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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT

PURSUANT TO SECTION 13 OR 15 (d) OF

THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007

Commission file number: 000-33063

SIERRA BANCORP

(Exact name of Registrant as specified in its charter)

California	**33-0937517**
(State of Incorporation)	**(IRS Employer Identification No)**
86 North Main Street, Porterville, California	**93257**
(Address of principal executive offices)	**(Zip Code)**

(559) 782-4900

(Registrant s telephone number, including area code)

Not Applicable

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (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 ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large accelerated filer ¨ Accelerated filer þ Non-accelerated filer ¨

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

YES ¨ NO þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common stock, no par value, 9,646,479 shares outstanding as of July 31, 2007

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PART I FINANCIAL INFORMATION

Item 1

SIERRA BANCORP

CONSOLIDATED BALANCE SHEETS

(dollars in thousands)

	June 30, 2007 (unaudited)	December 31, 2006 (audited)
ASSETS		
Cash and due from banks	$ 44,286	$ 52,645
Interest-bearing deposits in other banks	80	80
Federal funds sold	277	6,290
Total Cash & Cash Equivalents	44,643	59,015
Investment securities available for sale	186,081	190,272
Loans and leases:		
Gross loans and leases	909,447	888,008
Allowance for loan and lease losses	(12,103)	(11,579)
Deferred loan and lease fees, net	(3,411)	(3,618)
Net Loans and Leases	893,933	872,811
Premises and equipment, net	18,721	17,978
Other assets	72,575	74,998
TOTAL ASSETS	$1,215,953	$1,215,074
LIABILITIES AND SHAREHOLDERS EQUITY		
LIABILITIES		
Deposits:		
Non-interest bearing	$ 244,288	$ 281,024
Interest bearing	679,395	587,421
Total Deposits	923,683	868,445
Federal funds purchased and repurchase agreements	76,052	51,003
Short-term borrowings	72,000	131,400
Long-term borrowings	5,000	27,000
Other liabilities	14,871	15,927
Junior subordinated debentures	30,928	30,928
TOTAL LIABILITIES	1,122,534	1,124,703
SHAREHOLDERS EQUITY		
Common stock, no par value; 24,000,000 shares authorized; 9,687,379 and 9,749,913 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively	17,717	16,102
Retained earnings	78,760	75,928
Accumulated other comprehensive income	(3,058)	(1,659)

TOTAL SHAREHOLDER'S EQUITY	93,419	90,371
TOTAL LIABILITIES AND		
SHAREHOLDERS EQUITY	$ 1,215,953	$ 1,215,074

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

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SIERRA BANCORP

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share data, unaudited)

	For the Three-Month Period Ended June 30, 2007	2006	For the Six-Month Period Ended June 30, 2007	2006
Interest income:				
Interest and fees on loans	$ 20,170	$ 17,750	$ 39,808	$ 33,672
Interest on investment securities:				
Taxable	1,523	1,589	3,076	3,204
Tax-exempt	558	515	1,106	990
Interest on Federal funds sold and interest-bearing deposits	12	10	18	17
Total interest income	22,263	19,864	44,008	37,883
Interest expense:				
Interest on deposits	5,809	3,489	10,967	6,565
Interest on short-term borrowings	1,546	1,319	3,383	1,814
Interest on long-term borrowings	60	227	267	557
Interest on manditorily redeemable trust preferred securities	563	709	1,129	1,348
Total interest expense	7,978	5,744	15,746	10,284
Net Interest Income	14,285	14,120	28,262	27,599
Provision for loan losses	701	1,049	1,601	2,099
Net Interest Income after Provision for Loan Losses	13,584	13,071	26,661	25,500
Non-interest revenue:				
Service charges on deposit accounts	1,754	1,519	3,329	2,994
Gains on investment securities available-for-sale	6		11	
Other	2,986	1,327	4,395	2,421
Total other operating income	4,746	2,846	7,735	5,415
Other operating expense:				
Salaries and employee benefits	4,435	3,920	9,098	8,111
Occupancy expense	1,642	1,631	3,107	3,209
Other	2,889	2,659	5,745	5,239
Total other operating expenses	8,966	8,210	17,950	16,559
Income before income taxes	9,364	7,707	16,446	14,356
Provision for income taxes	3,309	2,608	5,638	4,807
Net Income	$ 6,055	$ 5,099	$ 10,808	$ 9,549
PER SHARE DATA				
Book value	$ 9.64	$ 8.56	$ 9.64	$ 8.56
Cash dividends	$ 0.15	$ 0.13	$ 0.30	$ 0.26
Earnings per share basic	$ 0.62	$ 0.52	$ 1.11	$ 0.98
Earnings per share diluted	$ 0.60	$ 0.50	$ 1.07	$ 0.93

