities              | 370                                          | 2                            | 2.14%           | 206                                          | 4                            | 7.69%           |
| Long-term subordinated<br>debt                                    | 24,771                                       | 584                          | 9.35%           | 22,351                                       | 519                          | 9.21%           |
| Total interest-bearing<br>liabilities                             | 2,175,470                                    | 20,518                       | 3.74%           | 1,800,939                                    | 14,761                       | 3.25%           |
| Noninterest-bearing deposits                                      | 455,312                                      |                              |                 | 440,234                                      |                              |                 |
| Other noninterest-bearing<br>liabilities                          | 36,916                                       |                              |                 | 24,926                                       |                              |                 |
| Shareholders' equity                                              | 301,499                                      |                              |                 | 238,272                                      |                              |                 |
| Total liabilities &<br>shareholders' equity                       | \$ 2,969,197                                 |                              |                 | \$ 2,504,371                                 |                              |                 |
| Net interest income (2)                                           |                                              | \$ 29,957                    |                 |                                              | \$ 25,473                    |                 |
| Net interest margin                                               |                                              |                              | 4.40%           |                                              |                              | 4.41%           |

(1) Nonaccrual loans have been included in the tables as loans carrying a zero yield. Amortized net deferred loan fees were included in the interest income calculations. The amortization of net deferred loan fees was \$1.2 million and \$463,000 for the three months ended September 30, 2007 and 2006, respectively.

(2) Tax-exempt income is calculated on a tax equivalent basis, based on a marginal tax rate of 35%.

15

---



| <i>(in thousands)</i>                                             | Nine months ending September 30,<br>2007 |                             |                 | Nine months ending September 30,<br>2006 |                             |                 |
|-------------------------------------------------------------------|------------------------------------------|-----------------------------|-----------------|------------------------------------------|-----------------------------|-----------------|
|                                                                   | Average<br>Balances (1)                  | Interest<br>Earned/<br>Paid | Average<br>Rate | Average<br>Balances (1)                  | Interest<br>Earned/<br>Paid | Average<br>Rate |
| <b>ASSETS</b>                                                     |                                          |                             |                 |                                          |                             |                 |
| Loans, net                                                        | \$ 1,905,945                             | \$ 112,607                  | 7.90%           | \$ 1,609,739                             | \$ 90,982                   | 7.56%           |
| Securities (2)                                                    | 584,057                                  | 23,239                      | 5.32%           | 630,895                                  | 23,138                      | 4.90%           |
| Interest-earning deposits<br>with banks and federal<br>funds sold | 29,621                                   | 1,180                       | 4.96%           | 9,558                                    | 354                         | 4.96%           |
| Total interest-earning assets                                     | 2,519,623                                | \$ 137,026                  | 7.27%           | 2,250,192                                | \$ 114,474                  | 6.80%           |
| Other earning assets                                              | 40,877                                   |                             |                 | 37,516                                   |                             |                 |
| Noninterest-earning assets                                        | 177,599                                  |                             |                 | 170,723                                  |                             |                 |
| Total assets                                                      | \$ 2,738,099                             |                             |                 | \$ 2,458,431                             |                             |                 |
| <b>LIABILITIES AND<br/>SHAREHOLDERS'<br/>EQUITY</b>               |                                          |                             |                 |                                          |                             |                 |
| Certificates of deposit                                           | \$ 645,320                               | \$ 21,431                   | 4.44%           | \$ 535,716                               | \$ 14,981                   | 3.74%           |
| Savings accounts                                                  | 110,340                                  | 349                         | 0.42%           | 117,278                                  | 320                         | 0.37%           |
| Interest-bearing demand and<br>money market accounts              | 973,999                                  | 20,837                      | 2.86%           | 869,438                                  | 13,466                      | 2.07%           |
| Total interest-bearing<br>deposits                                | 1,729,659                                | 42,617                      | 3.29%           | 1,522,432                                | 28,767                      | 2.53%           |
| Federal Home Loan Bank<br>advances                                | 197,294                                  | 8,117                       | 5.50%           | 215,649                                  | 8,344                       | 5.17%           |
| Securities sold under<br>agreements to repurchase                 | 52,967                                   | 2,177                       | 5.50%           | —                                        | —                           | —               |
| Other borrowings and<br>interest-bearing liabilities              | 333                                      | 6                           | 2.41%           | 1,033                                    | 51                          | 6.60%           |
| Long-term subordinated<br>debt                                    | 23,194                                   | 1,604                       | 9.25%           | 22,334                                   | 1,470                       | 8.80%           |
| Total interest-bearing<br>liabilities                             | 2,003,447                                | 54,521                      | 3.64%           | 1,761,448                                | 38,632                      | 2.93%           |
| Noninterest-bearing<br>deposits                                   | 429,836                                  |                             |                 | 437,955                                  |                             |                 |
| Other noninterest-bearing<br>liabilities                          | 31,085                                   |                             |                 | 25,013                                   |                             |                 |
| Shareholders' equity                                              | 273,731                                  |                             |                 | 234,015                                  |                             |                 |
| Total liabilities &<br>shareholders' equity                       | \$ 2,738,099                             |                             |                 | \$ 2,458,431                             |                             |                 |
| Net interest income (2)                                           |                                          | \$ 82,505                   |                 |                                          | \$ 75,842                   |                 |
| Net interest margin                                               |                                          |                             | 4.38%           |                                          |                             | 4.51%           |

(1) Nonaccrual loans have been included in the tables as loans carrying a zero yield. Amortized net deferred loan fees were included in the interest income calculations. The amortization of net deferred loan fees was \$2.5 million and \$1.5 million for the nine months ended September 30, 2007 and 2006, respectively.

(2) Tax-exempt income is calculated on a tax equivalent basis, based on a marginal tax rate of 35%.



