UNITED SECURITY BANCSHARES
Form 10-Q
August 08, 2008

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2008.

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _______ TO _____.

Commission file number: 000-32987

UNITED SECURITY BANCSHARES
(Exact name of registrant as specified in its charter)

CALIFORNIA (State or other jurisdiction of incorporation or organization)	91-2112732 (I.R.S. Employer Identification No.)
2126 Inyo Street, Fresno, California (Address of principal executive offices)	93721 (Zip Code)

Registrants telephone number, including area code (559) 248-4943

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).
Large accelerated filer o Accelerated filer x Non-accelerated filer o Small reporting company o

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

Aggregate market value of the Common Stock held by non-affiliates as of the last business day of the registrant's most recently completed second fiscal quarter - June 30, 2008: $121,168,727

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
(Title of Class)

Shares outstanding as of July 31, 2008: 11,798,089

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PART I. Financial Information

United Security Bancshares and Subsidiaries
Consolidated Balance Sheets – (unaudited)
June 30, 2008 and December 31, 2007

(in thousands except shares)		June 30, 2008		December 31, 2007
Assets				
Cash and due from banks	$	23,429	$	25,300
Federal funds sold		0		0
Cash and cash equivalents		23,429		25,300
Interest-bearing deposits in other banks		6,770		2,909
Investment securities available for sale (at fair value)		98,260		89,415
Loans and leases		589,104		598,220
Unearned fees		(1,448)		(1,739)
Allowance for credit losses		(11,223)		(10,901)
Net loans		576,433		585,580
Accrued interest receivable		2,817		3,658
Premises and equipment – net		14,942		15,574
Other real estate owned		7,514		6,666
Intangible assets		3,462		4,621
Goodwill		10,417		10,417
Cash surrender value of life insurance		14,178		13,852
Investment in limited partnership		2,918		3,134
Deferred income taxes		5,025		4,301
Other assets		6,696		6,288
Total assets	$	772,861	$	771,715
Liabilities & Shareholders' Equity				
Liabilities				
Deposits				
Noninterest bearing	$	134,663	$	139,066
Interest bearing		424,009		495,551
Total deposits		558,672		634,617
Federal funds purchased		82,640		22,280
Other borrowings		28,000		10,000
Accrued interest payable		1,097		1,903
Accounts payable and other liabilities		8,027		7,143
Junior subordinated debentures (at fair value)		12,741		13,341
Total liabilities		691,177		689,284
Shareholders' Equity				
Common stock, no par value				
20,000,000 shares authorized, 11,798,992 and 11,855,192				
issued and outstanding, in 2008 and 2007, respectively		31,740		32,587
Retained earnings		51,495		49,997
Accumulated other comprehensive loss		(1,551)		(153)
Total shareholders' equity		81,684		82,431
Total liabilities and shareholders' equity	$	772,861	$	771,715

See notes to consolidated financial statements

United Security Bancshares and Subsidiaries
Consolidated Statements of Income and Comprehensive Income (unaudited)

(In thousands except shares and EPS)	Quarter Ended June 30, 2008	Quarter Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Interest Income:				
Loans, including fees	$ 10,083	$ 12,809	$ 21,435	$ 25,909
Investment securities – AFS – taxable	1,282	1,000	2,600	1,933
Investment securities – AFS – nontaxable	15	27	39	54
Federal funds sold	1	49	17	145
Interest on deposits in other banks	50	77	84	157
Total interest income	11,431	13,962	24,175	28,198
Interest Expense:				
Interest on deposits	3,020	4,531	7,221	8,588
Interest on other borrowings	682	595	1,240	1,041
Total interest expense	3,702	5,126	8,461	9,629
Net Interest Income Before Provision for Credit Losses	7,729	8,836	15,714	18,569
Provision for Credit Losses	548	208	813	410
Net Interest Income	7,181	8,628	14,901	18,159
Noninterest Income:				
Customer service fees	1,272	1,176	2,469	2,312
Gain on redemption of securities	0	0	24	0
Gain on sale of other real estate owned	67	11	67	23
Gain on proceeds from bank-owned life insurance	0	219	0	219
Gain on swap ineffectiveness	0	33	9	32
(Loss) gain on fair value of financial liability	(39)	113	501	113
Shared appreciation income	33	18	143	24
Other	388	384	841	812
Total noninterest income	1,721	1,954	4,054	3,535
Noninterest Expense:				
Salaries and employee benefits	2,903	2,795	5,745	5,482
Occupancy expense	996	917	1,960	1,740
Data processing	69	99	149	236
Professional fees	408	333	717	766
Director fees	67	72	131	128
Amortization of intangibles	257	278	535	462
Correspondent bank service charges	96	129	226	205
Impairment loss on core deposit intangible	0	0	624	0
Loss on California tax credit partnership	108	116	216	217
Write-down on OREO	31	0	31	0
OREO expense	48	33	80	75
Other	661	745	1,346	1,406