Average shares outstanding, basic	9,738,048	9,764,871	9,733,862	9,758,934
Average shares outstanding, diluted	10,090,450	10,269,469	10,110,627	10,270,090

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

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SIERRA BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands, unaudited)

	Six Months Ended June 30, 2007	2006
Cash Flows from Operating Activities		
Net income	$ 10,808	$ 9,549
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on investment securities	$ (11)	$
Gain on sales of loans	(1,619)	
Loss on disposal of fixed assets	6	
(Gain) Loss on sale of foreclosed assets	(7)	18
Writedown on foreclosed assets		133
Share-based compensation expense	188	187
Provision for loan losses	1,601	2,099
Depreciation and amortization	1,633	1,723
Net amortization on securities premiums and discounts	132	443
(Increase) Decrease in unearned net loan fees	(207)	827
Increase in cash surrender value of life insurance policies	(613)	(436)
Proceeds from sales of loans held for sale	1,167	
Proceeds from sales of loan portfolio	11,952	
Originations of loans held for sale	(1,152)	
Decrease (Increase) in interest receivable and other assets	4,026	(3,238)
(Decrease) Increase in other liabilities	(54)	44
Excess tax benefit from share-based payment arrangements	(788)	(704)
Net cash provided by operating activities	27,062	10,645
Cash Flows from Investing Activities		
Maturities of securities available for sale	879	2,726
Proceeds from sales/calls of securities available for sale	2,503	110
Purchases of securities available for sale	(13,645)	(17,576)
Principal paydowns on securities available for sale	11,917	13,283
Increase in loans receivable, net	(33,340)	(94,787)
Purchases of premises and equipment, net	(2,152)	(3,023)
Proceeds from sales of foreclosed assets	66	399
Net cash used in investing activities	(33,772)	(98,868)
Cash Flows from Financing Activities		
Increase in deposits	55,238	15,658
Increase in federal funds purchased	23,900	25,000
(Decrease) Increase in borrowed funds	(81,400)	42,730
Increase (Decrease) in repurchase agreements	1,149	(7,776)
Proceeds from issuance of subordinated debentures		15,464
Cash dividends paid	(2,922)	(2,539)
Stock repurchased	(5,260)	(2,585)
Stock options exercised	845	1,164
Excess tax benefit from share-based payment arrangements	788	704
Net cash (used in) provided by financing activities	(7,662)	87,820

Decrease in cash and due from banks	(14,372)	(403)
Cash and Cash Equivalents		
Beginning of period	59,015	50,147
End of period	$ 44,643	$ 49,744

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

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SIERRA BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2007

Note 1 The Business of Sierra Bancorp

Sierra Bancorp (the Company) is a California corporation registered as a bank holding company under the Bank Holding Company Act of 1956, as amended, and is headquartered in Porterville, California. The Company was incorporated in November 2000 and acquired all of the outstanding shares of Bank of the Sierra (the Bank) in August 2001. The Company's principal subsidiary is the Bank, and the Company exists primarily for the purpose of holding the stock of the Bank and of such other subsidiaries it may acquire or establish. The Company's main source of income is dividends from the Bank, but the Company intends to explore supplemental sources of income in the future. The expenditures of the Company, including (but not limited to) the payment of dividends to shareholders, if and when declared by the Board of Directors, the cost of servicing debt, audit costs, and shareholder expenses will generally be paid from dividends remitted to the Company by the Bank.

At the present time, the Company s only other direct subsidiaries are Sierra Statutory Trust II and Sierra Capital Trust III, which were formed in March 2004 and June 2006, respectively, solely to facilitate the issuance of capital trust pass-through securities. Pursuant to FASB Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46), these trusts are not reflected on a consolidated basis in the financial statements of the Company. References herein to the Company include Sierra Bancorp and its consolidated subsidiary, the Bank, unless the context indicates otherwise.