The following tables set forth the total dollar amount of change in interest income and interest expense. The changes have been segregated for each major category of interest-earning assets and interest-bearing liabilities into amounts attributable to changes in volume, changes in rates and changes in rates multiplied by volume. Changes attributable to the combined effect of volume and interest rates have been allocated proportionately to the changes due to volume and the changes due to interest rates:

| <i>(in thousands)</i>                                       | <b>Three Months Ended September 30,<br/>2007 Compared to 2006</b> |             |              |
|-------------------------------------------------------------|-------------------------------------------------------------------|-------------|--------------|
|                                                             | <b>Volume</b>                                                     | <b>Rate</b> | <b>Total</b> |
| <b>Interest Income</b>                                      |                                                                   |             |              |
| Loans (1)                                                   | \$ 9,163                                                          | \$ 1,180    | \$ 10,343    |
| Securities (2)                                              | (752)                                                             | 448         | (304)        |
| Interest earning deposits with banks and federal funds sold | 184                                                               | 18          | 202          |
| Interest income (2)                                         | \$ 8,595                                                          | \$ 1,646    | \$ 10,241    |
| <b>Interest Expense</b>                                     |                                                                   |             |              |
| Deposits:                                                   |                                                                   |             |              |
| Certificates of deposit                                     | \$ 2,683                                                          | \$ 818      | \$ 3,501     |
| Savings accounts                                            | 2                                                                 | 24          | 26           |
| Interest-bearing demand and money market accounts           | 1,191                                                             | 1,255       | 2,446        |
| Total interest on deposits                                  | 3,876                                                             | 2,097       | 5,973        |
| Federal Home Loan Bank advances                             | (897)                                                             | (19)        | (916)        |
| Securities sold under agreements to repurchase              | 637                                                               | —           | 637          |
| Long-term subordinated debt                                 | 1                                                                 | (3)         | (2)          |
| Other borrowings and interest bearing liabilities           | 57                                                                | 8           | 65           |
| Interest expense                                            | \$ 3,674                                                          | \$ 2,083    | \$ 5,757     |

(1) Nonaccrual loans have been included in the tables as loans carrying a zero yield. Amortized net deferred loan fees were included in the interest income calculations. The amortization of net deferred loan fees was \$1.2 million and \$463,000 for the three months ended September 30, 2007 and 2006, respectively.

(2) Tax-exempt income is calculated on a tax equivalent basis, based on a marginal tax rate of 35%.

**Nine Months Ended September 30,  
2007 Compared to 2006  
Increase (Decrease) Due to**

| <i>(in thousands)</i>                                       | Volume |         | Rate |       | Total     |
|-------------------------------------------------------------|--------|---------|------|-------|-----------|
| <b>Interest Income</b>                                      |        |         |      |       |           |
| Loans (1)                                                   | \$     | 17,500  | \$   | 4,125 | \$ 21,625 |
| Securities (2)                                              |        | (1,864) |      | 1,965 | 101       |
| Interest earning deposits with banks and federal funds sold |        | 800     |      | 26    | 826       |
| Interest income (2)                                         | \$     | 16,436  | \$   | 6,116 | \$ 22,552 |
| <b>Interest Expense</b>                                     |        |         |      |       |           |
| <b>Deposits:</b>                                            |        |         |      |       |           |
| Certificates of deposit                                     | \$     | 3,640   | \$   | 2,810 | \$ 6,450  |
| Savings accounts                                            |        | (22)    |      | 51    | 29        |
| Interest-bearing demand and money market accounts           |        | 2,237   |      | 5,134 | 7,371     |
| Total interest on deposits                                  |        | 5,855   |      | 7,995 | 13,850    |
| Federal Home Loan Bank advances                             |        | (755)   |      | 528   | (227)     |
| Securities sold under agreements to repurchase              |        | 2,177   |      | —     | 2,177     |
| Long-term subordinated debt                                 |        | 59      |      | 75    | 134       |
| Other borrowings and interest bearing liabilities           |        | (13)    |      | (32)  | (45)      |
| Interest expense                                            | \$     | 7,323   | \$   | 8,566 | \$ 15,889 |

(1) Nonaccrual loans have been included in the tables as loans carrying a zero yield. Amortized net deferred loan fees were included in the interest income calculations. The amortization of net deferred loan fees was \$2.5 million and \$1.5 million for the nine months ended September 30, 2007 and 2006, respectively.

(2) Tax-exempt income is calculated on a tax equivalent basis, based on a marginal tax rate of 35%.

### Provision for Loan and Lease Losses

During the third quarter of 2007, the Company allocated \$1.2 million to its provision for loan and lease losses, compared to \$650,000 for the same period in 2006. For the nine months ended September 30, 2007, the Company allocated \$2.2 million to its provision for loan and lease losses, compared to \$1.1 million for the same period in 2006. The increased allocation is primarily the result of a higher rate of loan growth for the first nine months of 2007 compared to the same period in 2006. Excluding loans derived from our two acquisitions, the Company's net loans increased approximately \$217 million for the nine-months ended September 30, 2007 compared to \$91 million during the same period in 2006.

### Noninterest Income

Noninterest income increased \$1.5 million or 25% to \$7.6 million for the third quarter of 2007 compared to \$6.1 million for the third quarter of 2006. The increase in noninterest income is primarily due to increased service charges, fees, and other miscellaneous income earned over a larger customer base. Service charges and other fees increased \$670,000, or 23%, during the third quarter of 2007 as compared to the same period in 2006. This increase is the result of a change in our deposit account fee structure in conjunction with an increase in the number of deposit accounts. The increase in deposit accounts results from a combination of organic growth and accounts obtained from our two acquisitions which closed early in the third quarter. In addition, fees generated during the third quarter of 2007 within our CB Financial Services unit increased \$197,000, or 104%, over the same period in 2006. Fees earned by that unit during the first nine months of 2007 increased \$509,000, or 86%, over the same period in 2006. Other miscellaneous

income increased \$681,000 or 107% in the third quarter. This increase is attributed to the two acquisitions and fees collected from increased activity within our customer interest rate swap program which we started during the second quarter of 2007.

