Bank of Commerce Holdings
Form 10-Q
November 09, 2007

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

(Mark One)

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

For the quarterly period ended September 30, 2007

OR

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

For the transition period from __________ to __________

Commission file number 0-25135

Bank of Commerce Holdings

(Exact name of Registrant as specified in its charter)

California	94-2823865
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1901 Churn Creek Road Redding, California	96002
(Address of principal executive offices)	(Zip code)

Registrant s telephone number, including area code: (530) 722-3939

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

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, no par value per share

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

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

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes o No þ

Outstanding shares of Common Stock, no par value, as of September 28, 2007: 8,784,359

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Condensed Consolidated Balance Sheets
(Unaudited)

Amounts in thousands, except per share data	September 30, 2007	December 31, 2006	September 30, 2006
ASSETS			
Cash and due from banks	$ 12,366	$ 14,661	$ 17,535
Federal funds sold and securities purchased under agreements to resell	7,980	24,605	28,010
Cash and cash equivalents	20,346	39,266	45,545
Securities available-for-sale (including pledged collateral of $85,574 at September 30, 2007; $71,686 at December 31, 2006 and $74,022 at September 30, 2006)	93,423	95,601	97,614
Securities held-to-maturity, at cost (estimated fair value of $10,538 at September 30, 2007, $10,892 at December 31, 2006 and $10,788 at September 30, 2006)	10,592	10,810	10,841
Loans, net of the allowance for loan losses of $5,061 at September 30, 2007, $4,904 at December 31, 2006 and $4,753 at September 30, 2006	461,171	408,990	403,657
Bank premises and equipment, net	10,464	8,595	7,350
Other assets	19,979	20,180	20,211
TOTAL ASSETS	$ 615,975	$ 583,442	$ 585,218
LIABILITIES AND STOCKHOLDERS EQUITY			
Demand noninterest bearing	$ 70,809	$ 84,779	$ 81,125
Demand interest bearing	136,219	119,437	111,439
Savings	44,406	22,749	22,610
Certificates of deposits	220,803	212,442	214,019
Total deposits	472,237	439,407	429,193
Securities sold under agreements to repurchase	26,755	37,117	35,260
Federal Home Loan Bank borrowings	50,000	40,000	55,000
Other liabilities	6,734	7,537	6,352
Guaranteed Preferred Beneficial Interests in Company s Junior Subordinated Debt payable to unconsolidated subsidiary grantor trust	15,465	15,465	15,465
Total Liabilities	571,191	539,526	541,270

Commitments and contingencies			
Stockholders Equity:			
Preferred stock, no par value, 2,000,000 authorized no shares issued and outstanding in 2007 and 2006			
Common stock , no par value, 50,000,000 shares authorized; 8,784,359 shares issued and outstanding at September 30, 2007, 8,847,042 at December 31, 2006 and 8,926,842 at September 30, 2006	10,252	11,517	12,416
Retained earnings	35,617	33,336	32,526
Accumulated other comprehensive (loss), net of tax	(1,085)	(937)	(994)
Total Stockholders equity	44,784	43,916	43,948
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 615,975	$ 583,442	$ 585,218

See accompanying notes to condensed consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Condensed Consolidated Statements of Income (Unaudited)
Three and nine months ended September 30, 2007 and 2006

	Three Months Ended		Nine Months Ended	
Amounts in thousands, except for per share data	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Interest income:				
Interest and fees on loans	$ 9,350	$ 8,501	$ 26,779	$ 23,881
Interest on tax exempt securities	324	231	936	494
Interest on U.S. government securities	798	849	2,446	2,575
Interest on federal funds sold and securities purchased under agreements to resell	190	383	580	658
Interest on other securities	22	25	67	113
Total interest income	10,684	9,989	30,808	27,721
Interest expense:				
Interest on demand deposits	791	449	1,935	968
Interest on savings deposits	359	69	885	209
Interest on time deposits	2,702	2,423	7,934	5,844
Securities sold under agreements to repurchase	289	328	1,012	794
Interest on FHLB and other borrowing expense	628	918	1,799	2,492
Interest on junior subordinated debt payable to unconsolidated subsidiary grantor trust	274	272	814	796
Total interest expense	5,043	4,459	14,379	11,103
Net interest income	5,641	5,530	16,429	16,618
Provision for loan and lease losses	115	72	121	226
Net interest income after provision for loan losses	5,526	5,458	16,308	16,392
Noninterest income:				
Service charges on deposit accounts	70	81	215	255
Payroll and benefit processing fees	90	89	287	287
Earnings on cash surrender value - Bank owned life insurance	100	80	294	231
Net gain (loss) on sale of securities available-for-sale	0	(171)	46	(171)
Net gain on sale of loans	0	90	0	90
Merchant credit card service income, net	109	110	297	280
Mortgage brokerage fee income	21	32	56	84
Other income	136	117	447	331
Total non-interest income	526	428	1,642	1,387
Noninterest expense:				
Salaries and related benefits	2,402	1,996	6,458	5,870

Occupancy and equipment expense	635	467	1,636	1,350
FDIC insurance premium	13	12	39	36
Data processing fees	82	53	227	169
Professional service fees	216	149	663	503
Payroll and Benefit fees	25	24	81	78
Deferred compensation expense	105	94	303	272
Stationery and Supplies	34	71	141	180
Postage	39	26	106	91
Directors expense	86	45	207	170
Other expenses	391	362	1,356	1,128
Total non-interest expense	4,028	3,299	11,217	9,847
Income before provision for income taxes	2,024	2,587	6,733	7,932
Provision for income taxes	693	915	2,315	2,979
Net Income	$ 1,331	$ 1,672	$ 4,418	$ 4,953
Basic earnings per share	$ 0.15	$ 0.19	$ 0.50	$ 0.57
Weighted average shares basic	8,904	8,764	8,893	8,723
Diluted earnings per share	$ 0.15	$ 0.19	$ 0.49	$ 0.55
Weighted average shares diluted	8,929	8,937	8,983	8,945
Cash dividend per common share	$ 0.08	$ 0.07	$ 0.24	$ 0.20

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows (Unaudited)
Nine months ended September 30, 2007 and 2006

Dollars in thousands	September 30, 2007	September 30, 2006
Cash flows from operating activities:		
Net Income	$ 4,418	$ 4,953
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	121	226
Provision for depreciation and amortization	759	516
Compensation expense associated with stock options	48	40
Tax benefits from the exercise of stock options	(118)	(560)
(Gain) Loss on sale of securities available for sale	(46)	171
Amortization of investment premiums and accretion of discounts, net	(4)	8
Gain on sale of loans	0	(90)
Proceeds from sales of loans	0	2,090
Loans originated for sale	0	(2,000)
Gain on sale of equipment	(31)	0
Deferred Income Taxes, net	(260)	183
Effect of changes in:		
Other assets	494	(4,742)
Deferred loan fees	(66)	(43)
Other liabilities	(566)	(842)
Net cash (used in) /provided by operating activities	4,749	(90)
Cash flows from investing activities:		
Proceeds from maturities of available-for-sale securities	5,161	8,100
Proceeds from sales of available-for-sale securities	20,569	10,258
Proceeds from maturities of held-to-maturity securities	111	518
Purchases of available-for-sale securities	(23,495)	(26,155)
Loan originations, net of principal repayments	(52,237)	(40,535)
Purchases of premises and equipment	(2,702)	(2,236)
Net cash used by investing activities	(52,593)	(50,050)
Cash flows from financing activities:		
Net increase in deposits	32,830	57,077
Net increase (decrease) in securities sold under agreement to repurchase	(10,362)	12,376
Proceeds from Federal Home Loan Bank advances	20,000	70,000
Repayments of Federal Home Loan Bank advances	(10,000)	(70,000)
Dividends paid on common stock	(2,230)	(1,846)
Common stock Repurchase	(1,930)	0
Excess tax benefits from the exercise of stock options	118	527
Proceeds from stock options exercised	498	840
Net cash from Trust Preferred	0	155

Net cash provided by financing activities		28,924		69,129
Net (decrease) increase in cash and cash equivalents		(18,920)		18,989
Cash and cash equivalents, beginning of period		39,266		26,556
Cash and cash equivalents, end of period	$	20,346	$	45,545
Supplemental disclosures:				
Cash paid during the period for:				
Income taxes	$	2,533	$	2,936

See accompanying notes to condensed consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements

1. Consolidation and Basis of Presentation

The unaudited condensed consolidated financial statements include the accounts of Bank of Commerce Holdings (the Holding Company) and its subsidiaries Redding Bank of Commerce , Roseville Bank of Commerce and Sutter Bank of Commerce (RBC or the Bank) and Bank of Commerce Mortgage (collectively the Company). All significant inter-company balances and transactions have been eliminated. The financial information contained in this report reflects all adjustments that in the opinion of management are necessary for a fair presentation of the results of the interim periods. All such adjustments are of a normal recurring nature. Certain reclassifications have been made to the prior period condensed consolidated financial statements to conform to the current financial statement presentation. There is no effect on net income, earnings per share, or stockholders equity.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and general practices within the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in Bank of Commerce Holdings 2006 Annual Report on Form 10-K. The results of operations and cash flows for the 2007 interim periods shown in this report are not necessarily indicative of the results for any future interim period or the entire fiscal year.

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and repurchase agreements. Generally, federal funds are sold for a one-day period and securities purchased under agreements to resell are for no more than a 90-day period.

2. Recent Accounting pronouncements

On July 13, 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. 48, ***Accounting for Income Tax Uncertainties*** **(FIN 48). FIN 48 supplements Statement of Financial Accounting Standards No. 109,** ***Accounting for Income Taxes*** **(FAS 109),** by defining the threshold for recognizing tax benefits in the financial statements as more-likely-than-not to be sustained by the applicable taxing authority. The benefit recognized for a tax position that meets the more-likely-than-not criterion is measured based on the largest benefit that is more than 50% likely to be realized, taking into consideration the amounts and probabilities of the outcomes upon settlement. The Company adopted FIN 48 on January 1, 2007, as required. FIN 48 had no material effect on the consolidated financial statements upon adoption.

On September 15, 2006, the FASB issued FAS 157, ***Fair Value Measurements*****,** which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. FAS 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. FAS 157 is effective for the year beginning January 1, 2008, with early adoption permitted on January 1, 2007. We do not expect that the adoption of FAS 157 will have a material effect on our consolidated financial statements.

On September 29, 2006, the FASB issued FAS 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans An Amendment of FASB Statements No. 87, 88, 106, and 132R, requiring an employer to recognize on its balance sheet the funded status of pension and other postretirement plans, measure a plan s assets and its obligations that determine its funded status as of the end of the employer s fiscal year and recognize changes in a plan s funded status in the year in which the changes occur in comprehensive income. The requirement to recognize the funded status of our plans is effective December 31, 2006.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued) (Unaudited)

The funded status will be determined by comparing the fair value of plan assets and the projected benefit obligation or accumulated postretirement benefit obligation, as applicable, including actuarial gains and losses, prior service cost, and any remaining transition amounts. To the extent the fair value of plan assets is larger, the plan is considered over funded and an asset is recorded. Any previously recorded prepaid pension asset would be adjusted to reflect the funded status of the plan with the offset to accumulated other comprehensive income. Conversely, if a plan is under funded, a liability would be reported. The requirement to measure plan assets and benefit obligations as of the date of the employer s fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. We do not expect adoption of FAS 158 to have a material impact on our consolidated financial statements.