Total noninterest expense	5,644	5,517	11,760	10,717
Income Before Taxes on Income	3,258	5,065	7,195	10,977
Provision for Taxes on Income	1,188	1,757	2,625	4,066
Net Income	$ 2,070	$ 3,308	$ 4,570	$ 6,911
Other comprehensive (loss) income, net of tax:				
Unrealized (loss) gain on available for sale securities, interest rate swap, and past service costs of employee benefit plans - net income (benefit) tax of $(780), $(156), $(932) and $50	(1,171)	(262)	(1,398)	75
Comprehensive Income	$ 899	$ 3,046	$ 3,172	$ 6,986
Net Income per common share				
Basic	$ 0.18	$ 0.27	$ 0.39	$ 0.58
Diluted	$ 0.18	$ 0.27	$ 0.39	$ 0.57
Shares on which net income per common shares were based				
Basic	11,818,665	12,078,030	11,832,296	12,012,675
Diluted	11,821,658	12,135,006	11,836,368	12,068,897

See notes to consolidated financial statements

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United Security Bancshares and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
Periods Ended June 30, 2008

(In thousands except shares)	Common stock Number of Shares	Common stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance January 1, 2007	11,301,113	$ 20,448	$ 46,884	$ (1,290)	$ 66,042
Director/Employee stock options exercised	90,000	510			510
Net changes in unrealized loss on available for sale securities (net of income tax benefit of $39)				(58)	(58)
Net changes in unrealized loss on interest rate swaps (net of income tax of $61)				91	91
Net changes in unrecognized past service Cost on employee benefit plans (net of income tax of $28)				42	42
Dividends on common stock ($0.25 per share)			(3,034)		(3,034)
Repurchase and cancellation of common shares	(424,161)	(8,622)			(8,622)
Issuance of shares for business combination	976,411	21,537			21,536
Stock-based compensation expense		93			93
Cumulative effect of adoption of SFAS No. 159 (net income tax benefit of $613)			(845)		(845)
Cumulative effect of adoption of FIN48			(1,298)		(1,298)
Net Income			6,911		6,911
Balance June 30, 2007 (Unaudited)	11,943,363	33,966	48,618	(1,215)	81,369
Net changes in unrealized loss on available for sale securities (net of income tax of $644)				966	966
Net changes in unrealized loss on interest rate swaps (net of income tax of $36)				54	54
Net changes in unrecognized past service Cost on employee benefit plans (net of income tax of $14)				42	42
Dividends on common stock ($0.25 per share)			(2,967)		(2,967)
	(88,171)	(1,472)			(1,472)

Repurchase and cancellation of common shares					
Stock-based compensation expense		93			93
Net Income			4,346		4,346
Balance December 31, 2007	11,855,192	32,587	49,997	(153)	82,431
Director/Employee stock options exercised	8,000	70			70
Net changes in unrealized loss on available for sale securities (net of income tax benefit of $962)				(1,443)	(1,443)
Net changes in unrealized loss on interest rate swaps (net of income tax of $1)				2	2
Net changes in unrecognized past service Cost on employee benefit plans (net of income tax of $29)				43	43
Dividends on common stock ($0.26 per share)			(3,072)		(3,072)
Repurchase and cancellation of common shares	(64,200)	(978)			(978)
Stock-based compensation expense		61			61
Net Income			4,570		4,570
Balance June 30, 2008 (Unaudited)	11,798,992	$ 31,740	$ 51,495	$ (1,551)	$ 81,684