For the nine months ended September 30, 2007, noninterest income increased \$2.2 million or 12%, compared to the same period in 2006. Service charges and other fees increased 14% in the first nine months of 2007 compared to the same period in 2006. Other noninterest income increased \$933,000, or 45%, in the first nine months of 2007 compared to the same period in 2006. These increases are primarily attributable to the same factors discussed in the previous paragraph.

**Noninterest Expense**

Total noninterest expense increased \$4.3 million, or 24%, for the third quarter of 2007 from \$18.1 million for the third quarter of 2006. During the third quarter of 2006, noninterest expense was decreased by a favorable pre-tax, non-cash adjustment of \$611,000 related to the mark to market adjustments associated with our interest rate floor instruments. Excluding the effect of those adjustments, noninterest expense increased \$3.7 million from the same period in 2006. The two acquisitions completed during the quarter represent approximately \$2.1 million of the increase in noninterest expense inclusive of an estimated \$300,000 of nonrecurring expenses.

Total noninterest expense for the first nine months of 2007 increased \$5.5 million, or 9.6%, as compared to the same period in 2006. During the first nine months of 2006, noninterest expense was impacted unfavorably by a net pre-tax, non cash expense of \$1.2 million related to the mark to market adjustments associated with our interest rate floor instruments. Excluding the effect of those adjustments, and the two acquisitions, comparative noninterest expense for the period increased \$4.6 million from the same period in 2006. This increase is due primarily to increased compensation and employee benefits of \$5.4 million arising from an increase in our productive capacity and banking team additions. Legal and professional services increased \$658,000 for the first nine months of 2007; however, the 2006 expense included a recovery of \$328,000 of previously incurred professional expenses. Finally, occupancy expenses increased \$955,000 from the first nine months of 2006. This increase is due to a general increase in prevailing rents of existing facilities and our expansion efforts within the King, Thurston and Whatcom County markets. These expense increases were partially offset by lower advertising and promotional expenses which decreased \$335,000.

The following table presents selected items included in other noninterest expense and the associated change from period to period:

|                                         | <b>Three months ended</b> |             | <b>Increase</b>   | <b>Nine months ended</b> |             | <b>Increase</b>   |
|-----------------------------------------|---------------------------|-------------|-------------------|--------------------------|-------------|-------------------|
|                                         | <b>September 30,</b>      |             | <b>(Decrease)</b> | <b>September 30,</b>     |             | <b>(Decrease)</b> |
|                                         | <b>2007</b>               | <b>2006</b> | <b>Amount</b>     | <b>2007</b>              | <b>2006</b> | <b>Amount</b>     |
| Core deposit intangible amortization    | \$ 95                     | \$ 113      | \$ (18)           | \$ 287                   | \$ 339      | \$ (52)           |
| Software support & maintenance          | 221                       | 178         | 43                | 610                      | 529         | 81                |
| Telephone & network communications      | 351                       | 253         | 98                | 901                      | 828         | 73                |
| Federal Reserve Bank processing fees    | 98                        | 240         | (142)             | 338                      | 672         | (334)             |
| Supplies                                | 402                       | 304         | 98                | 979                      | 911         | 68                |
| Postage                                 | 435                       | 286         | 149               | 1,006                    | 929         | 77                |
| Investor relations                      | 22                        | 18          | 4                 | 180                      | 153         | 27                |
| Travel                                  | 122                       | 87          | 35                | 321                      | 231         | 90                |
| ATM network                             | 193                       | 138         | 55                | 483                      | 435         | 48                |
| Sponsorships & charitable contributions | 136                       | 103         | 33                | 392                      | 535         | (143)             |
| Regulatory premiums                     | 65                        | 65          | —                 | 173                      | 203         | (30)              |
| Directors fees                          | 96                        | 113         | (17)              | 311                      | 332         | (21)              |
| Employee expenses                       | 162                       | 115         | 47                | 482                      | 419         | 63                |
| Insurance                               | 127                       | 117         | 10                | 346                      | 353         | (7)               |
| Losses on CRA investments (1)           | 78                        | 220         | (142)             | 366                      | 589         | (223)             |
|                                         | —                         | (611)       | 611               | —                        | 1,164       | (1,164)           |

Interest rate floor valuation  
adjustment

|                                     |          |          |          |          |           |            |
|-------------------------------------|----------|----------|----------|----------|-----------|------------|
| Miscellaneous                       | 756      | 565      | 191      | 2,007    | 2,041     | (34)       |
| Total other non-interest<br>expense | \$ 3,359 | \$ 2,304 | \$ 1,055 | \$ 9,182 | \$ 10,663 | \$ (1,481) |

(1) A substantial portion, \$331,000 for the nine months ended September 30, 2007, of these losses is offset by credits taken as a reduction in our current period income tax expense.

Our efficiency ratio [noninterest expense divided by the sum of net interest income and noninterest income on a tax equivalent basis, excluding gain (loss) on sale of investment securities, net cost (gain) of OREO, and mark-to-market adjustments of interest rate floor instruments] was 59.23% for the third quarter 2007 and was 60.79% for the first nine months of 2007, compared to 58.81% and 59.48% for the third quarter and first nine months of 2006, respectively.