On February 15, 2007 the FASB issued FAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement 115.* FAS 159 provides an alternative measurement treatment for certain financial assets and financial liabilities, under an instrument-by-instrument election, that permits fair value to be used for both initial and subsequent measurement, with changes in fair values recognized in earnings. While FAS 159 is effective beginning January 1, 2008, earlier adoption is permitted as of January 1, 2007, provided that the entity also adopts all of the requirements of FAS 157. We do not expect adoption of FAS 159 to have a material impact on our consolidated financial statements.

3. Earnings per Share

Basic earnings per share exclude dilution and is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that subsequently shared in the earnings of the entity. The following table displays the computation of earnings per share for the three and nine months ended September 30, 2007 and 2006.

(Amounts in thousands, except per share data)	Three Months Ended		Nine Months Ended	
	Sept. 30, 2007	Sept. 30, 2006	Sept. 30, 2007	Sept. 30, 2006
Basic EPS Calculation:				
Numerator (net income)	$ 1,331	$ 1,672	$ 4,418	$ 4,953
Denominator (average common shares outstanding)	8,904	8,764	8,893	8,723
Basic earnings per share	$ 0.15	$ 0.19	$ 0.50	$ 0.57
Diluted EPS Calculation:				
Numerator (net income)	$ 1,331	$ 1,672	$ 4,418	$ 4,953
Denominator:				
Average common shares outstanding	8,904	8,764	8,893	8,723
Dilutive effect of stock options	74	173	90	222
	8,978	8,937	8,983	8,945
Diluted earnings per share	$ 0.15	$ 0.19	$ 0.49	$ 0.55

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

4. Stock Option Plan

The Company adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment, on January 1, 2006. The scope of FAS 123R includes a wide range of stock-based compensation arrangements including stock options, restricted stock plans, performance-based awards, stock appreciation rights, and employee stock purchase plans. FAS 123R requires that the Company measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the grant date. That cost must be recognized in the income statement over the vesting period of the award. Under the modified prospective transition method, awards that are granted, modified or settled beginning at the date of adoption will be measured and accounted for in accordance with FAS 123R. In addition, expense must be recognized in the income statement for unvested awards that were granted prior to the date of adoption. Prior to the adoption of FAS 123R and as permitted by FAS 123 and FAS 148, Accounting for Stock-Based Compensation Transition and Disclosure, the Company elected to follow APB 25 and related interpretations in accounting for our employee stock options.

The Company adopted FAS 123R using the modified prospective method. Under this transition method, stock option expense for the first quarter of 2006 included the cost for all share-based payments granted prior to, but not yet vested, as of January 1, 2006, as well as any share-based payments granted subsequent to December 31, 2005. This compensation expense is measured on the date of grant using an option-pricing model. The option-pricing model is based on certain assumptions and changes to those assumptions may result in different fair value estimates. Under APB 25, the Company accounted for stock options using the intrinsic value method and no compensation expense was recognized, as the grant price was equal to the strike price. In accordance with SFAS 123R the Company provides disclosures as if it had adopted the fair value-based method of measuring all outstanding employee stock options during 2005.

For the three months and nine months ending September 30, 2007, the stock option compensation expense charged against income was $12,738 and $48,489, respectively. At September 30, 2007, there was $157,874 of total unrecognized compensation costs related to non-vested share based payments which is expected to be recognized over a period of five years. No option grants were awarded during the third quarter of 2007.

During the nine months ended September 30, 2007 and 2006 the Company realized income tax benefits of $118,000 and $560,000 respectively, related to the exercise of nonqualified stock options. The income tax benefit is reflected in net cash provided by financing activities in the consolidated statements of cash flow for the same period.

During the nine months ended September 30, 2007 and 2006 the Company received cash of $498,421 and $839,873 respectively, upon exercise of stock-based compensation arrangements.

5. Comprehensive Income

The Company initiated a forward starting swap transaction with Morgan Keegan as the counterparty. Two transactions, $60 million and $40 million, aggregating $100 million were executed, both commencing on December 1, 2006 and maturing on June 1, 2009. Under the $60 million swap transaction, the Company received, on a monthly basis, a fixed rate of 7.90% and paid Morgan Keegan a floating rate payment tied to the Wall Street Prime Index commencing on January 1, 2007. Under the $40 million swap transaction the Company received, on a monthly basis, a fixed rate of 7.95% and paid Morgan Keegan a floating rate payment tied to the Wall Street Prime Index commencing on January 1, 2007. The $40 million swap had a Prime Indexed embedded floor of 6.5%. The purpose of this strategy was to protect or hedge net interest income in a declining rate environment. The Swap transaction was terminated during the second quarter of 2007 due to reduced market risk exposure. A $41,000 gain was recognized as a result of this transaction.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements (Continued)
(Unaudited)

The Company s total comprehensive income was as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Net income as reported	$ 1,331	$ 1,672	$ 4,418	$ 4,953
Other comprehensive income:				
Holding gain (loss) arising during period on AFS securities, net of tax	783	734	(148)	58
Reclassification adjustment on AFS securities, net of tax	0	100	(27)	100
Holding gain (loss) arising during period on derivative transactions, net of tax	0	138	51	138
Reclassification adjustment on derivative transactions, net of tax	0	0	(24)	0
Total comprehensive income	$ 2,114	$ 2,644	$ 4,270	$ 5,249

6. Junior Subordinated Debt Payable to Unconsolidated Subsidiary Grantor Trust

During the first quarter 2003, Bank of Commerce Holdings formed a wholly-owned Delaware statutory business trust, Bank of Commerce Holdings Trust I (the grantor trust), which issued $5.0 million of guaranteed preferred beneficial interests in Bank of Commerce Holdings junior subordinated debentures (the trust notes) to the public and $155,000 common securities to the Company. These debentures qualify as Tier 1 capital under Federal Reserve Board guidelines. The proceeds from the issuance of the trust notes were transferred from the grantor trust to the Holding Company and from the Holding Company to the Bank as surplus capital. The trust notes accrue and pay distributions on a quarterly basis at 3 month London Interbank Offered Rate (LIBOR) plus 3.30%. The rate at September 30, 2007 was 8.56%. The rate increase is capped at 2.75% annually and the lifetime cap is 12.5%. The final maturity on the trust note is March 18, 2033, and the debt allows for prepayment after five years on the quarterly payment date.

On July 29, 2005, Bank of Commerce Holdings (the Company) participated in a private placement to an institutional investor of $10 million of fixed rate trust preferred securities (the Trust Preferred Securities); through a newly formed Delaware trust affiliate, Bank of Commerce Holdings Trust II (the Trust). The Trust Preferred Securities mature on September 15, 2035, and are redeemable at the Company s option on any March 15, June 15, September 15 or December 15 on or after September 15, 2010. In addition, the Trust Preferred Securities require quarterly distributions by the Trust to the holder of the Trust Preferred Securities at a rate of 6.12%, until September 10, 2010 after which the rate will reset quarterly to equal 3-Month LIBOR plus 1.58%. The Trust simultaneously issued $310,000 of the Trust s common securities of beneficial interest to the Company.

The proceeds from the sale of the Trust Preferred Securities were used by the Trust to purchase from the Company the aggregate principal amount of $10,310,000 of the Company s floating rate junior subordinate notes (the Notes). The net proceeds to the Company from the sale of the Notes to the Trust will be used by the Company for general corporate purposes, including funding the growth of the Company s various financial services.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements (Continued)
(Unaudited)

The Notes were issued pursuant to a Junior Subordinated Indenture (the Indenture), dated July 29, 2005, by and between the Company and J.P. Morgan Chase Bank, National Association, as trustee. Like the Trust Preferred Securities, the Notes bear an interest rate of 6.12% until September 10, 2010, after which the rate will reset on a quarterly basis to equal 3-Month LIBOR plus 1.58%. The interest payments by the Company will be used to pay the quarterly distributions payable by the Trust to the holder of the Trust Preferred Securities. However, so long as no event of default, as described below, has occurred under the Notes, the Company may, at any time and from time to time, defer interest payments on the Notes (in which case the Trust will be entitled to defer distributions otherwise due on the Trust Preferred Securities) for up to twenty (20) consecutive quarters.

The Notes are subordinated to the prior payment of other indebtedness of the Company that, by its terms, is not similarly subordinated. Although the Notes will be recorded as a long term liability on the Company s balance sheet, for regulatory purposes, the Notes are expected to be treated as Tier 1 or Tier 2 capital under rulings of the Federal Reserve Board, the Company s primary federal regulatory agency.

The Notes mature on September 15, 2035, but may be redeemed at the Company s option at any time on or after September 15, 2010, or at any time upon certain events, such as a change in the regulatory capital treatment of the Notes, the Trust being deemed to be an investment company or the occurrence of certain adverse tax events. In each case, the Company may redeem the Notes for their aggregate principal amount, plus accrued interest.

7. Commitments and contingent liabilities

Lease Commitments The Company leases certain facilities at which it conducts its operations. Future minimum lease commitments under all non-cancelable operating leases as of September 30, 2007 are below:

(Dollars in thousands)	
2007	$ 138
2008	$ 592
2009	$ 558
2010	$ 524
2011	$ 454
Thereafter	$ 1,040
Total	$ 3,306
Minimum rental due in the future Under non-cancelable subleases	$ 0

Legal Proceedings The Company is involved in various pending and threatened legal actions arising in the ordinary course of business. The Company maintains reserves for losses from legal actions, which are both probable and estimable. In the opinion of management, the disposition of claims, currently pending will not have a material adverse affect on the Company s financial position or results of operations.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements (Continued)
(Unaudited)
FHLB Advances Included in other borrowings are advances from the Federal Home Loan Bank of San Francisco (FHLB) totaling $50,000,000 as of September 30, 2007 and $55,000,000 as of September 30, 2006. The FHLB advances bear fixed and floating interest rates ranging from 4.89% to 5.23%. Interest is payable quarterly. The following table illustrates borrowings outstanding at the end of the period:

Amount	Interest Rate	Maturity
$15,000,000	4.89%	11/30/2007
$10,000,000	5.12%	12/06/2007
$10,000,000	4.93%	01/24/2008
$ 5,000,000	5.23%	04/28/2008
$10,000,000	4.97%	01/24/2011
$50,000,000		

These borrowings are secured by an investment in FHLB stock and certain real estate mortgage loans which have been specifically pledged to the FHLB pursuant to their collateral requirements. Based upon the level of FHLB advances, the Company was required to hold a minimum investment in FHLB stock of $2,350,000 and to pledge $49,160,035 of its real estate mortgage loans to the FHLB as collateral as of September 30, 2007. At September 30, 2007, the Bank had available borrowing lines at the FHLB of $37,237,289 and additional federal fund borrowing lines at two correspondent banks totaling $25,000,000.

Off-Balance Sheet Financial Instruments - In the ordinary course of business, the Company enters various types of transactions, which involve financial instruments with off-balance sheet risk. These instruments include commitments to extend credit and standby letter of credits, which are not reflected in the accompanying consolidated balance sheets. These transactions may involve, to varying degrees, credit and interest rate risk more than the amount, if any recognized in the consolidated balance sheets. Commitments to extend credit are agreements to lend to customers. These commitments have specified interest rates and generally have fixed expiration dates but may be terminated by the Company if certain conditions of the contract are violated. Although currently subject to draw down, many of the commitments do not necessarily represent future cash requirements. Collateral held relating to these commitments varies, but generally includes real estate, securities and cash. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Credit risk arises in these transactions from the possibility that a customer may not be able to repay the Bank upon default of performance.

Collateral held for standby letters of credit is based on an individual evaluation of each customer s creditworthiness, but may include cash and securities. Commitments to extend credit and standby letters of credit bear similar credit risk characteristics as outstanding loans.