See notes to consolidated financial statements

United Security Bancshares and Subsidiaries
Consolidated Statements of Cash Flows (unaudited)

(In thousands)	Six Months Ended June 30, 2008	2007
Cash Flows From Operating Activities:		
Net income	$ 4,570	$ 6,911
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for credit losses	813	410
Depreciation and amortization	1,382	1,266
Amortization of investment securities	(73)	(62)
Gain on redemption of securities	(24)	0
Decrease in accrued interest receivable	840	111
Decrease in accrued interest payable	(806)	(67)
(Decrease) increase in unearned fees	(291)	3
Increase in income taxes payable	2,025	342
Stock-based compensation expense	61	93
Decrease in accounts payable and accrued liabilities	(846)	(1,217)
Gain on sale of other real estate owned	(67)	(23)
Write-down of other real estate owned	31	0
Impairment loss on core deposit intangible	624	0
Gain on swap ineffectiveness	(9)	(32)
Income from life insurance proceeds	0	(219)
Increase in surrender value of life insurance	(327)	(101)
Gain on fair value option of financial liabilities	(501)	(113)
Loss on tax credit limited partnership interest	216	217
Net (increase) decrease in other assets	(377)	537
Net cash provided by operating activities	7,241	8,056
Cash Flows From Investing Activities:		
Net increase in interest-bearing deposits with banks	(3,861)	(17)
Purchases of available-for-sale securities	(41,000)	(19,178)
Maturities and calls of available-for-sale securities	29,979	18,287
Net purchase of correspondent bank stock	0	255
Investments in limited partnerships	(17)	0
Investment in other bank stock	(72)	0
Net decrease (increase) in loans	5,888	(26,030)
Cash and equivalents received in bank acquisition	0	6,373
Proceeds from sales of foreclosed assets	52	14
Proceeds from settlement of other real estate owned	1,710	23
Capital expenditures for premises and equipment	(277)	(745)
Net cash used in investing activities	(7,598)	(21,018)
Cash Flows From Financing Activities:		
Net increase (decrease) in demand deposit and savings accounts	24,409	(57,132)
Net (decrease) increase in certificates of deposit	(100,354)	41,592
Net increase in federal funds purchased	60,360	13,060
Net increase in FHLB term borrowings	18,000	10,000

Proceeds from Director/Employee stock options exercised		70		510
Repurchase and retirement of common stock		(978)		(8,622)
Payment of dividends on common stock		(3,021)		(2,948)
Net cash used in financing activities		(1,514)		(3,540)
Net decrease in cash and cash equivalents		(1,871)		(16,502)
Cash and cash equivalents at beginning of period		25,300		43,068
Cash and cash equivalents at end of period	$	23,429	$	26,566

See notes to consolidated financial statements

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United Security Bancshares and Subsidiaries - Notes to Consolidated Financial Statements - (Unaudited)

1. Organization and Summary of Significant Accounting and Reporting Policies

The consolidated financial statements include the accounts of United Security Bancshares, and its wholly owned subsidiary United Security Bank (the “Bank”) and two bank subsidiaries, USB Investment Trust (the “REIT”) and United Security Emerging Capital Fund, (collectively the “Company” or “USB”). Intercompany accounts and transactions have been eliminated in consolidation.

These unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information on a basis consistent with the accounting policies reflected in the audited financial statements of the Company included in its 2007 Annual Report on Form 10-K. These interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring, nature) considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for any other interim period or for the year as a whole. Certain reclassifications have been made to the 2007 financial statements to conform to the classifications used in 2008. None of these reclassifications were material.

New Accounting Standards:

In September 2006, the Emerging Issues Task Force (EITF) reached a final consensus on Issue No. 06-4 (EITF *06-4), "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements."* EITF 06-4 requires employers to recognize a liability for future benefits provided through endorsement split-dollar life insurance arrangements that extend into postretirement periods in accordance with SFAS No. 106, *"Employers' Accounting for Postretirement Benefits Other Than Pensions* or APB Opinion No. 12, *Omnibus Opinion-1967."* The provisions of EITF 06-4 became effective on January 1, 2008 and are to be applied as a change in accounting principle either through a cumulative-effect adjustment to retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption, or through retrospective application to all prior periods. The Company's split-dollar life insurance benefits are limited to the employee's active service period. EITF 06-4 had no impact on the Company’s financial condition or results of operations.