The Bank is a California state-chartered bank headquartered in Porterville, California. It was incorporated in September 1977, opened for business in January 1978, and has grown to be the largest independent bank headquartered in the South San Joaquin Valley. The Bank is an independent multi-community bank that offers a full range of retail and commercial banking services primarily in the central and southern sections of the San Joaquin Valley. On the southern end, our footprint extends east through the Tehachapi plateau and into the northwestern tip of the Mojave Desert. We currently operate 21 full service branch offices throughout this geographic footprint. The Bank s two newest branches opened in Delano in April 2007 and Bakersfield in February 2006. Our next branch is expected to be another branch in the city of Bakersfield, which should open in late 2007 or early 2008. In addition to these full-service branches, the Bank has an agricultural credit unit and an SBA lending unit with staff located at our corporate headquarters, eight offsite ATMs, and a virtual branch through which customers can open deposit accounts and submit certain loan applications online. The Bank s deposit accounts are insured by the Federal Deposit Insurance Corporation (FDIC) up to maximum insurable amounts.

Note 2 Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in a condensed format, and therefore do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The information furnished in these interim statements reflects all adjustments that are, in the opinion of management, necessary for a fair statement of the results for such period. Such adjustments are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for any other quarter, or for the full year. Certain amounts reported for 2006 have been reclassified to be consistent with the reporting for 2007. The interim financial information should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission.

Note 3 Current Accounting Developments

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48) which clarifies the accounting and disclosure for uncertainty in tax positions as defined. FIN 48 seeks to reduce the diversity in certain recognition and measurement practices related to accounting for income taxes. We adopted FIN 48 effective January 1, 2007, and have determined that as of June 30, 2007 any uncertain tax positions that might exist are immaterial.

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In February 2006, the FASB issued Statement of Accounting Standards (SFAS) No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 (FAS 155). FAS 155 simplifies accounting for certain hybrid instruments currently governed by SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, by allowing fair value re-measurement of hybrid instruments that contain an embedded derivative that otherwise would require bifurcation. FAS 155 also eliminates the guidance in SFAS No. 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets, which provides such beneficial interests are not subject to SFAS No. 133. FAS 155 amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a Replacement of FASB Statement No. 125, by eliminating the restriction on passive derivative instruments that a qualifying special-purpose entity may hold. We adopted this statement effective January 1, 2007. It has not had, nor is it expected to have, a material impact on the Company s financial condition, results of operations or cash flows.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140 (FAS 156). FAS 156 requires an entity to recognize a servicing asset or servicing liability when it undertakes an obligation to service a financial asset in specific situations. The servicing asset or servicing liability shall be initially measured at fair value; however, an entity may elect the amortization method or fair value method for subsequent balance sheet reporting periods. We adopted this statement effective January 1, 2007. It has not had, nor is it expected to have, a material impact on the Company s financial condition, results of operations or cash flows.

In September 2006, the Emerging Issues Task Force (EITF) reached a final consensus on the subject titled Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Arrangements. The EITF has concluded that the recognition of a liability is required for the postretirement benefits provided through an endorsement split-dollar life insurance arrangement. Pursuant to the final consensus, if an employer has promised to pay a death benefit directly from the company to a participant (or designated beneficiary), then a liability for the present value of the death benefit must be accrued over the participant s required service period. However, if the employer has agreed to maintain a split-dollar arrangement and share some portion of the death benefits of the underlying insurance policy, then the postretirement cost of insurance, rather than the death benefit, should be accrued. Since most of the Company s agreements involving postretirement death benefits are split-dollar arrangements associated with an underlying insurance policy, we anticipate that our accrual requirement will, for the most part, be limited to the postretirement cost of insurance. The new guidance will be effective for fiscal years beginning after December 15, 2007. Transition to the new guidance requires a cumulative-effect adjustment to retained earnings at the beginning of the year of implementation, to reflect the change in accounting principle. We have engaged a consultant to review our split-dollar life insurance agreements and provide accounting assistance, and initial estimates are that this EITF guidance could result in a one-time charge to capital of about $1.1 million upon implementation on January 1, 2008, and a quarterly charge to expense of about $30,000 thereafter.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (FAS 157). FAS 157 enhances existing guidance for measuring assets and liabilities using fair value. Prior to the issuance of FAS 157, guidance for applying fair value was incorporated in several accounting pronouncements. FAS 157 provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the use of fair value to measure assets and liabilities. FAS 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under FAS 157, fair value measurements are disclosed by level within that hierarchy. While FAS 157 does not add any new fair value measurements, it does change current practice. Changes to practice include: (1) a requirement for an entity to include its own credit standing in the measurement of its liabilities; (2) a modification of the transaction price presumption; (3) a prohibition on the use of block discounts when valuing large blocks of securities for broker-dealers and investment companies; and (4) a requirement to adjust the value of restricted stock for the effect of the restriction even if the restriction lapses within one year. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years.