The Company s commitments to extend credit are illustrated below:

	September 30, 2007	September 30, 2006
Commitment lines of credit	$ 184,065,127	$ 155,898,477
Standby letters of credit	6,600,143	14,211,847
Guaranteed commitments outstanding	1,375,998	1,248,000
	$ 192,041,268	$ 171,358,324

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements (Continued)
(Unaudited)

Accounting for Income Tax Uncertainties (FIN 48)

In June 2006, the FASB issued Interpretation 48, Accounting for Uncertainty in Income Taxes (FIN 48), an interpretation of FASB Statement No. 109, Accounting for Income Taxes. FIN 48 clarifies the accounting and reporting for income taxes where interpretation of the law is uncertain. FIN 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken in income tax returns. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted this Statement on January 1, 2007. As a result of the implementation of Interpretation 48, it was not necessary for the Company to recognize any increase in the liability for unrecognized tax benefits.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and California state jurisdiction.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense.

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

Forward Looking Statements and Risk Factors

This discussion and information in the accompanying financial statements contains certain forward-looking statements, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such statements are subject to risks and uncertainties that could cause actual results to differ materially from those stated. These risks and uncertainties include the Company s ability to maintain or expand its market share and net interest margins, or to implement its marketing and growth strategies. Further, actual results may be affected by the Company s ability to compete on price and other factors with other financial institutions; customer acceptance of new products and services; and general trends in the banking and the regulatory environment, as they relate to the Company s cost of funds and return on assets. The reader is advised that this list of risks is not exhaustive and should not be construed as any prediction by the Company as to which risks would cause actual results to differ materially from those indicated by the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements.

For additional information concerning risks and uncertainties related to the Company and its operations please refer to the Company s Annual Report on Form 10-K for the year ended December 31, 2006, under the heading Risk factors that may affect results . *Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.*

The following sections discuss significant changes and trends in financial condition, capital resources and liquidity of the Company from December 31, 2006 to September 30, 2007. Also discussed are significant trends and changes in the Company s results of operations for the three and nine months ended September 30, 2007, compared to the same period in 2006. The consolidated financial statements and related notes appearing elsewhere in this report are condensed and unaudited. The following discussion and analysis is intended to provide greater detail of the Company s financial condition and results.

Corporate Overview

Bank of Commerce Holdings (the Holding Company) is a financial holding company (FHC) registered under the Bank Holding Company Act of 1956, as amended, and was incorporated in California on January 21, 1982 for the purpose of organizing, as a wholly owned subsidiary, Redding Bank of Commerce (the Bank). The Company celebrates its 25th anniversary during 2007. As a financial holding company, the Holding Company is subject to the Financial Holding Company Act and to supervision by the Board of Governors of the Federal Reserve System (FRB). The Holding Company s principal business is to serve as a holding company for Redding Bank of Commerce , Roseville Bank of Commerce , Sutter Bank of Commerce and Bank of Commerce Mortgage , a California corporation and for other banking or banking-related subsidiaries which the Holding Company may establish or acquire (collectively the Company).

The Holding Company also has two unconsolidated subsidiaries, Bank of Commerce Holdings Trust I and II. During 2003, Bank of Commerce Holdings formed a wholly-owned Delaware statutory business trust, Bank of Commerce Holdings Trust I (the grantor trust), which issued $5.0 million of guaranteed preferred beneficial interests in Bank of Commerce Holdings junior subordinated debentures (the Trust Notes). These debentures qualify as Tier 1 capital under Federal Reserve Board guidelines. The proceeds from the issuance of the Trust Notes were transferred from the grantor trust to the Holding Company and from the Holding Company to the Bank as surplus capital. The Trust Notes accrue and pay distributions on a quarterly basis at 3 month London Interbank Offered Rate (LIBOR) plus 3.30%. The rate at September 30, 2007 was 8.56%. The rate increase is capped at 2.75% annually and the lifetime cap is 12.5%. The final maturity on the Trust Notes is March 18, 2033, and the debt allows for prepayment after five years on the quarterly payment date.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

During 2005, Bank of Commerce Holdings formed a wholly-owned Delaware statutory business trust, Bank of Commerce Holdings Trust II (the grantor trust), which issued $10.0 million of guaranteed preferred beneficial interests in Bank of Commerce Holdings junior subordinated debentures (the Trust Notes). The proceeds of the issuance will qualify as either Tier I or Tier II Capital under Federal Reserve Board guidelines. $5 million of the proceeds from the issuance of the Trust Notes were transferred from the grantor trust to the Holding Company and from the Holding Company to the Bank as surplus capital and $5 million of the issuance is retained at the Holding Company for investment purposes. The issuance is priced at a fixed rate for the first five years at 6.12%.

The Company will provide free of charge upon request, or through links to publicly available filings accessed through its Internet website, the Company s annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, if any, as soon as reasonably practical after such reports have been filed with the Securities and Exchange Commission. The Internet addresses of the Company are www.bankofcommerceholdings.com, www.reddingbankofcommerce.com, www.rosevillebankofcommerce.com, www.sutterbankofcommerce.com and www.bankofcommercemortgage.com. Reports may also be obtained through the Securities and Exchange Commission s website at www.sec.gov.

The Bank was incorporated as a California banking corporation on November 25, 1981, and received its certificate of authority to begin banking operations on October 22, 1982. The Bank operates five full service branch facilities. Two are operated under Redding Bank of Commerce , located in Redding, California. Two are operated under Roseville Bank of Commerce , one located in Roseville, California and the second location in Citrus Heights, California. One office is operated under Sutter Bank of Commerce and is located in Yuba City, California.

The Company also operates Bank of Commerce Mortgage , an affiliate of Bank of Commerce. The principal business of the subsidiary is mortgage brokerage services. The subsidiary has an affiliated business arrangement with BWC Mortgage Services. Under the terms of the agreement, BWC Mortgage Services underwrites or brokers mortgage products, and manages the independent contractors, supporting staff and broker relationships with various secondary market lenders. Bank of Commerce Mortgage in turn provides office space, equipment and marketing support for the mortgage brokerage services. Bank of Commerce Mortgage , through this agreement, offers a full array of single-family and multi-family residential real estate mortgages including equity lines. Bank of Commerce Mortgage pays ten percent of gross premiums earned to BWC Mortgage Services.

On June 15, 2004, the Company was listed on the NASDAQ National Market under the trading symbol BOCH (Bank of Commerce Holdings).

During April 2007, the Bank filed an application with the FDIC and DFI for authority to open an additional branch in the Redding market, located in the Placer Heights Plaza shopping center. The new office will have a focus on consumer applications and convenience hours and is planned to open in the fourth quarter of 2007.

The Holding Company s principal source of income is dividends from its subsidiaries. The Holding Company conducts its corporate business operations at the administrative office of the Bank located at 1901 Churn Creek Road, Redding, California. The Company conducts its business operations in two geographic market areas, Redding and Roseville, California. The Company considers Upstate California to be the major market area of the bank.

The Bank is principally supervised and regulated by the California Department of Financial Institutions (DFI) and the Federal Deposit Insurance Corporation (FDIC), and conducts a general commercial banking business in the counties of El Dorado, Placer, Shasta, Sacramento, Sutter and Yuba, California. Through the Bank and mortgage subsidiaries, the Company provides a wide range of financial services and products. The services offered by the Bank include those traditionally offered by commercial banks of similar size and character in California. Products such as lock-box servicing, courier services, checking accounts, interest-bearing checking and savings accounts, money market deposit accounts, merchant bankcard, commercial, construction, agricultural, term loans, and equity lines of credit, travelers checks, safe deposit boxes, collection services, payroll services and electronic banking activities.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The focus of the Bank is to provide financial services to the communities in its major market areas, including, but not limited to, specialty financing, lock-box accounting, courier services, payroll accounting packages, benefit administration and billing services, merchant credit card processing, and health savings accounts. The Bank currently does not offer trust services or international banking services. The services offered by the Mortgage Company include single and multi-family residential residence new financing, refinancing and equity lines of credit.

The Company s vision is to embrace changes in the industry and develop profitable business strategies that allow us to maintain our customer relationships and build new ones. Our competitors are no longer just banks. We must compete with financial powerhouses that want our core business. The flexibility provided by the Financial Holding Company Act will become increasingly important. We have developed strategic plans that evaluate additional financial services and products that can be delivered to our customers efficiently and profitably. Producing quality returns is, as always, a top priority.

Many of the Bank s customers are small to medium sized businesses, professionals and other individuals with medium to high net worth. The Bank emphasizes servicing the needs of local businesses and professionals and individuals requiring specialized services. The business strategy of the Bank is to focus on its lending activities and core deposit generation, developing products and services to meet the needs of its clients. The Bank s principal lines of lending are (i) commercial, (ii) real estate construction, (iii) commercial and residential real estate, (iv) agricultural, and (v) home equity lines of credit. The majority of the loans of the Bank are direct loans made to individuals and small businesses in the major market areas of the Bank and are secured by real estate. See Risk Factors That May Affect Results-Dependence on Real Estate in the Company s 2006 Annual Report on Form 10-K.

The Company s credit risk management processes include comprehensive credit policies, judgmental or statistical credit underwriting, frequent and detailed risk measurement and modeling, and a continual loan review and audit process. In addition, regulatory examiners review and perform detailed testing of our credit underwriting, loan administration and allowance processes. The Company uses detailed tracking and analysis to measure concentrations, credit performance and exception rates. Credit Administration strives to identify problem loans early. The Chief Credit Officer, who reports to the Chief Executive Officer, provides Company wide credit oversight. Each branch or market has a lending group manager with the responsibility for managing their own credit risks. The Chief Executive Officer delegates authority, limits and other requirements to the Lending Group Managers. These delegations are routinely reviewed and amended if there are changes in personnel, credit performance or business requirements.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Risk Factors

Economic Conditions and Geographic Concentration

An economic slowdown could reduce demand for the Company s products and services and lead to lower revenues and lower earnings. A change in California s economic and business conditions may adversely affect the ability of our borrowers to repay their loans, causing us to incur higher credit losses. The Company earns revenue from interest and fees charged on loans and financial services. When the economy slows, the demand for these products and services may fall, reducing our interest and fee income, and our earnings. In addition, during periods of economic slowdown or recession, the Bank may experience a decline in collateral values and an increase in delinquencies and defaults due to the borrowers ability to repay their loans. Several factors could cause the economy to slow down or even recede, including higher energy costs, higher interest rates, reduced consumer or corporate spending, a slowdown in housing, natural disasters, terrorist activities, military conflicts, and the normal cyclical nature of the economy.

The Company s primary lending focus has historically been commercial real estate, commercial lending and, to a lesser extent, construction lending. At September 30, 2007, all of the Company s real estate mortgage, real estate construction loans, and commercial real estate loans, were secured fully or in part by deeds of trust on underlying real estate. The Company s dependence on real estate increases the risk of loss in the loan portfolio of the Company and its holdings of other real estate owned if economic conditions in California deteriorate in the future. Deterioration of the real estate market in California could have a material adverse effect on the Company s business, financial condition and results of operations.

Changes in Interest Rates could reduce the Company s Net Interest Income and Earnings

The Company s net interest income is the interest earned on loans, debt securities and other assets minus the interest paid on deposits, long-term and short-term debt and other liabilities. Net interest income reflects both our net interest margin the difference between the yield on earning assets and the interest paid on deposits and other sources of funding and the amount (volume) of earning assets we hold. As a result, changes in either the net interest margin or the volume of earning assets could adversely affect our net interest income and earnings.