### Reconciliation of Financial Data to GAAP Financial Measures

| <i>(in thousands)</i>                                                               | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|-------------------------------------------------------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                                                                     | 2007                                | 2006      | 2007                               | 2006      |
| Net interest income (1)                                                             | \$ 28,860                           | \$ 24,405 | \$ 79,258                          | \$ 73,013 |
| Tax equivalent adjustment for non-taxable investment securities interest income (2) | 1,097                               | 1,068     | 3,247                              | 2,829     |
| Adjusted net interest income                                                        | \$ 29,957                           | \$ 25,473 | \$ 82,505                          | \$ 75,842 |
| Noninterest income                                                                  | \$ 7,631                            | \$ 6,108  | \$ 20,549                          | \$ 18,348 |
| Gain on sale of investment securities, net                                          | —                                   | —         | —                                  | (10)      |
| Tax equivalent adjustment for BOLI income (2)                                       | 270                                 | 230       | 742                                | 675       |
| Adjusted noninterest income                                                         | \$ 7,901                            | \$ 6,338  | \$ 21,291                          | \$ 19,013 |
| Noninterest expense                                                                 | \$ 22,425                           | \$ 18,098 | \$ 63,093                          | \$ 57,574 |
| Net gain on sale of OREO                                                            | —                                   | —         | —                                  | 11        |
| Interest rate floor valuation adjustment                                            | —                                   | 611       | —                                  | (1,164)   |
| Adjusted noninterest expense                                                        | \$ 22,425                           | \$ 18,709 | \$ 63,093                          | \$ 56,421 |
| Efficiency ratio (fully taxable-equivalent)                                         | 59.23%                              | 58.81%    | 60.79%                             | 59.48%    |
| Statutory Tax Rate                                                                  | 35.00%                              | 35.00%    | 35.00%                             | 35.00%    |

(1) Amount represents net interest income before provision for loan losses.

(2) Fully taxable-equivalent basis: Non taxable revenue is increased by the statutory tax rate to recognize the income tax benefit of the income realized.

### Income Taxes

We recorded an income tax provision of \$3.6 million and \$9.4 million for the third quarter and first nine months of 2007, respectively, compared with a provision of \$3.4 million and \$8.9 million for the same periods in 2006. The effective tax rate for the third quarter of 2007 and 2006 was 28% and 29%, respectively, as well as 27% for both nine month periods ending September 30, 2007 and 2006. For additional information, refer to the Company's annual report on Form 10-K for the year ended December 31, 2006.

### Credit Risk Management

The extension of credit in the form of loans or other credit products to individuals and businesses is one of our principal business activities. Our policies and applicable laws and regulations require risk analysis as well as ongoing portfolio and credit management. We manage our credit risk through lending limit constraints, credit review, approval policies, and extensive, ongoing internal monitoring. We also manage credit risk through diversification of the loan portfolio by type of loan, type of industry, type of borrower and by limiting the aggregation of debt limits to a single



borrower. In analyzing our existing portfolio, we review our consumer and residential loan portfolios by their performance as a pool of loans since no single loan is individually significant or judged by its risk rating, size, or potential risk of loss. In contrast, the monitoring process for the commercial business, private banking, real estate construction, and commercial real estate portfolios includes periodic reviews of individual loans with risk ratings assigned to each loan and performance judged on a loan by loan basis. We review these loans to assess the ability of the borrower to service all of its interest and principal obligations and, as a result, the risk rating may be adjusted accordingly. In the event that full collection of principal and interest is not reasonably assured, the loan is appropriately downgraded and, if warranted, placed on nonaccrual status even though the loan may be current as to principal and interest payments. Additionally, we review these types of loans for impairment in accordance with SFAS No. 114, "Accounting by Creditors for the Impairment of a Loan". Impaired loans are considered for nonaccrual status and will typically remain as such until all principal and interest payments are brought current and the prospects for future payments in accordance with the loan agreement appear relatively certain.

Loan policies, credit quality criteria, portfolio guidelines and other controls are established under the guidance of our Chief Credit Officer and approved, as appropriate, by the Board. Credit Administration, together with the loan committee, has the responsibility for administering the credit approval process. As another part of its control process, we use an internal credit review process independent of the lending and credit administration functions to provide assurance that loans and commitments are made and maintained as prescribed by its credit policies. This includes a review of documentation when the loan is initially extended and subsequent monitoring to assess continued performance and proper risk assessment.

### *Loan Portfolio Analysis*

We are a full service commercial bank, originating a wide variety of loans, but concentrating our lending efforts on originating commercial business and commercial real estate loans.

The following table sets forth the Company's loan portfolio by type of loan for the dates indicated:

| <i>(in thousands)</i>                                                | <b>September 30,<br/>2007</b> | <b>% of<br/>Total</b> | <b>December 31,<br/>2006</b> | <b>% of<br/>Total</b> |
|----------------------------------------------------------------------|-------------------------------|-----------------------|------------------------------|-----------------------|
| <b>Commercial business</b>                                           | \$ 732,195                    | 33.1%                 | \$ 617,899                   | 36.1%                 |
| <b>Real estate:</b>                                                  |                               |                       |                              |                       |
| One-to-four family residential                                       | 55,233                        | 2.5                   | 51,277                       | 3.0                   |
| Commercial and five or more family residential commercial properties | 872,342                       | 39.4                  | 687,635                      | 40.3                  |
| <b>Total real estate</b>                                             | <b>927,575</b>                | <b>41.9</b>           | <b>738,912</b>               | <b>43.3</b>           |
| <b>Real estate construction:</b>                                     |                               |                       |                              |                       |
| One-to-four family residential                                       | 231,017                       | 10.4                  | 92,124                       | 5.4                   |
| Commercial and five or more family residential commercial properties | 154,455                       | 7.0                   | 115,185                      | 6.8                   |
| <b>Total real estate construction</b>                                | <b>385,472</b>                | <b>17.4</b>           | <b>207,309</b>               | <b>12.2</b>           |
| <b>Consumer</b>                                                      | <b>171,786</b>                | <b>7.8</b>            | <b>147,782</b>               | <b>8.6</b>            |
| <b>Sub-total loans</b>                                               | <b>2,217,028</b>              | <b>100.2</b>          | <b>1,711,902</b>             | <b>100.2</b>          |
| Less: Deferred loan fees                                             | (4,277)                       | (0.2)                 | (2,940)                      | (0.2)                 |
| <b>Total loans</b>                                                   | <b>\$ 2,212,751</b>           | <b>100.0%</b>         | <b>\$ 1,708,962</b>          | <b>100.0%</b>         |
| Loans held for sale                                                  | \$ 2,273                      |                       | \$ 933                       |                       |