In March 2008, the Financial Accounting Standards Board (FASB) issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities - an Amendment of FASB Statement 133.” SFAS No. 161 enhances required disclosures regarding derivatives and hedging activities, including enhanced disclosures regarding how an entity uses derivative instruments and how derivative instruments and related hedged items are accounted for and affect an entity’s financial position, financial performance, and cash flows. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. Adoption of SFAS No. 161 as of January 1, 2009 will not have a material impact on the Company’s consolidated financial position or results of operations, as it impacts financial statement disclosure only.

2. ***Investment Securities Available for Sale***

Following is a comparison of the amortized cost and approximate fair value of securities available-for-sale, as of June 30, 2008 and December 31, 2007:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
June 30, 2008:				
U.S. Government agencies	$ 44,120	$ 245	$ (220)	$ 44,145
U.S. Government agency collateralized mortgage obligations	41,417	131	(1,984)	39,564
Obligations of state and political subdivisions	1,287	18	0	1,305
Other investment securities	13,821	0	(575)	13,246
	$ 100,645	$ 394	$ (2,779)	$ 98,260
December 31, 2007:				
U.S. Government agencies	$ 65,764	$ 524	$ (302)	$ 65,986
U.S. Government agency collateralized mortgage obligations	7,782	44	(4)	7,822
Obligations of state and political subdivisions	2,227	54	0	2,281
Other investment securities	13,752	0	(426)	13,326
	$ 89,525	$ 622	$ (732)	$ 89,415

Included in other investment securities at June 30, 2008 are a short-term government securities mutual fund totaling $7.6 million, a CRA-qualified mortgage fund totaling $4.8 million, and a money-market mutual fund totaling $821,000. Included in other investment securities at December 31, 2007, is a short-term government securities mutual fund totaling $7.7 million, a CRA-qualified mortgage fund totaling $4.9 million, and an overnight money-market mutual fund totaling $752,000. The short-term government securities mutual fund invests in debt securities issued or guaranteed by the U.S. Government, its agencies or instrumentalities, with a maximum duration equal to that of a 3-year U.S. Treasury Note.

There were realized gains totaling $24,000 on calls of available-for-sale securities during the six months ended June 30, 2008. There were no realized losses on sales or calls of available-for-sale securities during the six months ended June 30, 2008. There were no realized gains or losses on sales or calls of available-for-sale securities during the six months ended June 30, 2007.

Securities that have been temporarily impaired less than 12 months at June 30, 2008 are comprised of four collateralized mortgage obligations and three U.S. government agency securities with a total weighted average life of 3.0 years. As of June 30, 2008, there were two other investment securities and one U.S. government agency security with a total weighted average life of 1.5 years that have been temporarily impaired for twelve months or more.

The following summarizes temporarily impaired investment securities at June 30, 2008:

(In thousands)	Less than 12 Months		12 Months or More		Total	
	Fair Value (Carrying	Unrealized	Fair Value (Carrying	Unrealized	Fair Value (Carrying	Unrealized

	Amount)	Losses	Amount)	Losses	Amount)	Losses
Securities available for sale:						
U.S. Government agencies	$ 5,336	$ (48)	$ 4,842	$ (172)	$ 10,178	$ (220)
U.S. Government agency collateralized mortgage obligations	22,419	(1,984)	0	0	22,419	(1,984)
Obligations of state and political subdivisions	0	0	0	0	0	0
Other investment securities	0	0	12,425	(575)	12,425	(575)
Total impaired securities	$ 27,755	$ (2,032)	$ 17,267	$ (747)	$ 45,022	$ (2,779)

Because the decline in market value is attributable to changes in market rates of interest rather than credit quality, and because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be at maturity, the Company considers these investments to be temporarily impaired at June 30, 2008.