Changes in interest rates, up or down, could adversely affect the net interest margin. The yield we pay on our deposits and our funding costs tend to move in the same direction in response to changes in interest rates, one can rise or fall faster than the other (timing differences). A significant portion of the Company s assets are tied to variable rate pricing and the Company is considered to be asset sensitive. As a result, the Company is generally adversely affected by declining interest rates. In addition, changes in monetary policy, including changes in interest rates, influence the origination of loans, the purchase of investments and the generation of deposits, thereby affecting the rates received on loans and securities and paid on deposits, which could have a material adverse effect on the Company s business, financial condition and results of operations. See Quantitative and Qualitative Disclosure about Market Risk.

Changes in the slope of the yield-curve , or the spread between short-term and long-term interest rates could also reduce our net interest margin. Normally, the yield curve is upward sloping, meaning that short-term rates are lower than long-term rates. Because our liabilities tend to be shorter in duration than our assets, when the yield curve flattens or even inverts, the Company will experience pressure on the net interest margin as the cost of funds increases relative to the yield that can be earned on assets.

The Company assesses interest rate risk by estimating the effect on earnings in various scenarios that differ based on assumptions about the direction, magnitude and speed of interest rate changes and the slope of the yield curve. The Company may hedge some interest rate risk with interest rate derivatives. The Company does not hedge all of its interest rate risk. There is risk that changes in interest rates could reduce our net interest income and earnings in material amounts, especially if actual conditions turn out to be materially different that the assumptions used in the model. One example: If interest rates rise or fall faster than assumed or the slope of the yield curve changes, the Company may incur losses on debt securities held as investments.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

To reduce the interest rate risk, the Company may choose to rebalance the investment and loan portfolio, refinance debt outstanding or take other strategic actions. The Company may incur losses or expenses when taking such actions.

Lending Risks Associated with Commercial Banking and Construction Activities

The business strategy of the Company is to focus on commercial, single family and multi-family real estate loans, construction loans and commercial business loans. Loans secured by commercial real estate are generally larger and involve a greater degree of credit and transaction risk than residential mortgage (one-to-four family) loans. Because payments on loans secured by commercial and multi-family real estate properties are often dependent on successful operation or management of the underlying properties, repayment of such loans may be subject to a greater extent to the then prevailing conditions in the real estate market or the economy. Moreover, real estate construction financing is generally considered to involve a higher degree of credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property s value at completion of construction or development compared to the estimated cost (including interest) of construction. If the estimate of value proves to be inaccurate, the Company may be confronted with a project which, when completed, has a value which is insufficient to assure full repayment of the construction loan. Although the Company manages lending risks through its underwriting and credit administration policies, no assurance can be given that such risks would not materialize, in which event the Company s financial condition, results of operations, cash flows and business prospects could be materially adversely affected.

Adequacy of Allowance for Loan and Lease Losses (ALLL)

Higher credit losses could require the Company to increase the allowance for loan and lease losses through a charge to earnings. When the Company loans money or commits to loan money it incurs credit risk or the risk of losses if our borrowers do not repay their loans. The Company provides a reserve for credit risk by establishing an allowance through a charge to earnings. The amount of the allowance is based on an assessment of credit losses inherent in the loan portfolio (including unfunded credit commitments). The process for determining the amount of the allowance is critical to our financial results and condition. It requires difficult, subjective and complex judgments about the future, including forecasts of economic or market conditions that might impair our borrower s ability to repay their loans. The Company might increase the allowance because of changing economic conditions or unexpected events. The Company s allowance for loan and lease losses was approximately $5.1 million, or 1.09% of total loans at September 30, 2007.

Potential Volatility of Deposits

The Bank s depositors could choose to take their money out of the bank and put it into alternative investments, causing an increase in funding costs and reducing net interest income. Checking, savings and money market account balances can decrease when customers perceive that alternative investments, such as equities, provide a better risk/return tradeoff. When customers move funds out of bank deposits into other investments, the Bank will lose a relatively low cost source of funds, increasing funding costs.

At September 30, 2007, time certificates of deposit in excess of $100,000 represented approximately 29% of the dollar value of the total deposits of the Company. As such, these deposits are considered volatile and could be subject to withdrawal. Withdrawal of a material amount of such deposits could adversely affect the liquidity of the Company, profitability, business prospects, results of operations and cash flows. The Company monitors activity of volatile liability deposits on a quarterly basis.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Dividends

Bank of Commerce Holdings, the parent holding company, is a separate and distinct legal entity from its subsidiaries. The Company conducts no other significant activity than the management of its investment in the Bank and Mortgage Company and as such, the Company is dependent on these subsidiaries for income. The ability of the Bank and Mortgage Company to pay cash dividends in the future depends on the profitability, growth and capital needs of the Bank and Mortgage Company. These dividends are used to pay dividends on common stock and interest and principal on debt. In addition, the California Financial Code restricts the ability of the Bank to pay dividends. No assurance can be given that the Company or the Bank will pay any dividends in the future or, if paid, such dividends will not be discontinued.

Changes in Accounting Policies or Accounting Standards, and Changes in How Accounting Standards are interpreted or applied, Could Materially Affect How the Company Reports its Financial Results and Condition

The Company s accounting policies are fundamental to understanding our financial results and condition. Some of these policies require use of estimates and assumptions that may affect the value of our assets or liabilities and financial results. Three of our accounting policies are critical because they require management to make difficult, subjective and complex judgments about matters that is inherently uncertain and because it is likely that materially different amount would be reported under different conditions or using different assumptions (refer to *Critical Accounting Policies).*

From time to time the Financial Accounting Standards Board (FASB) and the SEC change the financial accounting and reporting standards that govern the preparation of financial statements. In addition, accounting standard setters and those who interpret the accounting standards (such as the FASB, SEC, banking regulators and outside auditors) may change or even reverse their previous interpretations or positions on how these standards should be applied. Changes in financial accounting and reporting standards and changes in current interpretations may be beyond the Company s control, can be hard to predict and could materially impact how we report our financial results and condition. The Company could be required to apply a new or revised standard retroactively or apply an existing standard differently, also retroactively, in each case resulting in restating prior period financial statements.

Government Regulation and Legislation

The Company and the Bank are subject to extensive state and federal regulation, supervision and legislation, which govern almost all aspects of the operations of the Company and the Bank. The business of the Company is particularly susceptible to being affected by the enactment of federal and state legislation which may have the effect of increasing or decreasing the cost of doing business, modifying permissible activities or enhancing the competitive position of other financial institutions. Such laws are subject to change from time to time and are primarily intended for the protection of consumers, depositors and the deposit insurance funds and not for the protection of shareholders of the Company. The Company cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on the business and prospects of the Company, but it could be material and adverse.

Recent high-profile events have resulted in additional regulations. For example, Sarbanes-Oxley limits the types of non-audit services our outside auditors may provide to the company in order to preserve the independence of our auditors. If our auditors were found not to be independent under SEC rules, we could be required to engage new auditors and file new financial statements and audit reports with the SEC.

The Patriot Act which was enacted in the wake of the September 2001 terrorist attacks, requires the Company to implement new or revised policies and procedures related to anti-money laundering, compliance, suspicious activities, currency transaction reports and due diligence on customers. The Patriot Act also requires federal bank regulators to evaluate the effectiveness of an applicant in combating money laundering in determining whether to approve a proposed bank acquisition.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

From time to time, Congress considers legislation that could significantly change our regulatory environment, potentially increasing the cost of doing business, limiting activities or affecting the competitive balance among banks, savings associations, credit unions and other financial institutions.

Certain Ownership Restrictions under California and Federal Law

Federal law prohibits a person or group of persons acting in concert from acquiring control of a bank holding company unless the FRB has been given 60 days prior written notice of such proposed acquisition and within that time period the FRB has not issued a notice disapproving the proposed acquisition or extending for up to another 30 days, the period during which such a disapproval may be issued. An acquisition may be made before the expiration of the disapproval period if the FRB issues written notice of its intent not to disapprove the action.

Under a rebuttal presumption established by the FRB, the acquisition of more than 10% of a class of voting stock of a bank with a class of securities registered under Section 12 of the Exchange Act (such as the common stock), would, under the circumstances set forth in the presumption, constitute the acquisition of control. In addition, any company would be required to obtain the approval of the FRB under the BHCA, before acquiring 25% (5% in the case of an acquirer that is, or is deemed to be, a bank holding company) or more of the outstanding shares of the Company s common stock, or such lesser number of shares as constitute control. See Regulation and Supervision of Bank Holding Companies in the Company s 2006 Annual Report on Form 10-K.

Under the California Financial Code, no person shall, directly or indirectly, acquire control of a California licensed bank or a bank holding company unless the Commissioner has approved such acquisition of control. A person would be deemed to have acquired control of the Company and the Bank under this state law if such person, directly or indirectly, has the power (i) to vote 25% or more of the voting power of the Company or (ii) to direct or cause the direction of the management and policies of the Company. For purposes of this law, a person who directly or indirectly owns or controls 10% or more of the common stock would be presumed to direct or cause the direction of the management and policies of the Company and thereby control the Company.

Negative Publicity could Damage our Reputation

Reputation risk, or the risk to the Company s earnings and capital from negative public opinion, is inherent in the financial services business. Negative public opinion could adversely affect our ability to keep and attract customers and expose us to adverse legal and regulatory consequences. Negative public opinion could result from actual or alleged conduct in any number of activities, including lending practices, corporate governance, acquisitions, and from actions taken by government regulators and community organizations in response to that conduct.

Environmental Risks

The Company, in its ordinary course of business, acquires real property securing loans that are in default, and there is a risk that hazardous substance or waste, contaminants or pollutants could exist on such properties. The Company may be required to remove or remediate such substances from the affected properties at its expense, and the cost of such removal or remediation may substantially exceed the value of the affected properties or the loans secured by such properties. Furthermore, the Company may not have adequate remedies against the prior owners or other responsible parties to recover its costs. Finally, the Company may find it difficult or impossible to sell the affected properties either before or following any such removal. In addition, the Company may be considered liable for environmental liabilities concerning its borrowers properties, if, among other things, it participates in the management of its borrowers operations. The occurrence of such an event could have a material adverse effect on the Company s business, financial condition, results of operations and cash flows.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Shares Eligible for Future Sale

As of September 28, 2007, the Company had 8,784,359 shares of Common Stock outstanding, of which 5,964,584 shares are eligible for sale in the public market without restriction and 2,819,775 shares are eligible for sale in the public market pursuant to Rule 144 under the Securities Act of 1933, as amended (the Securities Act). Future sales of substantial amounts of the Company s common stock, or the perception that such sales could occur, could have a material adverse effect on the market price of the common stock. In addition, options to acquire 380,245 shares of the issued and outstanding shares of common stock at exercise prices ranging from $3.23 to $11.47 have been issued to directors and certain employees of the Company under the Company s 1998 Stock Option Plan. No prediction can be made as to the effect, if any, that future sales of shares, or the availability of shares for future sale, will have on the market price of the Company s common stock.

UNRESOLVED STAFF COMMENTS

No comments to report.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Executive Overview

Our Company was established to make a profitable return while serving the financial needs of the business and professional communities of our markets. We are in the financial services business, and no line of financial services is beyond our charter as long as it serves the needs of businesses, professionals and consumers in our communities. The mission of our Company is to provide its stockholders with a safe, profitable return on their investment, over the long term. Management will attempt to minimize risk to our stockholders by making prudent business decisions, will maintain adequate levels of capital and reserves, and will maintain effective communications with stockholders.

Our Company s most valuable asset is its customers. We will consider their needs first when we design our products. High-quality customer service is an important mission of our Company, and how well we accomplish this mission will have a direct influence on our profitability.

Our vision is to embrace changes in the industry and develop profitable business strategies that allow us to maintain our customer relationships and build new ones. Our competitors are no longer just banks. We must compete with financial powerhouses that want our core business. The flexibility provided by the Financial Holding Company Act is becoming increasingly important. We have developed strategic plans that evaluate additional financial services and products that can be delivered to our customers efficiently and profitably. Producing quality returns is, as always, a top priority.