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In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (FAS 159). FAS 159 permits the measurement of many financial instruments and certain other balance sheet items at fair value, in order to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Upon adoption, balance sheet items designated for fair value accounting are marked to market through equity, and the fair value option may also be selectively applied to items acquired after the adoption date. Unrealized gains and losses on all items so designated are reported in earnings at each subsequent reporting date. The fair value option may be applied instrument by instrument (with a few exceptions), and is applied only to entire instruments and not to portions thereof. FAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Early adoption for 2007 is permitted if adoption occurs after the issuance of FAS 159 but within 120 days of the beginning of the fiscal year, the adopting entity has not yet issued financial statements for any interim period in 2007, and FAS 157 is simultaneously adopted. The Company has decided that neither FAS 159 nor FAS 157 will be adopted early. Furthermore, other than our investments which are currently classified as available-for-sale and are thus reported at fair value in accordance with FAS 115, we do not anticipate that fair value accounting will be applied to any balance sheet item upon adoption of FAS 159 and FAS 157 on January 1, 2008, in which case there would be no impact on our financial condition, results of operations or cash flows. However, we cannot say with certainty that such application will not occur.

Note 4 Supplemental Disclosure of Cash Flow Information

During the six months ended June 30, 2007 and 2006, cash paid for interest due on interest-bearing liabilities was $16.2 million and $10.0 million, respectively. There was $4.0 million in cash paid for income taxes during the six months ended June 30, 2007, and $3.9 million paid for income taxes during the six months ended June 30, 2006. There were two mobile homes acquired in the settlement of $76,000 in loans for the six months ended June 30, 2007, and no real estate or related assets acquired for the six months ended June 30, 2006. There were no loans made to finance the sale of other real estate for the six months ended June 30, 2007, and none for the six months ended June 30, 2006.

Note 5 Share Based Compensation

On March 15, 2007, the Company s Board of Directors approved a new plan, the 2007 Stock Incentive Plan, which was approved by the Company s shareholders on May 23, 2007. Our 1998 Stock Option Plan was concurrently terminated, although 792,401 options granted and currently still outstanding under the 1998 Plan were not affected. The total number of shares of the Company s authorized but unissued stock reserved and available for issuance pursuant to Awards under the new plan is 1,500,000 shares. Further details on the new plan are provided below in Note 9 Recent Developments. There were no stock options granted by the Company under either plan in the second quarter of 2007, although 13,000 shares were granted under the 1998 plan in the second quarter of 2006. The options granted during the second quarter of 2006 had a calculated fair value of $6.34 per share, using the following assumptions: Expected dividend yield of 2.0%; volatility of 25.7%; average risk-free interest rate of 5.09%; and expected option term of 4.8 years.

Pursuant to FASB Statement 123(R), share-based employee compensation expense is reflected in our income statement for each option granted, over the vesting period of such option. The Company is utilizing the Black-Scholes model to value stock options, and the multiple option approach is used to allocate the resulting valuation to actual expense. Under the multiple option approach, an employee s options for each vesting period are separately valued and amortized. This appears to be the FASB-preferred method for option grants with multiple vesting periods, which is the case for most options granted by the Company. A charge of $93,000 was reflected in the Company s income statement during the second quarter of 2007 and $87,000 was reflected during the second quarter of 2006, as pre-tax compensation expense related to outstanding and unvested stock options. For the first half, these charges amounted to $188,000 in 2007 and $187,000 in 2006.

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Note 6 Earnings Per Share

Earnings per share for all periods presented in the Consolidated Statements of Income are computed based on the weighted average number of shares outstanding during each period. There were 9,738,048 weighted average shares outstanding during the second quarter of 2007, and 9,764,871 during the second quarter of 2006. There were 9,733,862 weighted average shares outstanding during the first six months of 2007, and 9,758,934 during the first six months of 2006.

Diluted earnings per share include the effect of the potential issuance of common shares, which for the Company is limited to shares that would be issued on the exercise of outstanding stock options. The dilutive effect of all options outstanding was calculated using the treasury stock method, excluding anti-dilutive transactions and adjusting for unamortized expense and windfall tax benefits. For the second quarter and first six months of 2007, the dilutive effect of options outstanding calculated under the treasury stock method totaled 352,402 and 376,765, respectively, which were added to basic weighted average shares outstanding for purposes of calculating diluted earnings per share. Likewise, for the second quarter and first six months of 2006, shares totaling 504,598 and 511,156, respectively, were added to basic weighted average shares outstanding in order to calculate diluted earnings per share.