For the first nine months of the year, total loans increased \$504 million, or 29%, from \$1.71 billion at December 31, 2006. Recent acquisitions contributed \$287 million in loans (as of July 23, 2007), while the remaining increase largely resulted from broad-based internal loan growth.

*Commercial Loans:* We are committed to providing competitive commercial lending in our primary market areas. We believe that increases in commercial lending during the nine months of 2007 were due to the confidence of business owners in the stability of our local economy as well as the contribution of our new commercial banking team added late in the fourth quarter of 2006. Management expects to continue to expand its commercial lending products and to emphasize, in particular, relationship banking with businesses, and business owners.

*Real Estate Loans:* These loans are used to collateralize outstanding advances from the FHLB. Generally, our policy is to originate residential loans for sale to third parties. Those residential loans are secured by properties located within our primary market areas, and typically have loan-to-value ratios of 80% or lower. In certain circumstances the loan amounts may exceed 80% if accompanied by private mortgage insurance. However, we do not underwrite residential real estate loans for the subprime market.

Generally, commercial and five-or-more family residential real estate loans are made to borrowers who have existing banking relationships with us. Our underwriting standards generally require that the loan-to-value ratio for these loans not exceed 75% of appraised value, cost, or discounted cash flow value, as appropriate, and that commercial properties maintain debt coverage ratios (net operating income divided by annual debt servicing) of 1.2 or better. However, underwriting standards can be influenced by competition and other factors. We endeavor to maintain the highest practical underwriting standards while balancing the need to remain competitive in our lending practices.

*Real Estate Construction Loans:* We originate a variety of real estate construction loans. One-to-four family residential construction loans are originated for the construction of custom homes (where the home buyer is the borrower) and to provide financing to builders for the construction of pre-sold homes and speculative residential construction. Growth in this sector of the portfolio is due to the contribution of our new Builder Banking team added at the end of the fourth quarter of 2006.

*Consumer Loans:* Consumer loans include automobile loans, boat and recreational vehicle financing, home equity and home improvement loans and miscellaneous personal loans.

*Foreign Loans:* Our banking subsidiaries are not involved with loans to foreign companies or foreign countries.

### Nonperforming Assets

Nonperforming assets consist of: (i) nonaccrual loans; (ii) in most cases restructured loans, for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower or the deferral of interest or principal, have been granted due to the borrower's weakened financial condition (interest on restructured loans is accrued at the restructured rates when it is anticipated that no loss of original principal will occur); (iii) other real estate owned; and (iv) other personal property owned. Collectively, nonaccrual and restructured loans are considered nonperforming loans.

*Nonaccrual loans:* The consolidated financial statements are prepared according to the accrual basis of accounting. This includes the recognition of interest income on the loan portfolio, unless a loan is placed on a nonaccrual basis, which occurs when there are serious doubts about the collectibility of principal or interest. Generally our policy is to discontinue the accrual of interest on all loans past due 90 days or more and place them on nonaccrual status.

At September 30, 2007 nonperforming assets increased to 0.33% of period-end assets up from 0.14% of period-end assets at December 31, 2006. The increase in nonperforming assets during the year is primarily centered in two lending relationships. The first relationship is a single \$4.9 million credit originated in October, 2006 in which Columbia Bank participates with another lender who acts as agent in the transaction. The borrower is engaged in the business of selling residential lots to builders for the purpose of constructing single family residences. The borrower's inability to obtain final plat approval prior to the expiration of agreements for the sale of lots at a predetermined price combined with softening market conditions resulted in new agreements for the sale of lots at prices reduced from the original agreements. Given these developments, management believes the conservative course of action is to place the loan on nonaccrual until a restructure of the debt is completed. The second relationship is for money we advanced in 2005 for the construction of an office building in Oregon; the building has now been completed with the exception of certain tenant improvements. However, the loans became past due as the borrower encountered operational challenges including delays, cost overruns and the inability to lease up the building as originally anticipated. We are pursuing our remedies in accordance with the loan agreements which evidence this transaction.

The following tables set forth, at the dates indicated, information with respect to our nonaccrual loans, restructured loans, total nonperforming loans and total nonperforming assets:

| <i>(in thousands)</i>                          | September 30,<br>2007 | December 31,<br>2006 |
|------------------------------------------------|-----------------------|----------------------|
| Nonaccrual:                                    |                       |                      |
| Commercial business                            | \$ 2,081              | \$ 1,777             |
| Real estate:                                   |                       |                      |
| One-to-four family residential                 | 5,057                 | 366                  |
| Commercial and five or more family residential | 1,246                 | 217                  |
| Total real estate                              | 6,303                 | 583                  |
| Real estate construction:                      |                       |                      |
| Commercial and five or more family residential | 1,500                 | —                    |
| Consumer                                       | 99                    | 54                   |
| Total nonaccrual loans                         | 9,983                 | 2,414                |
| Restructured:                                  |                       |                      |
| Commercial business                            | 257                   | 1,066                |

Edgar Filing: COLUMBIA BANKING SYSTEM INC - Form 10-Q

|                            |    |        |    |       |
|----------------------------|----|--------|----|-------|
| Total nonperforming loans  |    | 10,240 |    | 3,480 |
| Other real estate owned    |    | 181    |    |       |
| Total nonperforming assets | \$ | 10,421 | \$ | 3,480 |

22

---

The remaining nonperforming assets are centered in a small number of lending relationships which management considers adequately reserved. Generally these relationships are well collateralized, though loss of principal on certain of these loans will remain in question until the loans are paid or collateral is liquidated. The Company will continue its collection efforts and liquidation of collateral to recover as large a portion of the nonaccrual assets as possible. Substantially, all nonperforming loans are to borrowers within the state of Washington.