The Company s long term success rests on the shoulders of the leadership team to effectively work to enhance the performance of the Company. As a financial services company, we are in the business of taking risk. Whether we are successful depends largely upon whether we take the right risks and get paid appropriately for the risks we take. Our governance structure enables us to manage all major aspects of the Company s business effectively through an integrated process that includes financial, strategic, risk and leadership planning.

We define risks to include not only credit, market and liquidity risk the traditional concerns for financial institutions but also operational risks, including risks related to systems, processes or external events, as well as legal, regulatory and reputation risks.

Our management processes, structures and policies help to ensure compliance with laws and regulations and provide clear lines for decision-making and accountability. Results are important, but equally important is how we achieve those results. Our core values and commitment to high ethical standards is material to sustaining public trust and confidence in our Company. For additional information concerning risks and uncertainties related to the Company and its operations please refer to the Company s Annual Report on Form 10-K for the year ended December 31, 2006 under the heading of Risk Management.

Sources of Income

The Company derives its income from two principal sources: (i) net interest income, which is the difference between the interest income it receives on interest-earning assets and the interest expense it pays on interest-bearing liabilities, and (ii) fee income, which includes fees earned on deposit services, income from SBA lending, electronic-based cash management services, mortgage brokerage fee income, payroll services, and merchant credit card processing services.

The profitability of the Bank depends to a great extent on net interest income. Interest rate factors are highly sensitive to many factors, which are beyond the Company s control, including general economic conditions, inflation, recession, and the policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board. Because of the Bank s predisposition to variable rate pricing and non-interest bearing demand deposit accounts, the Bank is considered asset sensitive. As a result, the Company is adversely affected by declining interest rates.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

	September 30, 2007	September 30, 2006
Profitability Ratios		
Net Interest Income to Average Assets	3.76%	4.09%
Net Income to Average Equity	9.76%	11.46%
Efficiency Ratio[1]	62.07%	54.69%
Capital Ratios		
Leverage Ratio	9.40%	10.39%
Risk Based Capital	$ 61,318	$ 64,937
Tier 1 Capital	10.19%	12.11%
Total Capital	11.18%	13.17%
Per Common Share Data		
Dividend Payout Ratio	48.38%	37.27%
Book Value	$ 5.04	$ 4.92
Market Price	$ 11.00	$ 10.95
High	$ 12.50	$ 11.00
Low	$ 9.45	$ 9.14

Financial Highlights Results of Operations

Net income for the third quarter of 2007 totaled $1,331,000, a decrease of 20.39% from the $1,672,000 reported for the same quarterly period of 2006. On the same basis, diluted earnings per common share for the third quarter of 2007 were $0.15, compared to $0.19 for the same period of 2006, a 21.05% decrease. Return on average assets (ROA) and return on average equity (ROE) for the third quarter of 2007 were 0.93% and 12.03%, respectively, compared with 1.17% and 15.11%, respectively, for the third quarter of 2006.

Net income for the nine-month period ended September 30, 2007 totaled $4,418,000, a decrease of 10.80% over net income of $4,953,000 reported for the same nine-month period ended September 30, 2006. On the same basis, diluted earnings per common share for the nine-months ended September 30, 2007 was $0.49, compared to $0.55 for the same nine-month period in 2006, a 10.91% decrease. ROA was 1.01% and ROE was 13.02% for the first nine-months of 2007 compared with 1.22% and 15.28%, respectively, for the same nine-month period of 2006.

Net Interest Income and Net Interest Margin

Net interest income is the primary source of the Company s income. Net interest income represents the excess of interest and fees earned on interest-earning assets (loans, securities and Federal Funds sold) over the interest paid on deposits and borrowed funds. Net interest margin is net interest income expressed as a percentage of average earning assets. Net interest income for the quarter ended September 30, 2007 was $5.6 million compared with $5.5 million for the same period in 2006, an increase of 2.0%. Net interest income for the nine-months ended September 30, 2007 was $16.4 million compared with $16.6 million for the same nine-month period in 2006, a decrease of 1.1%.

Average earning assets for the nine-months ended September 30, 2007 increased $35.8 million or 7.0% compared with the same period in the prior year. Average loans, the largest component of average earning assets, increased $35.7 million or 9.2% on average compared with the prior year period. Average securities including federal funds sold increased $122,000 or 0.9% over the prior period. Overall, the yield on earning assets increased to 7.51% for the nine-month period ended September 30, 2007 compared to 7.23% for the same period in the prior year. The increase is primarily due to new loan production priced at higher rates and the repositioning of the securities portfolio; lower

coupon bonds were sold and replaced with higher yielding securities.

[1] The efficiency ratio is noninterest expense divided by total revenue (net interest income and noninterest income)

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Average interest-bearing liabilities for the nine-months ended September 30, 2007 increased $43.4 million or 10.3% compared with the prior year period. Average non-interest bearing deposits decreased by $6.5 million, or 8.3% over the prior year nine-month period. Average borrowings decreased $20.2 million compared with the prior year period. The borrowings were repaid with core deposit growth.

The overall cost of interest-bearing liabilities for the first nine-months 2007 was 4.13% compared with 3.51% for the first nine-months of 2006. The increase was primarily a result of increases in the interest paid on interest-bearing liabilities. The net effect of the changes discussed above resulted in an decrease of $189,000 or 1.1% in net interest income for the nine-month period ended September 30, 2007 from the same period in 2006. Net interest margin decreased thirty three basis points to 4.00% from 4.33% for the same period a year ago.

Liquidity

The objective of liquidity management is to ensure that the Company can efficiently meet the borrowing needs of our customers, withdrawals of our depositors and other cash commitments under both normal operating conditions and under unforeseen and unpredictable circumstances of industry or market stress.

The Asset Liability Management Committee (ALCO) establishes and monitors liquidity guidelines that require sufficient asset-based liquidity to cover potential funding requirements and to avoid over-dependence on volatile, less reliable funding markets. In addition to the immediately liquid resources of cash and due from banks and federal funds sold, asset liquidity is supported by debt securities in the available for sale security portfolio and wholesale lines of credit with the Federal Home Loan Bank and borrowing lines with other financial institutions. Customer core deposits have historically provided the Company with a source of relatively stable and low-cost funds.

The Company s consolidated liquidity position remains adequate to meet short-term and long-term future contingencies. At September 30, 2007, the Company had overnight investments of $8.0 million and available lines of credit of at the Federal Home Loan bank of approximately $37.2 million, and two federal funds borrowing line with correspondent banks of $25.0 million.

Capital Management

The Company has an active program for managing stockholder capital. Capital is used to fund organic growth, acquisitions, pay dividends and repurchase shares. The objective of effective capital management is to produce above market long-term returns by using capital when returns are perceived to be high and issuing capital when costs are perceived to be low.

Periodically, the Board of Directors authorizes the Company to repurchase shares. Share repurchase announcements are published in press releases and SEC 8-K filings. Typically we do not give any public notice before repurchasing shares. Various factors determine the amount and timing of our share repurchases, including our capital requirements, market conditions and legal considerations. These factors can change at any time and there can be no assurance as to the number of shares repurchased or the timing of the repurchases.

Our policy has been to repurchase shares under the safe harbor conditions of Rule 10b-18 of the Exchange Act including a limitation on the daily volume of repurchases. The Company s potential sources of capital include retained earnings, common and preferred stock issuance and issuance of subordinated debt and trust notes. The Company and bank are subject to various regulatory capital adequacy requirements as prescribed by the Federal Reserve Bank. Risk-based capital guidelines establish a risk-adjusted ratio relating capital to difference categories of assets and off-balance sheet exposures.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

At September 30, 2007, the Company and Bank were well capitalized under applicable regulatory capital adequacy guidelines.

September 30, 2007	Capital	Actual Ratio	Well Capitalized Requirement	Minimum Capital Requirement
The Company				
Leverage	$ 55,869,296	9.40%	n/a	4.0%
Tier 1 Risk-Based	55,869,296	10.19%	n/a	4.0%
Total Risk-Based	61,318,404	11.18%	n/a	8.0%
Redding Bank of Commerce				
Leverage	$ 56,116,414	9.31%	5.0%	4.0%
Tier 1 Risk-Based	56,116,414	10.23%	6.0%	4.0%
Total Risk-Based	61,565,522	11.23%	10.0%	8.0%

Short and Long Term Borrowings

The Company actively uses Federal Home Loan Bank (FHLB) advances as a source of wholesale funding to support growth strategies as well as to provide liquidity. At September 30, 2007, the Company s FHLB advances were a combination of fixed term and variable borrowings without call or put option features.

At September 30, 2007, the Bank had $50 million in FHLB term advances outstanding at an average rate of 4.99% compared to $55 million at an average rate of 5.14% at September 30, 2006.

Allowance for Loan and Lease Losses

The Allowance for Loan and Lease Losses is management s estimate of credit losses inherent in the loan portfolio at the balance sheet date. The Company has established a process using several analytical tools and benchmarks, to calculate a range of probable outcomes and determine the adequacy of the allowance. No single statistic or measurement determines the adequacy of the allowance. Loan recoveries and the provision for credit losses increase the allowance, while loan charge-offs decrease the allowance.

The allowance for loan and lease losses is the Company s *most significant* management accounting estimate. The Company follows a methodology for calculating the appropriate level for the allowance for loan and lease losses as discussed under Asset Quality and Allowance for Loan and Lease Losses (ALLL) in this document. The entire allowance is used to absorb credit losses inherent in the loan portfolio. The allowance includes an amount for imprecision or uncertainty to incorporate a range of probable outcomes inherent in estimates used for the allowance, which may change from period to period. This portion of the total allowance is the results of the Company s judgment of risks inherent in the portfolio, economic uncertainties, historical loss experience and other subjective factors, including industry trends. The methodology used is refined to calculate a portion of the allowance for each portfolio type to reflect our view of the risk in these portfolios.

Changes in the estimate of the allowance for loan and lease losses and the related provision expense can materially affect net income. Determining the allowance for loan and lease losses requires management to make forecasts of losses that are highly uncertain and require a high degree of judgment.

Provision for loan and lease losses of $121,000 were provided for the nine-months ended September 30, 2007 compared with $226,000 for the same period of 2006. The Company s allowance for loan and lease losses was 1.09% of total loans at September 30, 2007 and 1.16% at September 30, 2006, while its ratio of non-performing assets to total assets was 0.17% at September 30, 2007, compared to 0.00% at September 30, 2006.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Factors that may affect future results

As a financial services company, our earnings are significantly affected by general business and economic conditions. These conditions include short-term and long-term interest rates, inflation, monetary supply, fluctuations in both debt and equity capital markets, and the strength of the United States economy and local economies in which we operate. For example, an economic downturn, increase in unemployment, or other events that negatively impact household and/or corporate incomes could decrease the demand for the Company s loan and non-loan products and services and increase the number of customers who fail to pay interest or principal on their loans. Geopolitical conditions can also affect our earnings. Acts or threats of terrorism, actions taken by the United States or other governments in response to acts or threats of terrorism and our military conflicts including the aftermath of the war with Iraq, could impact business conditions in the United States.

The Board of Governors of the Federal Reserve System regulates the supply of money and credit in the United States. Its policies determine in large part our cost of funds for lending and investing and the return we earn on those loans and investments, both of which impact our net interest margin, and can materially affect the value of financial instruments we hold. Its policies can also affect our borrowers, potentially increasing the risk of failure to repay their loans. Changes in Federal Reserve Board policies are beyond our control and hard to predict or anticipate.