Note 7 Comprehensive Income

Comprehensive income includes net income and other comprehensive income. The Company s only source of other comprehensive income is derived from unrealized gains and losses on investment securities available-for-sale. Reclassification adjustments, resulting from gains or losses on investment securities that were realized and included in net income of the current period that also had been included in other comprehensive income as unrealized holding gains or losses in the period in which they arose, are excluded from comprehensive income of the current period. The Company s comprehensive income was as follows (dollars in thousands):

	For the Three-month Period Ended June 30,		For the Six-month Period Ended June 30,	
	2007	2006	2007	2006
Net income	$ 6,055	$ 5,099	$ 10,808	$ 9,549
Other comprehensive income/(loss):				
Unrealized holding gain/(loss)	(2,995)	(2,620)	(2,405)	(3,122)
Less: reclassification adjustment	6		11	
Pre-tax other comprehensive inc/(loss)	(3,001)	(2,620)	(2,416)	(3,122)
Less: tax impact of above	(1,262)	(1,103)	(1,016)	(1,340)
Net other comprehensive income/(loss)	(1,739)	(1,517)	(1,400)	(1,782)
Comprehensive income	$ 4,316	$ 3,582	$ 9,408	$ 7,767

Note 8 Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business, which is necessary for us to meet the financing needs of our customers. These financial instruments consist of commitments to extend credit and to issue standby letters of credit. The Company uses the same credit policies in making commitments that it does for making loans included on the balance sheet. Commitments generally have fixed expiration dates or other termination clauses, and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, total commitment amounts do not necessarily represent future cash requirements.

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The Company s exposure to credit loss for commitments to extend credit and issue letters of credit is represented by the contractual amount of those instruments, and a $160,000 reserve for potential losses on unfunded commitments is reflected as a liability on the Company s balance sheet at June 30, 2007. The following financial instruments represent off-balance-sheet credit risk (dollars in thousands):

	June 30, 2007	December 31, 2006
Commitments to extend credit	$ 224,678	$ 261,316
Standby letters of credit	$ 13,346	$ 17,139
Commercial letters of credit	$ 11,180	$ 11,393
Credit card commitments	$	$ 39,602

Commitments to extend credit consist primarily of unfunded single-family residential construction loans, home equity lines of credit, commercial real estate construction loans and commercial revolving lines of credit. Construction loans are established under standard underwriting guidelines and policies and are secured by deeds of trust, with disbursements made over the course of construction. Commercial revolving lines of credit have a high degree of industry diversification.

Standby letters of credit are generally unsecured and are issued by the Company to guarantee the performance of a customer to a third party, while commercial letters of credit represent the Company s commitment to pay a third party on behalf of a customer upon fulfillment of contractual requirements. The credit risk involved in issuing letters of credit is essentially the same as the risk in extending unsecured loans to customers.

Note 9 Recent Developments

On March 15, 2007, the Board of Directors of Bank of the Sierra approved the sale of the Bank s credit card portfolio, consisting of $8.2 million in consumer card balances and $2.6 million in commercial loan balances. This decision was reached because of the financial benefits of a sale, as well as the expanded credit card options and superior service that the purchaser can provide to our customers. The sale of our Credit Card Portfolio to Elan Financial Services, a wholly owned subsidiary of U.S. Bancorp, took place effective June 1, 2007. It generated a premium on balances sold of about $1.2 million and enabled us to release the approximate $400,000 liability we had accrued for the redemption of credit card scorecard points, for a total pre-tax gain of $1.6 million. The sale also freed up the $500,000 loan loss allowance allocated to credit card balances. In projecting the impact of the sale on operating income going forward, it should be noted that we will continue to participate in a share of the interchange and interest revenue generated by credit cards issued in our name. Furthermore, we have eliminated most of the costs associated with our credit cards, including funding costs, personnel costs, servicing costs, net loan losses, and the scorecard liability accrual. With the exception of the gain on sale, the sale-related impact on pre-tax operating income has thus far been immaterial. Starting around October 2007, after the credit card servicing is transferred from the current processor to Elan, our pre-tax operating income is expected to initially increase by around $25,000 per quarter. That number should climb if customer penetration and usage levels increase as anticipated, although no assurance can be provided in that regard.