### Allowance for Loan and Lease Losses

At September 30, 2007, our allowance for loan and lease losses (“ALLL”) was \$25.4 million, or 1.15% of total loans (excluding loans held for sale) and 248% and 244% of nonperforming loans and nonperforming assets, respectively. This compares with an allowance of \$20.2 million, or 1.18% of the total loan portfolio (excluding loans held for sale) and 580% of both nonperforming loans and nonperforming assets at December 31, 2006. As noted above, the increase in nonperforming loans at September 30, 2007 is primarily attributable to the lending relationships mentioned above.

There have been no significant changes during the first nine months of 2007 in estimation methods or assumptions that affected our methodology for assessing the appropriateness of the ALLL. Adjustments to the percentages of the allowance allocated to loan categories are made based on trends with respect to delinquencies and problem loans within each pool of loans. The Company maintains a prudent approach to credit quality and underwriting and will continue to add to its loan and lease loss allowance as appropriate in order to maintain adequate reserves.

In addition to the ALLL, we maintain an allowance for unfunded loan commitments and letters of credit. We report this allowance as a liability on our consolidated balance sheet. We determine this amount using estimates of the probability of the ultimate funding and losses related to those credit exposures. This methodology is similar to the methodology we use for determining the adequacy of our ALLL. At September 30, 2007 and December 31, 2006, our allowance for unfunded loan commitments and letters of credit was \$349,000 and \$339,000, respectively. The increase of \$10,000 from year-end 2006 reflects a transfer of allowance resulting from the recent acquisitions.

The following table provides an analysis of the Company’s allowance for loan and lease losses at the dates and the periods indicated:

| <i>(in thousands)</i>                       | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---------------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                             | 2007                                | 2006      | 2007                               | 2006      |
| Beginning balance                           | \$ 21,339                           | \$ 20,990 | \$ 20,182                          | \$ 20,829 |
| Charge-offs:                                |                                     |           |                                    |           |
| Commercial business                         | (459)                               | (439)     | (653)                              | (545)     |
| Commercial real estate                      | —                                   | —         | —                                  | —         |
| Consumer                                    | (69)                                | (404)     | (201)                              | (878)     |
| Total charge-offs                           | (528)                               | (843)     | (854)                              | (1,423)   |
| Recoveries:                                 |                                     |           |                                    |           |
| Commercial business                         | 77                                  | 38        | 485                                | 202       |
| Commercial real estate                      | —                                   | 9         | 12                                 | 64        |
| Real estate: One-to-four family residential | —                                   | 20        | —                                  | 20        |
| Real estate construction:                   |                                     |           |                                    |           |
| One-to-four family residential              | —                                   | —         | —                                  | 7         |
| Consumer                                    | 69                                  | 62        | 165                                | 112       |
| Total recoveries                            | 146                                 | 129       | 662                                | 405       |
| Net charge-offs                             | (382)                               | (714)     | (192)                              | (1,018)   |
| Acquisition transfers of allowance          | 3,192                               | —         | 3,192                              | —         |

Edgar Filing: COLUMBIA BANKING SYSTEM INC - Form 10-Q

|                                                       |    |           |    |           |    |           |    |           |
|-------------------------------------------------------|----|-----------|----|-----------|----|-----------|----|-----------|
| Provision charged to expense                          |    | 1,231     |    | 650       |    | 2,198     |    | 1,115     |
| Ending balance                                        | \$ | 25,380    | \$ | 20,926    | \$ | 25,380    | \$ | 20,926    |
| Total loans, net at end of period (1)                 | \$ | 2,212,751 | \$ | 1,655,809 | \$ | 2,212,751 | \$ | 1,655,809 |
| Allowance for loan and lease losses<br>to total loans |    | 1.15%     |    | 1.26%     |    | 1.15%     |    | 1.26%     |

---

(1) Excludes loans held for sale

During the third quarter of 2007, the Company had net loan charge-offs of \$382,000, compared to net loan charge-offs of \$714,000 in the same period of 2006. Charge-offs during the quarter were primarily centered in one credit to a borrower in the wholesale distribution industry. For the first nine months of 2007, the Company had net loan charge-offs of \$192,000, compared to net loan charge-offs of \$1.0 million during the same period of 2006.

## Securities

Approximately 98% of our securities are classified as available for sale and carried at fair value. These securities are used by management as part of our asset/liability management strategy and may be sold in response to changes in interest rates or significant prepayment risk. In accordance with our investment strategy, management monitors market conditions with a view to realize gains on its available for sale securities portfolio when prudent. At September 30, 2007 and December 31, 2006, the market value of securities available for sale had an unrealized loss, net of tax, of \$1.9 million and \$3.8 million, respectively. The change in market value of securities available for sale is due primarily to fluctuations in interest rates.

Securities decreased \$28 million, or 5%, from \$593 million at December 31, 2006, to \$565 million at September 30, 2007. This decrease was primarily a result of investment maturities and scheduled principal reductions and prepayments on mortgage-backed securities.