We operate in a highly competitive industry that could become even more competitive because of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can now merge creating a financial holding company that can offer virtually any type of financial service, including banking, securities underwriting, insurance (agency and underwriting) and merchant banking. Technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of our competitors have fewer regulatory constraints and some have lower cost structures.

The holding company, subsidiary bank and non-bank subsidiary are heavily regulated at the federal and state levels. This regulation is to protect depositors, federal deposit insurance funds and the banking system as a whole, not investors. Congress and state legislatures and federal and state regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies including changes in interpretation and implementation could affect us in substantial and unpredictable ways including limiting the types of financial services and products we may offer. Our failure to comply with the laws, regulations or policies could result in sanctions by regulatory agencies and damage our reputation. For more information, refer to the Supervision and Regulation section in the Company s 2007 Annual Report on Form 10-K.

Our success depends, in part, on our ability to adapt our products and services to evolving industry standards. There is increasing pressure on financial services companies to provide products and services at lower prices. This can reduce our net interest margin and revenues from fee-based products and services. In addition, the widespread adoption of new technologies, including internet-based services, could require us to make substantial expenditures to modify or adapt our existing products and services. Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people can be intense.

The holding company is a separate and distinct legal entity from its subsidiaries. It receives substantially all of its revenues from dividends from its subsidiaries. These dividends are the principal source of funds to pay dividends on the holding company s common stock and interest and principal on its debt. Various federal and state laws and regulations limit the amount of dividends that our bank may pay to the holding company. For more information, refer to Dividends and Other Distributions in the Company s 2006 Annual Report on Form 10-K.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Critical Accounting Policies

The Securities and Exchange Commission (SEC) issued disclosure guidance for critical accounting policies. The SEC defines critical accounting policies as those that require application of management s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods.

Our accounting policies are integral to understanding the results reported. Accounting policies are described in detail in Note 2 of the NOTES TO CONSOLIDATED FINANCIAL STATEMENTS in the Company s 2006 Annual Report on Form 10-K. Not all of the significant accounting policies presented in Note 2 to the Consolidated Financial Statements contained in the Company s 2006 Annual Report on Form 10-K require management to make difficult, subjective or complex judgments or estimates.

Preparation of financial statements

The preparation of these financial statements requires management to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses. On an ongoing basis, management evaluates the estimates used. Estimates are based upon historical experience, current economic conditions and other factors that management considers reasonable under the circumstances.

Use of estimates

These estimates result in judgments regarding the carrying values of assets and liabilities when these values are not readily available from other sources, as well as assessing and identifying the accounting treatments of contingencies and commitments. Actual results may differ from these estimates under different assumptions or conditions.

Accounting Principles Generally Accepted in the United States of America

The Company s financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The Company s significant accounting policies are presented in Note 2 to the Consolidated Financial Statements contained in the Company s 2006 Annual Report on Form 10-K.

The Company follows accounting policies typical to the commercial banking industry and in compliance with various regulations and guidelines as established by the Financial Accounting Standards Board (FASB), the American Institute of Certified Public Accountants (AICPA) and the Bank s primary federal regulator, the Federal Deposit Insurance Corporation (FDIC). The following is a brief description of the Company s current accounting policies involving significant management judgments.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Allowance for Loan and Lease Losses (ALLL)

The allowance for loan and lease losses is management s best estimate of the probable losses that may be sustained in our loan portfolio. The allowance is based on two basic principles of accounting. (1) SFAS No.5 which requires that losses be accrued when they are probable of occurring and estimable and (2) SFAS No. 114, which requires that losses be accrued based on the differences between that value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance. The Company performs periodic and systematic detailed evaluations of its lending portfolio to identify and estimate the inherent risks and assess the overall collectibility. These evaluations include general conditions such as the portfolio composition, size and maturities of various segmented portions of the portfolio such as secured, unsecured, construction, and Small Business Administration (SBA).

Additional factors include concentrations of borrowers, industries, geographical sectors, loan product, loan classes, size and collateral types; volume and trends of loan delinquencies and non-accrual; criticized and classified assets and trends in the aggregate in significant credits identified as watch list items. There are several components to the determination of the adequacy of the ALLL. Each of these components is determined based upon estimates that can and do change when the actual events occur. The Company estimates the SFAS No. 5 portion of the ALLL based on the segmentation of its portfolio. For those segments that require an ALLL, the Company estimates loan losses on a monthly basis based upon its ongoing loan review process and analysis of loan performance. The Company follows a systematic and consistently applied approach to select the most appropriate loss measurement methods and support its conclusions and rationale with written documentation. One method of estimating loan losses for groups of loans is through the application of loss rates to the groups aggregate loan balances. Such rates typically reflect historical loss experience for each group of loans, adjusted for relevant economic factors over a defined period of time. The Company evaluates and modifies its loss estimation model as needed to ensure that the resulting loss estimate is consistent with GAAP.

For individually impaired loans, SFAS No. 114 provides guidance on the acceptable methods to measure impairment. Specifically, SFAS No. 114 states that when a loan is impaired, the Company should measure impairment based on the present value of expected future principal and interest cash flows discounted at the loan s effective interest rate, except that as a practical expedient, a creditor may measure impairment based on a loan s observable market price or the fair value of collateral, if the loan is collateral dependent. When developing the estimate of future cash flows for a loan, the Company considers all available information reflecting past events and current conditions, including the effect of existing environmental factors.

Revenue recognition

The Company s primary sources of revenue are interest income. Interest income is recorded on an accrual basis. Note 2 to the Consolidated Financial Statements contained in the Company s 2006 Annual Report on Form 10-K offers an explanation of the process for determining when the accrual of interest income is discontinued on an impaired loan.

Stock-based Compensation

Statement of Financial Accounting Standards No. 123 (revised 2004); ***Accounting for Stock Based Compensation*** was adopted by the Company as of January 1, 2006, using the modified prospective transition method. Under the modified prospective transition method, compensation cost is recognized on or after the required effective date for the portion of outstanding awards, for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated under Statement No. 123 for either recognition or pro forma disclosures.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The amount of the reduction for the fiscal years 2004 through 2006 is disclosed in Note 13 to the Consolidated Financial Statements contained in the Company s 2006 Annual Report on Form 10-K, based upon the assumptions listed therein. Accounting principles generally accepted in the United States of America (GAAP), itself may change over time, having impact over the reporting of the Company s financial activity. Although the economic substance of the Company s transactions would not change, alterations in GAAP could affect the timing or manner of accounting or reporting.

Income Taxes

The Company accounts for income taxes under the asset liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using currently enacted tax rates applied to such taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. If future income should prove non-existent or less than the amount of deferred tax assets within the tax years to which they may be applied, the asset may not be realized and our net income will be reduced. Our deferred tax assets are described further in Note 12 of the NOTES TO CONSOLIDATED FINANCIAL STATEMENTS in the Company s 2006 Annual Report on Form 10-K.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The following table presents the Company s daily average balance sheet information together with interest income and yields earned on average interest-bearing assets and interest expense and rates paid on average interest-bearing liabilities. Average balances are average daily balances.

Table 1.

Average Balances, Interest Income/Expense and Yields/Rates Paid
(Unaudited, Dollars in thousands)

	Nine Months Ended September 30, 2007			Nine Months Ended September 30, 2006		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
Earning Assets						
Portfolio Loans	$ 424,593	$ 26,779	8.41%	$ 388,886	$ 23,881	8.19%
Tax-exempt Securities	31,774	936	3.93%	18,059	494	3.65%
US Government Securities	73,810	2,446	4.42%	83,440	2,575	4.11%
Federal Funds Sold	14,809	580	5.22%	17,335	658	5.06%
Other Securities	2,000	67	4.47%	3,437	113	4.38%
Average Earning Assets	$ 546,986	$ 30,808	7.51%	$ 511,157	$ 27,721	7.23%
Cash & Due From Banks	$ 14,084			$ 14,161		
Bank Premises	9,938			6,500		
Allowance for Loan and Lease Losses	(4,916)			(4,459)		
Other Assets	16,996			14,969		
Average Total Assets	$ 583,088			$ 542,328		
Interest Bearing Liabilities						
Demand Interest Bearing	$ 115,937	$ 1,935	2.23%	$ 106,002	$ 968	1.22%
Savings Deposits	38,553	885	3.06%	25,095	209	1.11%
Certificates of Deposit	215,219	7,934	4.92%	182,478	5,844	4.27%
Repurchase Agreements	35,427	1,012	3.81%	28,010	794	3.78%
FHLB Borrowings	44,396	1,799	5.40%	64,597	2,492	5.14%
Trust Preferred Borrowings	15,000	814	7.24%	15,000	796	7.08%
Average Interest Bearing Liabilities	464,532	$ 14,379	4.13%	421,182	$ 11,103	3.51%
Non interest Demand	71,880			78,388		
Other Liabilities	1,419			4,547		
Shareholder Equity	45,257			38,211		
Average Liabilities and Stockholders Equity	$ 583,088			$ 542,328		

Net Interest Income and Net Interest Margin	$ 16,429	4.00%	$ 16,618	4.33%

Interest income on loans includes fee income of approximately $188,000 and $383,000 for the period ended September 30, 2007 and 2006 respectively. The Company s average total assets increased to $547.0 million at September 30, 2007 compared to $511.2 million for the same period in 2006, an increase of $35.8 million or 7.0%.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The following tables set forth changes in interest income and expense for each major category of earning assets and interest-bearing liabilities, and the amount of change attributable to volume and rate changes for the periods indicated. Changes attributable to rate/volume have been allocated to volume changes.

Table 2.

	Analysis of Changes in Net Interest Income and Interest Expense (Unaudited)		
	September 30, 2007	over	September 30, 2006
(Dollars in thousands)	Volume	Rate	Total
Increase(Decrease) In Interest Income			
Portfolio Loans	$ 2,467	$ 431	$ 2,898
Tax-exempt Securities	417	25	442
US Government Securities	(256)	127	(129)
Federal Funds Sold	(92)	14	(78)
Other Securities	(47)	1	(46)
Total Increase	$ 2,489	$ 598	$ 3,087
Increase(Decrease) In Interest Expense			
Interest Bearing Demand	$ 433	$ 534	$ 967
Savings Deposits	431	245	676
Certificates of Deposit	1,501	589	2,090
Repurchase Agreements	214	4	218
FHLB Borrowings	(777)	84	(693)
Trust Preferred Borrowings	6	12	18
Total Increase	$ 1,808	$ 1,468	$ 3,276
Net Increase	$ 681	$ (870)	$ (189)

Net interest income for the quarter ended September 30, 2007 was $5.6 million compared with $5.5 million for the same period in 2006, an increase of 1.8%. Net interest income for the nine-months ended September 30, 2007 was $16.4 million compared with $16.6 million for the same nine-month period in 2006, a decrease of 1.2%.

Average earning assets for the nine-months ended September 30, 2007 increased $35.8 million or 7.0% compared with the same period in the prior year. Average loans, the largest component of earning assets, increased $35.7 million or 9.2% on average compared with the prior year period. Overall, the yield on earning assets increased to 7.51% for the nine-month period compared to 7.23% for the same period in the prior year. The increase is primarily due to new loan production priced at higher rates and the repositioning of the security portfolio; lower coupon bonds were sold and replaced with higher yielding securities.

The overall cost of interest-bearing liabilities for the first nine-months 2007 was 4.13% compared with 3.51% for the first nine-months of 2006. The increase was primarily a result of increases in the interest paid on interest-bearing liabilities. The net effect of the changes discussed above resulted in a decrease of $189,000 or 1.11% in net interest income for the nine-month period ended September 30, 2007 from the same period in 2006. Net interest margin

decreased thirty three basis points to 4.00% from 4.33% for the same period a year ago.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Noninterest Income

The Company s non-interest income consists of service charges on deposit accounts, other fee income, processing fees for credit card payments and gains or losses on security sales. The following table sets forth a summary of noninterest income for the periods indicated.