The Company s Board of Directors also approved the 2007 Stock Incentive Plan (the 2007 Plan) on March 15, 2007, which the Company s shareholders approved at the Annual Shareholders Meeting on May 23, 2007. The 2007 Plan provides for the issuance of both incentive and nonqualified stock options to officers and employees, and of nonqualified stock options to non-employee directors, of the Company. The 2007 Plan also provides for the issuance of restricted stock awards to these same classes of eligible participants, which awards may be granted on such terms and conditions as are established at the discretion of the Board of Directors or the Compensation Committee. As noted above in Note 5 Share Based Compensation, the maximum number of shares to be issued under the 2007 Plan is 1,500,000 shares of the Company s authorized but unissued common stock, subject to adjustment for stock splits and dividends.

In June 2007, the Company negotiated new contracts for debit and ATM networks, as well as for processing debit and ATM transactions. While the final contracts have not yet been executed, major economic terms have been agreed upon. Based on growth expectations for debit and ATM transactions and relative to the terms of current contracts, the new contracts are expected to enhance the Company s pre-tax income by a total of $2.9 million over five years commencing in mid-November 2007, although that amount could ultimately be significantly different than projected. For the first 12 months of the new contracts the total income enhancement

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is expected to be close to $450,000, of which approximately $300,000 should be from reduced non-interest expense and the remainder is expected in the form of higher non-interest revenue. Furthermore, the new contracts will allow us to implement new programs and technologies such as debit rewards , contactless debit cards, and improved fraud detection capabilities.

On July 19, 2007, the Board of Directors of the Company approved a $0.16 per share dividend. The dividend is payable on August 21, 2007 to shareholders of record as of August 7, 2007. The total dividend will be approximately $1.54 million and represents about 30% of second quarter consolidated core net income, which is close to the average payout ratio for all publicly-traded financial institutions during 2006. The recommended dividend meets all applicable legal and regulatory requirements for the Company.

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PART I FINANCIAL INFORMATION

ITEM 2

MANAGEMENT S DISCUSSION AND

ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This Form 10-Q includes forward-looking statements that involve inherent risks and uncertainties. Words such as expects , anticipates , believes , projects , and estimates or variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed, forecast in, or implied by such forward-looking statements.

A variety of factors could have a material adverse impact on the Company s financial condition or results of operations, and should be considered when evaluating the potential future financial performance of the Company. These include but are not limited to the possibility of deterioration in economic conditions in the Company s service areas; risks associated with fluctuations in interest rates; liquidity risks; increases in nonperforming assets and net credit losses that could occur, particularly in times of weak economic conditions or rising interest rates; the loss in market value of available-for-sale securities that could result if interest rates change substantially or an issuer has real or perceived financial difficulties; and risks associated with the multitude of current and future laws and regulations to which the Company is and will be subject.

CRITICAL ACCOUNTING POLICIES

The Company s financial statements are prepared in accordance with accounting principles generally accepted in the United States. The financial information and disclosures contained within those statements are significantly impacted by Management s estimates and judgments, which are based on historical experience and various other assumptions that are believed to be reasonable under current circumstances. Actual results may differ from those estimates under divergent conditions.

Critical accounting policies are those that involve the most complex and subjective decisions and assessments, and have the greatest potential impact on the Company s stated results of operations. In Management s opinion, the Company s critical accounting policies deal with the following areas: the establishment of the Company s allowance for loan and lease losses, as explained in detail in the Provision for Loan and Lease Losses and Allowance for Loan and Lease Losses sections of this discussion and analysis; deferred loan origination costs, which are estimated based on an annual evaluation of expenses (primarily salaries) associated with successful loan originations and are allocated to individual loans as they are booked, but can actually vary significantly for individual loans depending on the characteristics of such loans; income taxes, especially with regard to the ability of the Company to recover deferred tax assets, as discussed in the Provision for Income Taxes and Other Assets sections of this discussion and analysis; goodwill, which is evaluated annually based on changes in the market capitalization of the Company and for which management has determined that no impairment exists; and equity-based compensation, which is discussed in greater detail in Note 5 to the consolidated financial statements. Critical accounting areas are evaluated on an ongoing basis to ensure that the Company s financial statements incorporate the most recent expectations with regard to these areas.

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OVERVIEW OF THE RESULTS OF OPERATIONS

AND FINANCIAL CONDITION

RESULTS OF OPERATIONS SUMMARY

Second Quarter 2007 Compared to Second Quarter 2006

Net income for the quarter ended June 30, 2007 was $6.1 million compared to $5.1 million for the quarter ended June 30, 2006, an improvement of 19%. Basic and diluted earnings per share for the second quarter of 2007 were $0.62 and $0.60, compared to $0.52 and $0.50 for the second quarter of 2006. The Company s annualized return on average equity was 25.90% and annualized return on average assets was 2.00% for the quarter ended June 30, 2007, compared to a return on equity of 24.74% and return on assets of 1.82% for the quarter ended June 30, 2006. The primary drivers behind the variance in net income are as follows:

The Company sold $11 million in credit card balances in June 2007, resulting in a $1.6 million pre-tax gain on sale of loans that equates to an increase of approximately $930,000 in net income. This gain added $0.09 to diluted earnings per share in the second quarter of 2007, and boosted the Company s annualized return on average equity and return on average assets for the quarter by about 398 basis points and 31 basis points, respectively.