The following table sets forth our securities portfolio by type for the dates indicated:

|                                                                                                                               | September 30,<br>2007 | December 31,<br>2006 |
|-------------------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------|
|                                                                                                                               | (in thousands)        |                      |
| <b>Securities Available for Sale</b>                                                                                          |                       |                      |
| U.S. Government-sponsored enterprise                                                                                          | \$ 62,639             | \$ 75,452            |
| U.S. Government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations | 306,194               | 325,096              |
| State and municipal securities                                                                                                | 192,282               | 189,958              |
| Other securities                                                                                                              | 3,746                 | 2,352                |
| <b>Total</b>                                                                                                                  | <b>\$ 564,861</b>     | <b>\$ 592,858</b>    |
| <b>Securities Held to Maturity</b>                                                                                            |                       |                      |
| State & municipal securities                                                                                                  | \$ 1,245              | \$ 1,822             |

## Liquidity and Sources of Funds

Our primary sources of funds are customer deposits. Additionally, we utilize advances from the Federal Home Loan Bank of Seattle (the "FHLB"), wholesale repurchase agreements and brokered deposits to supplement our funding needs. These funds, together with loan repayments, loan sales, retained earnings, equity and other borrowed funds are used to make loans, to acquire securities and other assets, and to fund continuing operations.

### *Deposit Activities*

Our deposit products include a wide variety of transaction accounts, savings accounts and time deposit accounts. Core deposits (demand deposit, savings, and money market accounts) increased \$163.8 million or 11% and certificate of deposit balances increased \$290.6 million, or 53% compared to year-end 2006. The increase in total deposits of \$454.4 million included approximately \$309.5 million from the recent acquisitions.

Competitive pressure from banks in our market areas with a strained liquidity posture may slow our deposit growth but, in the long-term, we anticipate continued growth in our core deposits through both the addition of new customers and our current client base. However, our cost of funds may still increase due to changes in the mix of interest bearing and non-interest bearing accounts and growth in higher yielding deposits.

We have established a branch system to serve our consumer and business depositors. In addition, management's strategy for funding asset growth is to make use of brokered and other wholesale deposits on an as-needed basis. At



September 30, 2007 brokered and other wholesale deposits (excluding public deposits) totaled \$60.5 million or 2% of total deposits compared to \$10.5 million, or less than 1% of total deposits, at year-end 2006. The brokered deposits have varied maturities.

The following table sets forth the Company's deposit base by type of product for the dates indicated:

| <b>Deposit Composition</b>            | <b>September 30,<br/>2007</b> | <b>December 31,<br/>2006</b> | <b>September 30,<br/>2006</b> |
|---------------------------------------|-------------------------------|------------------------------|-------------------------------|
| Demand and other non-interest bearing | \$ 474,600                    | \$ 432,293                   | \$ 455,773                    |
| Interest bearing demand               | 451,282                       | 414,198                      | 395,281                       |
| Money market                          | 593,301                       | 516,415                      | 495,933                       |
| Savings                               | 118,347                       | 110,795                      | 113,647                       |
| Certificates of deposit               | 840,264                       | 549,650                      | 559,431                       |
| Total deposits                        | \$ 2,477,794                  | \$ 2,023,351                 | \$ 2,020,065                  |

### *Borrowings*

We rely on FHLB advances as another source of both short and long-term borrowings. FHLB advances are collateralized by one-to-four family real estate mortgages, investment securities and certain other assets. At September 30, 2007, we had FHLB advances of \$252.3 million, compared to advances of \$205.8 million at December 31, 2006.

We also utilize wholesale repurchase agreements as a supplement to our funding sources. Wholesale repurchase agreements are secured by our U.S. Government agency and government-sponsored enterprise mortgage-backed securities. At September 30, 2007, we had no repurchase agreements, compared to repurchase agreements of \$20.0 million at December 31, 2006. Management anticipates that we will continue to rely on both FHLB advances and wholesale repurchase agreements in the future, and we will use those funds primarily to make loans and purchase securities.

During 2001, the Company, through a special purpose trust ("the Trust") participated in a pooled trust preferred offering, whereby the Trust issued \$22.0 million of 30 year floating rate capital securities. The capital securities constitute guaranteed preferred beneficial interests in debentures issued by the Trust. The debentures had an initial rate of 7.29% and a rate of 8.94% at September 30, 2007. The floating rate is based on the 3-month LIBOR plus 3.58% and is adjusted quarterly. Through the Trust, we may call the debentures at any time for a premium and after ten years at par, allowing us to retire the debt early if market conditions are favorable. Through recent acquisition, the Company assumed an additional \$3.0 million in floating rate trust preferred obligations; these debentures had a rate of 9.11% at September 30, 2007. The floating rate is based on the 3-month LIBOR plus 3.75% and is adjusted quarterly.

The trust preferred obligations are classified as long-term subordinated debt and our related investment in each trust is recorded in other assets on the consolidated balance sheets. The balance of the long-term subordinated debt was \$25.5 million at September 30, 2007 and \$22.4 million at December 31, 2006. The subordinated debt payable to each trust is on the same interest and payment terms as the trust preferred obligations issued by the respective trust.

Additionally, we have a \$20.0 million line of credit with a large commercial bank with an interest rate indexed to LIBOR. At September 30, 2007 and December 31, 2006 there was no balance outstanding on the line of credit. In the event of discontinuance of the line by either party, we have up to two years to repay any outstanding balance.

### **Contractual Obligations & Commitments**

The Company is party to many contractual financial obligations, including repayment of borrowings, operating and equipment lease payments, commitments to extend credit and investments in affordable housing partnerships. At September 30, 2007, the Company had commitments to extend credit of \$873.9 million compared to \$764.3 million at December 31, 2006.