(Dollars in thousands)	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Noninterest income				
Service charges on deposit accounts	$ 70	$ 81	$ 215	$ 255
Payroll and benefit processing fees	90	89	287	287
Earnings on cash surrender value - Bank owned insurance	100	80	294	231
Net loss on sale of securities available-for-sale	0	(171)	46	(171)
Net gain on sale of loans	0	90	0	90
Merchant credit card service income, net	109	110	297	280
Mortgage brokerage fee income	21	32	56	84
Other Income	136	117	447	331
Total Noninterest income	$ 526	$ 428	$ 1,642	$ 1,387

Noninterest income increased $98,000 or 22.9% for the quarter ended September 30, 2007 over September 30, 2006. The most significant portion of the increase is the absence of realized losses in the available-for-sale securities portfolio**.** The ALCO Roundtable restructured the Investment portfolio in the third quarter 2006 to improve yield and protect income in a declining rate environment by extending maturities through purchases in the municipal market. Noninterest income increased $255,000 or 18.4% for the nine-months ended September 30, 2007 over September 30, 2006. The increase for the nine-month period is specifically related to the aforementioned investment restructure strategy.

Noninterest Expense

(Dollars in Thousands)	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Noninterest Expense				
Salaries and related benefits	$ 2,402	$ 1,996	$ 6,458	$ 5,870
Occupancy and equipment expense	635	467	1,636	1,350
FDIC insurance premium	13	12	39	36
Data processing expense	82	53	227	169
Professional service fees	216	149	663	503
Payroll and Benefit expense	25	24	81	78
Deferred compensation expense	105	94	303	272
Stationery and Supplies	34	71	141	180
Postage	39	26	106	91
Directors expense	86	45	207	170

Other expenses	391	362	1,356	1,128
Total Noninterest expense	$ 4,028	$ 3,299	$ 11,217	$ 9,847

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Noninterest expense for the quarter ended September 30, 2007 was $4.0 million, an increase of $729,000 or 22.1% over the same period a year ago. Salaries and employee benefits increased $406,000 or 20.3% over the same period a year ago; the increase is primarily attributable to an one-time executive severance package associated with the company s former Chief Executive Officer.

Non-interest expense for the nine-months ended September 30, 2007 was $11.2 million compared to $9.8 million in the same period a year ago, an increase of $1.4 million or 13.9% over the same nine-month period a year ago. Salaries and employee benefits increased $588,000 or 10.0% over the same nine-month period a year for the same reason mentioned above.

Income Taxes

The Company accounts for income taxes under the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using currently enacted tax rates applied to such taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company s effective tax rate varies with changes in the relative amounts of its non-taxable income and non-deductible expenses. The decrease in the Company s tax provision is attributable to increases in non-taxable income related to a reduction in the municipal security portfolio and reclassification of enterprise zone qualified credits.

The following table reflects the Company s tax provision and the related effective tax rate for the periods indicated. (Dollars in thousands)

	Three Months Ended		Nine Months Ended	
Income Taxes	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Tax provision	$ 693	$ 915	$2,315	$ 2,979
Effective tax rate	34.2%	35.4%	34.4%	37.6%

The Company s provision for income taxes includes both federal and state income taxes and reflects the application of federal and state statutory rates to the Company s net income before taxes. The principal difference between statutory tax rates and the Company s effective tax rate is the benefit derived from investing in tax-exempt securities and enterprise zone qualifying loans. Increases and decreases in the provision for taxes reflect changes in the Company s net income before tax.

On January 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 prescribes a recognition threshold that a tax position is required to meet before being recognized in the financial statements and provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods and disclosure and transition issues. The Company has analyzed filing positions of federal and state jurisdictions, as well as all open tax years in these jurisdictions. The Company believes that its income tax filing positions and deductions will be sustained on audit and does not anticipate any adjustments that will results in a material change to its financial position. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to FIN 48. In addition, the Company did not record a cumulative effect adjustment related to the adoption of FIN 48.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The Company has an unrealized tax benefit of $4.2 million for the nine months ended September 30, 2007. The Company does not reasonably estimate that the unrecognized tax benefit will change significantly within the next twelve months. Deferred tax assets are recognized subject to management judgment that realization is more likely than not. The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense.

The Company files a consolidated federal and state income tax return. The Company determines deferred income tax assets and liabilities using the balance sheet method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between book and tax basis of assets and liabilities, and recognizes enacted changes in tax rates and laws.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at September 30, 2007 consist of the following:

	September 30, 2007	December 31, 2006
Deferred Tax Assets		
State Franchise taxes	197,031	276,048
Deferred compensation	1,888,885	1,735,541
Loan loss reserves	2,260,163	1,926,296
Net unrealized losses on securities available-for-sale	758,747	655,559
Other	187,857	208,910
Total Deferred Tax Assets	5,292,683	4,802,354
Deferred Tax Liabilities		
Depreciation	(152,602)	(229,998)
Deferred loan origination costs	(552,014)	(413,431)
Deferred state taxes	(270,315)	(245,348)
Other	(158,240)	0
Total Deferred Tax Liabilities	(1,133,171)	(888,777)
Total Net Deferred Tax Asset	$ 4,159,512	$ 3,913,577

Asset Quality

The Company concentrates its lending activities primarily within in El Dorado, Placer, Sutter, Sacramento, Shasta, Tehama and Yuba Counties, California, and the location of the Bank s five full service branches, specifically identified as Upstate California. The Company manages its credit risk through diversification of its loan portfolio and the application of underwriting policies and procedures and credit monitoring practices. Although the Company has a diversified loan portfolio, a significant portion of its borrowers ability to repay the loans is dependent upon the professional services and commercial real estate development industry sectors. Generally, the loans are secured by real estate or other assets and are expected to be repaid from the cash flows of the borrower or proceeds from the sale of collateral.

The following table sets forth the amounts of loans outstanding by category as of the dates indicated:

Portfolio Loans	September 30, 2007	December 31, 2006
Commercial and financial loans	$ 146,164	$ 121,754
Real estate-construction loans	121,936	110,693

Real estate-commercial		165,594		159,370
Real estate-other		25,698		12,986
Real estate-mortgage		1,360		4,278
Installment		153		203
Agricultural		4,494		3,971
Other loans		1,065		937
Less:				
Net deferred loan fees		(232)		(298)
Allowance for loan losses		(5,061)		(4,904)
Total net loans	$	461,171	$	408,990

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The Company s practice is to place an asset on nonaccrual status when one of the following events occurs: (i) any installment of principal or interest is 90 days or more past due (unless in management s opinion the loan is well secured and in the process of collection). (ii) Management determines the ultimate collection of principal or interest to be unlikely or (iii) the terms of the loan have been renegotiated due to a serious weakening of the borrower s financial condition. Nonperforming loans are loans that are on nonaccrual, are 90 days past due and still accruing or have been restructured.

Net portfolio loans have increased to $461.2 million, up $52.2 million or 12.8% at September 30, 2007 compared to $409.0 million at December 31, 2006. The portfolio mix reflects increases in production in commercial and financial loans, real estate construction and real estate commercial. Installment and real estate mortgage loans have declined. The balance of the portfolio remains relatively consistent with the mix at December 31, 2006, with commercial and financial loans of approximately 32%, real estate construction of 26% and commercial real estate at 36%. Impaired loans are loans for which it is probable that the Bank will not be able to collect all amounts due and payable. The Bank did not have any impaired loans as of September 30, 2007 and December 31, 2006.

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

(Dollars in thousands)

Non performing assets	September 30, 2007	December 31, 2006
Nonaccrual loans	$ 1,030	$ 0
90 days past due and still accruing interest	0	0
Total nonaccrual loans	1,030	0
Other Real Estate Owned	0	0
Total non performing assets	$ 1,030	$ 0

Allowance for Loan and Lease Losses (ALLL)

The allowance for loan and lease losses is management s estimate of the amount of probable loan losses in the loan portfolio. The Company determines the allowance for loan losses based on an ongoing evaluation. The evaluation is inherently subjective because it requires material estimates, including the amounts and timing of cash flows expected to be received on impaired loans. Those estimates may be susceptible to significant change. The Company makes provisions to the ALLL on a regular basis through charges to operations that are reflected in the Company s statements of income as a provision for loan losses. When a loan is deemed uncollectible, it is charged against the allowance. Any recoveries of previously charged-off loans are credited back to the allowance. There is no precise method of predicting specific losses or amounts that ultimately may be charged-off on particular categories of the loan portfolio.

The Company s allowance for loan and lease losses is the accumulation of various components that are calculated based upon independent methodologies. All components of the allowance for loan losses represent an estimation performed pursuant to SFAS No. 5, *Accounting for Contingencies* or SFAS No. 114, *Accounting by Creditors for Impairment of a Loan.* Management s estimate of each SFAS No. 5 *Accounting for Contingencies* component is based on certain observable data that management believes is the most reflective of the underlying loan losses being estimated. Changes in the amount of each component of the allowance for loan losses are directionally consistent with changes in the observable data, taking into account the interaction of the SFAS No. 5 components over time.

An essential element of the methodology for determining the allowance for loan and lease losses is the Company s loan risk evaluation process, which includes loan risk grading individual commercial, construction, commercial real estate and most consumer loans. Loans are assigned loan risk grades based on the Company s assessment of conditions that affect the borrower s ability to meet its contractual obligations under the loan agreement. That process includes reviewing borrower s current financial information, historical payment experience, loan documentation, public

information, and other information specific to each individual borrower. Loans are reviewed on an annual or rotational basis or as management become aware of information affecting the borrower s ability to fulfill its obligations. Loan risk grades carry a dollar weighted risk percentage.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The ALLL is a general reserve available against the total loan portfolio. It is maintained without any inter-allocation to the categories of the loan portfolio, and the entire allowance is available to cover loan losses. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of the examination process, periodically review the Company s ALLL. Such agencies may require the Company to provide additions to the allowance based on their judgment of information available to them at the time of their examination. Accordingly, it is not possible to predict the effect future economic trends may have on the level of the provision for loan losses in future periods. In addition to the ALLL, an allowance for unfunded loan commitments and letters of loan is determined using estimates of the probability of funding. This reserve is carried as a liability on the condensed consolidated balance sheet.

The ALLL should not be interpreted as an indication that charge-offs in future periods will occur in the stated amounts or proportions.

The following table summarizes the activity in the ALLL reserves for the periods indicated.

	Three Months Ended		Nine Months Ended	
(Dollars in thousands) Allowance for Loan Losses	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Beginning balance for Loan Losses	$ 4,943	$ 4,502	$ 4,904	$ 4,316
Provision for Loan Losses	115	72	121	226
Charge offs:				
Commercial	0	(0)	0	(269)
Real Estate	0	(0)	0	0
Other	0	(1)	0	(1)
Total Charge offs	0	(1)	0	(270)
Recoveries:				
Commercial	1	180	26	475
Real Estate	0	0	0	0
Other	2	0	10	6
Total Recoveries	3	180	36	481
Ending Balance	$ 5,061	$ 4,753	$ 5,061	$ 4,753
ALLL to total loans	1.09%	1.16%	1.09%	1.16%
Net Charge offs to average loans	0.00%	0.00%	0.00%	0.01%

Securities Portfolio

The Company s available-for-sale securities consists of both debt and marketable equity securities. The portfolio is comprised of U.S. Treasury securities, U.S. Agency securities, mortgage-backed securities, and obligations of states and political subdivisions. Securities classified as available-for-sale are recorded at fair value. Unrealized gains and losses, after applicable income taxes, are reported in cumulative other comprehensive income. The Company uses the most current quotations to estimate the fair value of these securities.