Net interest income increased by $165,000, or 1%. The percentage increase in net interest income was substantially lower than the 8% increase in average earning assets due to compression in our net interest margin, which was 38 basis points lower in the second quarter of 2007 than in the second quarter of 2006 primarily because of the relatively higher cost and higher proportion of interest-bearing liabilities.

The provision for loan losses was $348,000 lower in the second quarter of 2007, due primarily to the sale of $11 million of our credit card loans and the release of the associated allowance for loan losses.

Despite a drop in average transaction account balances, service charges on deposit accounts increased by $235,000, or 15%, due to an increase in the absolute number of deposit accounts and a higher percentage of returned item and overdraft charges collected relative to transaction account balances.

The expense recorded for salaries and benefits increased by $515,000, or 13%. The increase is the result of the following: lower loan volume, which resulted in a drop in the deferral of salary costs associated with successful loan originations and, by extension, led to higher salaries expense; additional salaries and benefits related to our new Delano branch; and regular annual salary adjustments.

An increase of $152,000 in marketing expense associated with our new deposit initiatives was the main reason for the increase in other operating expenses.

The Company s tax accrual rate increased to 35.3% in the second quarter of 2007 from 33.8% in the second quarter of 2006, principally because the $1.6 million gain on sale of credit card loans is taxable at the Company s 42% blended marginal tax rate.

First Half 2007 Compared to First Half 2006

Net income for the first six months of 2007 was $10.8 million, which is $1.3 million higher than net income for the first six months of 2006 and represents a 13% increase. Basic and diluted earnings per share were $1.11 and $1.07 for the first six months of 2007, compared to $0.98 and $0.93 for the first six months of the prior year. The Company realized an annualized return on average equity of 23.69% for the first half of 2007 and 23.62% for the first half of 2006, and achieved a return on assets for the same periods of 1.80% and 1.76%, respectively. The principal reasons for the net income variance for the first half include the following:

As with second quarter results, the gain on sale of credit card balances supplemented pre-tax and net income for the first half of 2007. The effect on diluted earnings per share for the first half of 2007 was the same as for the quarter, but the increase in annualized return on average equity and return on average assets for the half was substantially lower at about 204 basis points and 15 basis points, respectively.

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Net interest income increased by $663,000, or 2%. Again, this was proportionately less than the 11% increase in average earning assets because of a 43 basis point drop in our net interest margin for the half.

The provision for loan losses was $498,000 lower in the first half of 2007, due to the sale of our credit card loans and slower growth in other loan categories.

Service charges on deposits increased by $335,000, or 11%, for the same reasons noted in the quarterly summary.

In addition to service charges on deposits and gains on the sale of loans, other first-half non-interest income increased by $366,000, or 15%, due to increases in credit and debit card interchange fees, dividends on Federal Home Loan Bank (FHLB) stock, and income from bank-owned life insurance (BOLI).

Salaries and benefits increased by $987,000, or 12%, for the same reasons outlined in the quarterly summary.

Occupancy expense declined by $102,000, or 3%, for the half, because of first quarter 2007 property tax refunds resulting from assessor audits, and lower depreciation expense on furniture and equipment.

Other non-interest expenses increased by $506,000, or 10%, due mainly to a $403,000 increase in marketing expense.

The tax accrual rate for the first half of 2007 was higher for the same reason outlined in the quarterly summary.

FINANCIAL CONDITION SUMMARY

June 30, 2007 relative to December 31, 2006

The Company s total assets were $1.216 billion at June 30, 2007, an increase of only $879,000 relative to total assets of $1.215 billion at December 31, 2006. The most significant characteristics of and changes in the Company s balance sheet during the first six months of 2007 are outlined below:

Net loan growth was only $21 million, or 2%, due to the sale of $11 million in credit card balances. Balance sheet growth was minimal because loan growth was largely offset by an $8 million reduction of cash and due from banks, a $6 million decline in fed funds sold, a $4 million decline in investment securities, and a $2 million drop in other assets.