### **Capital Resources**

Shareholders' equity at September 30, 2007 was \$330 million, up 31% from \$252.3 million at December 31, 2006. The increase is due primarily to net income of \$25.1 million for the first nine months of 2007 and the issuance of additional shares as a result of the recent acquisitions. Shareholders' equity was 10.6% and 9.9% of total period-end assets at September 30, 2007, and December 31, 2006, respectively.

*Capital Ratios:* Banking regulations require bank holding companies to maintain a minimum "leverage" ratio of core capital to adjusted quarterly average total assets of at least 3%. In addition, banking regulators have adopted risk-based capital guidelines, under which risk percentages are assigned to various categories of assets and off-balance sheet items to calculate a risk-adjusted capital ratio. Tier I capital generally consists of common shareholders' equity and trust preferred obligations, less goodwill and certain identifiable intangible assets, while Tier II capital includes the allowance for loan losses and subordinated debt, both subject to certain limitations. Regulatory minimum risk-based capital guidelines require Tier I capital of 4% of risk-adjusted assets and total capital (combined Tier I and Tier II) of 8% to be considered "adequately capitalized".

Federal Deposit Insurance Corporation regulations set forth the qualifications necessary for a bank to be classified as “well capitalized”, primarily for assignment of FDIC insurance premium rates. To qualify as “well capitalized,” banks must have a Tier I risk-adjusted capital ratio of at least 6%, a total risk-adjusted capital ratio of at least 10%, and a leverage ratio of at least 5%. Failure to qualify as “well capitalized” can negatively impact a bank’s ability to expand and to engage in certain activities.

The Company and its subsidiaries qualify as “well-capitalized” at September 30, 2007 and December 31, 2006.

|                                 | Company   |            | Columbia Bank |            | Astoria   |            | Requirements           |                  |
|---------------------------------|-----------|------------|---------------|------------|-----------|------------|------------------------|------------------|
|                                 | 9/30/2007 | 12/31/2006 | 9/30/2007     | 12/31/2006 | 9/30/2007 | 12/31/2006 | Adequately capitalized | Well-capitalized |
| Total risk-based capital ratio  | 11.01%    | 13.23%     | 10.35%        | 12.50%     | 12.50%    | 11.98%     | 8%                     | 10%              |
| Tier I risk-based capital ratio | 10.00%    | 12.21%     | 9.35%         | 11.48%     | 11.28%    | 10.93%     | 4%                     | 6%               |
| Leverage ratio                  | 8.87%     | 9.86%      | 8.44%         | 9.32%      | 9.06%     | 8.48%      | 4%                     | 5%               |

#### *Stock Repurchase Program*

In March 2002 the Board of Directors approved a stock repurchase program whereby the Company may systematically repurchase up to 500,000 of its outstanding shares of Common Stock. The Company may repurchase shares from time to time in the open market or in private transactions, under conditions which allow such repurchases to be accretive to earnings while maintaining capital ratios that exceed the guidelines for a well-capitalized financial institution.

In August, 2007 the Company repurchased a block of 64,788 shares of its common stock from Thomas L. Matson, Sr., a director of Columbia. The shares were purchased pursuant to Columbia’s stock repurchase program at \$32.74 per share, the closing price of Columbia’s common stock on August 17, 2007.

### **Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

A number of measures are used to monitor and manage interest rate risk, including income simulations and interest sensitivity (gap) analyses. An income simulation model is the primary tool used to assess the direction and magnitude of changes in net interest income resulting from changes in interest rates. Basic assumptions in the model include prepayment speeds on mortgage-related assets, cash flows and maturities of other investment securities, loan and deposit volumes and pricing. These assumptions are inherently subjective and, as a result, the model cannot precisely estimate net interest income or precisely predict the impact of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes and changes in market conditions and management strategies, among other factors. At September 30, 2007, based on the measures used to monitor and manage interest rate risk, there has not been a material change in the Company’s interest rate risk since December 31, 2006. For additional information, refer to “Management’s Discussion and Analysis of Financial Condition and Results of Operation” referenced in the Company’s 2006 Annual Report on Form 10-K.

### **Item 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

An evaluation was carried out under the supervision and with the participation of the Company’s management, including the Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934). Based

on that evaluation, the CEO and CFO have concluded that as of the end of the period covered by this report, our disclosure controls and procedures are effective in ensuring that the information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is (i) accumulated and communicated to our management (including the CEO and CFO) to allow timely decisions regarding required disclosure, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

### **Changes in Internal Controls Over Financial Reporting**

There was no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1. LEGAL PROCEEDINGS**

The Company and its banking subsidiaries are parties to routine litigation arising in the ordinary course of business. Management believes that, based on the information currently known to them, any liabilities arising from such litigation will not have a material adverse impact on the Company's financial condition, results of operations or cash flows.

### **Item 1A. RISK FACTORS**

There have been no material changes from risk factors previously disclosed in the Company's 2006 Annual Report on Form 10-K.

### **Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

In August, 2007 the Company repurchased a block of 64,788 shares of its common stock from Thomas L. Matson, Sr., a director of Columbia. The shares were purchased pursuant to Columbia's stock repurchase program at \$32.74 per share, the closing price of Columbia's common stock on August 17, 2007. In total, 64,788 shares have been repurchased under this program and 435,212 shares may yet be purchased.

### **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**

- 3.1 Amended and Restated Bylaws
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

COLUMBIA BANKING SYSTEM, INC.

Date: November 7, 2007

By /s/ MELANIE J. DRESSEL  
Melanie J. Dressel  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: November 7, 2007

By /s/ GARY R. SCHMINKEY  
Gary R. Schminkey  
Executive Vice President and  
Chief Financial Officer  
(Principal Financial Officer)

Date: November 7, 2007

By /s/ CLINT E. STEIN  
Clint E. Stein  
Senior Vice President and  
Chief Accounting Officer  
(Principal Accounting Officer)