Securities classified as held-to-maturity are recorded at cost. Portions of the securities portfolio are used for pledging requirements for deposits of state and local subdivisions, securities sold under repurchase agreements, and FHLB advances.

The Company does not include federal funds sold as securities. These investments are included in cash and cash equivalents. Debt securities in the securities available-for-sale portfolio provide asset liquidity, in addition to the immediately liquid resources of cash and due from banks and federal funds sold.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Total available-for-sale securities decreased $4,271,000 or 4.29% at September 30, 2007 compared to September 30, 2006. As of September 30, 2007, the Company has pledged $1.0 million of securities for treasury, tax and loan accounts, $19.7 million for deposits of public funds, approximately $42.8 million for collateralized repurchase agreements, and $34.0 million towards securing Federal Home Loan Bank borrowings.

The following table summarizes the amortized cost of the Company s available-for-sale securities held on the dates indicated.

	as of September 30, 2007			
(Dollars in thousands)	Amortized Costs	Unrealized Gains	Unrealized Losses	Estimated Fair Value
U.S. government & agencies	$ 26,992	$ 7	$ (395)	$ 26,604
Obligations of state and political subdivisions	23,697	42	(431)	23,308
Mortgage backed securities	42,577	1	(1,011)	41,567
Other securities	2,000	0	(56)	1,944
Total	$ 95,266	$ 50	$ (1,893)	$ 93,423

	as of September 30, 2007			
(Dollars in thousands)	Amortized Costs	Unrealized Gains	Unrealized Losses	Estimated Fair Value
U.S. government & agencies	$ 35,954	$ 19	$ (785)	$ 35,188
Obligations of state and political subdivisions	20,026	129	(159)	19,996
Mortgage backed securities	41,558	124	(1,224)	40,458
Other securities	2,000	0	(28)	1,972
Total	$ 99,538	$ 272	$ (2,196)	$ 97,614

Economic factors may affect market pricing over the stated maturity of the security. The unrealized losses associated with securities are not considered to be other-than-temporary because their unrealized losses are related to changes in interest rates and do not affect the expected cash flows of the underlying collateral or issuer. Security income is accrued when earned and included in interest income. The Company requires a credit rating of A or higher on its initial acquisition of investments and maintains an average rating of AA on the overall securities portfolio. As of September 30, 2007, seventy-one securities were in a loss position. Management has evaluated each security in an unrealized loss position to determine if the impairment is other-than-temporary. Management has determined that no security is other than temporarily impaired. The unrealized losses are due to interest rate changes and the Company has the ability and intent to hold all securities with identified impairments to the earlier of the forecasted recovery or the maturity of the underlying security.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Market risk is the risk that values of assets and liabilities or revenues will be adversely affected by changes in market conditions such as market movements. The risk is inherent in the financial instruments associated with our operations and activities including loans, deposits, securities, short-term borrowings, long-term debt and derivatives. Market-sensitive assets and liabilities are generated through loans and deposits associated with our banking business, our Asset Liability Management (ALM) process, and credit risk mitigation activities. Traditional loan and deposit products are reported at amortized cost for assets or the amount owed for liabilities. These positions are subject to changes in economic value based on varying market conditions. Interest rate risk is the effect of changes in economic value of our loans and deposits, as well as our other interest rate sensitive instruments and is reflected in the levels of future income and expense produced by these positions versus levels that would be generated by current levels of interest rates. We seek to mitigate interest rate risk as part of the ALM process.

Interest rate risk, which potentially can have a significant earnings impact, is an integral part of financial services. The Company is subject to interest rate risk for the following reasons:

- Assets and liabilities may mature or reprice at different times (for example, if assets reprice faster than liabilities and interest rates fall, earnings will initially decline);

- Assets and liabilities may reprice at the same time but by different amounts (for example, the level of interest rates in the market is falling and the Company may reduce rates paid on checking and savings deposit accounts by an amount that is less than the general decline in market rates);

- Short-term and long-term market interest rates may change by different amounts (for example, the shape of the yield curve may affect new loan yields and funding costs differently); or

- The remaining maturities of various assets and liabilities may shorten or lengthen as interest rates change (for example, if long-term mortgage rates decline sharply, mortgage-backed securities held in the securities available-for-sale may prepay significantly earlier than anticipated, which could reduce portfolio income.)

Our overall goal is to manage interest rate sensitivity so that movements in interest rates do not adversely affect net interest income. Interest rates risk is measured as the potential volatility in our net interest income caused by changes in market interest rates. Lending and deposit taking create interest rate sensitive positions on our balance sheet. Interest rate risk from these activities as well as the impact of ever changing market conditions is mitigated using the ALM process. The Company does not operate a trading account and does not hold a position with exposure to foreign currency exchange or commodities. The Company faces market risk through interest rate volatility.

The Board of Directors has overall responsibility for the Company s interest rate risk management policies. The Company has an Asset/Liability Management Committee (ALCO) which establishes and monitors guidelines to control the sensitivity of earnings to changes in interest rates. The internal ALCO Roundtable group maintains a net interest income forecast using different rate scenarios utilizing a simulation model. This group updates the net interest income forecast for changing assumptions and differing outlooks based on economic and market conditions.

The simulation model used includes measures of the expected repricing characteristics of administered rate (NOW, savings and money market accounts) and non-related products (demand deposit accounts, other assets and other liabilities). These measures recognize the relative sensitivity of these accounts to changes in market interest rates, as demonstrated through current and historical experience, recognizing the timing differences of rate changes. In the simulation of net interest margin and net income the forecast balance sheet is processed against five rate scenarios. These five rate scenarios include a flat rate environment, which assumes interest rates are unchanged in the future and four additional rate ramp scenarios ranging for + 200 to - 200 basis points in 100 basis point increments, unless the rate environment cannot move in these basis point increments before reaching zero.

The formal policies and practices adopted by the Company to monitor and manage interest rate risk exposure measure risk in two ways: (i) repricing opportunities for earning assets and interest-bearing liabilities and (ii) changes in net interest income for declining interest rate shocks of 100 to 200 basis points. Because of the Company s predisposition to variable rate, pricing and noninterest bearing demand deposit accounts the Company is asset sensitive. As a result,

management anticipates that, in a declining interest rate environment, the Company s net interest income and margin would be expected to decline, and, in an increasing interest rate environment, the Company s net interest income and margin would be expected to increase.

However, no assurance can be given that under such circumstances the Company would experience the described relationships to declining or increasing interest rates. Because the Company is asset sensitive, the Company is adversely affected by declining rates rather than rising rates.

To estimate the effect of interest rate shocks on the Company s net interest income, management uses a model to prepare an analysis of interest rate risk exposure. Such analysis calculates the change in net interest income given a change in the federal funds rate of 100 or 200 basis points up or down. All changes are measured in dollars and are compared to projected net interest income. Management s most recent calculation estimated an annualized reduction in net interest income attributable to a 100 and 200 basis point decline in the federal funds rate at $774,810 and $1,371,422, respectively. At December 31, 2006, the estimated annualized reduction in net interest income attributable to a 100 and 200 basis point decline in the federal funds rate was $1,197,142 and $2,093,350, respectively, with a similar and opposite result attributable to a 100 and 200 basis point increase in the federal funds rate.

The ALCO has established a policy limitation to interest rate risk of -14% of net interest margin and -20% of the present value of equity.

The securities portfolio is integral to our asset liability management process. The decision to purchase or sell securities is based upon the current assessment of economic and financial conditions, including the interest rate environment, liquidity, regulatory requirements and the relative mix of our cash positions.

The Company s approach to managing interest rate risk may include the use of derivatives. This helps to minimize significant, unplanned fluctuations in earnings, fair values of assets and liabilities and cash flows caused by interest rate volatility. This approach involves modifying the repricing characteristics of certain assets and liabilities so that changes in interest rates do not have a significant adverse effect on the net interest margin and cash flows. As a result of interest rate fluctuations, hedged assets and liabilities will gain or lose market value. In a fair value hedging strategy, the effect of this unrealized gain or loss will generally be offset by income or loss on the derivatives linked to the hedged assets and liabilities. For a cash flow hedge, the change in the fair value of the derivative to the extent that it is effective is recorded through other comprehensive income.

We may use derivatives as part of our interest rate risk management, including interest rate swaps, caps and floors. At inception, the relationship between hedging instruments and hedged items is formally documented with our risk management objective, strategy and our evaluation of effectiveness of the hedge transactions. This includes linking all derivatives designated as fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific transactions. Periodically, as required, we formally assess whether the derivative we designated in the hedging relationship is expected to be and has been highly effective in offsetting changes in fair values or cash flows of the hedged item. The Company s use of derivatives is monitored by the Directors ALCO committee.

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ITEM 4. CONTROLS AND PROCEDURES

As required by SEC rules the Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Company s President and Chief Executive Officer and with the Company s Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures, pursuant to Exchange Act Rule 13a-14.

As part of the disclosure controls and procedures, management has formed the SEC Disclosure Committee. This committee reviews the quarterly filing to a disclosure checklist to ensure that all functional areas of the Company have participated in the disclosure review. In addition, operational and accounting audits are performed ongoing throughout the year by the Company s internal auditors to support the control structure.

Based upon that evaluation, the Company s President and Chief Executive Officer along with the Company s Chief Financial Officer concluded that the Company s disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in this Form 10-Q.

There have been no significant changes in the Company s internal controls, or in other factors, which would significantly affect internal controls subsequent to the date the Company carried out its evaluation.

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PART II. Other Information

Item 1. Legal proceedings

The Company is involved in various pending and threatened legal actions arising in the ordinary course of business. The Company maintains reserves for losses from legal actions, which are both probable and estimable. In the opinion of management, the disposition of claims, currently pending will not have a material adverse affect on the Company s financial position or results of operations.

Item 1a. Risk Factors

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

Item 2. Purchases of Equity Securities by the Issuer and Affiliated Purchasers

On August 28, 2007, the Company s Board of Directors approved the adoption of a program to effect repurchases of the Company s common stock pursuant to SEC Rule 10b-18. The program limits the repurchase amount to not more than $2,400,000 of the Company s outstanding shares of common stock under the program for a period beginning on August 28, 2007 and ending December 31, 2007. The shares are purchased in open market transactions through a broker, subject to availability.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased	Maximum Approximate Dollar Value of Shares that may yet be Purchased
September 1, 2007 through September 30, 2007	169,336	$ 11.40	169,336	$ 470,282

Item 3. Defaults upon Senior Securities

N/A.

Item 4. Submission of Matters to a vote of Security Holders

N/A

Item 5. Other Information

On August 21, 2007, the company filed an 8-K announcing the Board of Directors decision to place the President and Chief Executive Officer Michael C. Mayer on administrative leave for matters not related to his duties at the company. Mr. Patrick J. Moty was appointed as interim President and Chief Executive Officer. On August 30, 2007, the company filed an 8-K announcing the termination of Mr. Mayer s employment contract and naming Mr. Patrick J. Moty as the new President and Chief Executive Officer of the Company.

Item 6. Exhibits

(31.1) Certification of Chief Executive Officer pursuant to Sarbanes-Oxley Act of 2002

(31.2) Certification of Chief Financial Officer pursuant to Sarbanes-Oxley Act of 2002

(32) Certification of Chief Executive Officer and Chief Financial Officer pursuant to Sarbanes-Oxley Act of 2002

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SIGNATURES

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

BANK OF COMMERCE HOLDINGS

(Registrant)

Date: November 9, 2007

/s/ Linda J. Miles
Linda J. Miles
Executive Vice President &
Chief Financial Officer