Nonperforming assets ended the period at only $403,000, or 0.04% of gross loans plus foreclosed assets, about half the level at December 31, 2006. The Company has no subprime exposure in its loan portfolio.

The Company had net loan losses of $1.1 million in the first six months of 2007 compared to net losses of $903,000 in the first six months of 2006. Net charge-offs in the first half of 2007 include $168,000 attributable to a single commercial loan relationship, along with several unsecured consumer credit lines totaling over $500,000 and equity lines totaling over $200,000.

Total deposits increased by $55 million, or 6%, due in part to our current marketing initiative focused on consumer deposits, which increased by $20 million. Business-related deposit balances increased by $21 million, and public deposits increased by about $13 million.

Overall, deposits experienced a significant shift out of non-interest demand and savings accounts and into NOW accounts, money market accounts, and time deposits. This shift contributed to our increased funding costs.

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Because deposits grew by $55 million but total assets increased only negligibly, we were able to reduce our reliance on other borrowings by $56 million.

EARNINGS PERFORMANCE

The Company earns income from two primary sources. The first is net interest income, which is interest income generated by earning assets less interest expense on interest-bearing liabilities. The second is non-interest income, which primarily consists of customer service charges and fees but also comes from non-customer sources such as bank-owned life insurance. The majority of the Company s non-interest expenses are operating costs that relate to providing a full range of banking services to our customers.

NET INTEREST INCOME AND NET INTEREST MARGIN

For the second quarter, net interest income increased by $165,000, or 1%, to $14.3 million in 2007 from $14.1 million in 2006. For the first half, net interest income increased by $663,000, or 2%, to $28.3 million in 2007 from $27.6 million in 2006. The level of net interest income depends on several factors in combination, including growth in earning assets, yields on earning assets, the cost of interest-bearing liabilities, the relative volumes of earning assets and interest-bearing liabilities, and the mix of products which comprise the Company s earning assets, deposits, and other interest-bearing liabilities. Occasionally, net interest income is also impacted by the recovery of interest on loans that have been on non-accrual and are either sold or returned to accrual status, or by the reversal of accrued but unpaid interest for loans placed on non-accrual.

The following Average Balances and Rates table shows, for the quarters noted, the average balance of each principal balance sheet category and the amount of interest income or interest expense associated with that category. This table also shows the calculated yields on each major component of the Company s investment and loan portfolio, the average rates paid on each key segment of the Company s interest bearing liabilities, and the net interest margin.

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Average Balances and Rates

(dollars in thousands, except per share data)

	For the Quarter Ended June 30, 2007 (a) (b) (f)			For the Quarter Ended June 30, 2006 (a) (b) (f)		
Assets	**Average Balance**	**Income/ Expense**	**Average Rate/ Yield**	**Average Balance**	**Income/ Expense**	**Average Rate/ Yield**
Investments:						
Federal funds sold/Due from time	$ 801	$ 12	6.01%	$ 900	$ 10	4.46%
Taxable	133,078	1,523	4.59%	143,797	1,589	4.43%
Non-taxable	55,428	558	6.21%	51,597	515	6.16%
Equity	10		0.00%	9		0.00%
Total Investments	189,317	2,093	5.07%	196,303	2,114	4.89%
Loans and Leases:(c)(e)						
Agricultural	9,870	198	8.05%	10,412	229	8.82%
Commercial	139,190	3,335	9.61%	138,466	3,209	9.30%
Real Estate	675,770	14,744	8.75%	589,618	12,686	8.63%
Consumer	56,312	1,417	10.09%	52,826	1,247	9.47%
Consumer Credit Cards	5,736	202	14.13%	8,401	192	9.17%
Direct Financing Leases	17,259	274	6.37%	12,018	187	6.24%
Other	469		0.00%	455		0.00%
Total Loans and Leases	904,606	20,170	8.94%	812,196	17,750	8.77%
Total Interest Earning Assets(e)	1,093,923	22,263	8.27%	1,008,499	19,864	8.01%
Other Earning Assets	7,608			8,035		
Non-Earning Assets	111,995			104,611		
Total Assets	$ 1,213,526			$ 1,121,145		
Liabilities and Shareholders Equity						
Interest Bearing Deposits:						
NOW	$ 77,354	$ 73	0.38%	$ 69,344	$ 18	0.10%
Savings Accounts	59,620	78	0.52%	70,845	93	0.53%
Money Market	139,175	1,101	3.17%	126,789	669	2.12%
TDOA s, IRA & KEOGH s	24,226	232	3.84%	23,302	186	3.20%
Certificates of Deposit<$100,000	124,193					