At June 30, 2008 and December 31, 2007, available-for-sale securities with an amortized cost of approximately $85.4 million and $71.0 million (fair value of $83.6 million and $71.3 million) were pledged as collateral for public funds, treasury tax and loan balances, and repurchase agreements.

3. ***Loans and Leases***

Loans include the following:

(In thousands)		June 30, 2008	% of Loans		December 31, 2007	% of Loans
Commercial and industrial	$	220,547	37.4%	$	204,385	34.2%
Real estate – mortgage		136,775	23.2%		142,565	23.8%
Real estate – construction		155,046	26.4%		178,296	29.8%
Agricultural		51,890	8.8%		46,055	7.7%
Installment/other		17,203	2.9%		18,171	3.0%
Lease financing		7,643	1.3%		8,748	1.5%
Total Gross Loans	$	589,104	100.0%	$	598,220	100.0%

Loans over 90 days past due and still accruing totaled $1.2 million and $189,000 at June 30, 2008 and December 31, 2007, respectively. Nonaccrual loans totaled $44.0 million and $21.6 million at June 30, 2008 and December 31, 2007, respectively.

An analysis of changes in the allowance for credit losses is as follows:

(In thousands)		June 30, 2008		December 31, 2007		June 30, 2007
Balance, beginning of year	$	10,901	$	8,365	$	8,365
Provision charged to operations		813		5,697		410
Losses charged to allowance		(564)		(4,493)		(168)
Recoveries on loans previously charged off		73		64		30
Reserve acquired in merger		0		1,268		1,268
Balance at end-of-period	$	11,223	$	10,901	$	9,905

The allowance for credit losses represents management's estimate of the risk inherent in the loan portfolio based on the current economic conditions, collateral values and economic prospects of the borrowers. The formula allowance for unfunded loan commitments totaling $426,000 and $548,000 at June 30, 2008 and December 31, 2007, respectively, is carried in other liabilities. The Company’s market areas of the San Joaquin Valley, the greater Oakhurst area, East Madera County, and Santa Clara County, have all been impacted by the economic downturn related to depressed real estate markets and the tightening of liquidity markets. The Company has taken these events into account when reviewing estimates of factors that may impact the allowance for credit losses.

The following table summarizes the Company’s investment in loans for which impairment has been recognized for the periods presented:

(in thousands)		June 30, 2008		December 31, 2007		June 30, 2007
Total impaired loans at period-end	$	40,735	$	20,627	$	17,921
Impaired loans which have specific allowance		8,546		10,750		14,314
Total specific allowance on impaired loans		4,169		4,452		5,056
Total impaired loans which as a result of write-downs or the fair value of the		32,189		9,877		3,607

collateral, did not have a specific allowance

(in thousands)	YTD – 6/30/08	YTD - 12/31/07	YTD – 6/30/07
Average recorded investment in impaired loans during period	$ 25,829	$ 15,857	$ 11,973
Income recognized on impaired loans during period	0	0	0

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4. Deposits

Deposits include the following:

(In thousands)	June 30, 2008	December 31, 2007
Noninterest-bearing deposits	$ 134,663	$ 139,066
Interest-bearing deposits:		
NOW and money market accounts	180,540	153,717
Savings accounts	42,001	40,012
Time deposits:		
Under $100,000	56,966	52,297
$100,000 and over	144,502	249,525
Total interest-bearing deposits	424,009	495,551
Total deposits	$ 558,672	$ 634,617

5. Short-term Borrowings/Other Borrowings

At June 30, 2008, the Company had collateralized and uncollateralized lines of credit with the Federal Reserve Bank of San Francisco and other correspondent banks aggregating $331.1 million, as well as Federal Home Loan Bank ("FHLB") lines of credit totaling $36.8 million. At June 30, 2008, the Company had total outstanding balances of $32.0 million drawn against its FHLB line of credit. The weighted average cost of borrowings outstanding at June 30, 2008 was 2.55%. Of the $32.0 million in FHLB borrowings outstanding at June 30, 2008, $4.0 million was in two-week borrowings, and the other $28.0 million consists of FHLB term-borrowings summarized in the table below.

FHLB term borrowings at June 30, 2008 (in 000's):

Term	Balance at 3/31/08	Fixed Rate	Maturity
1 year	$ 7,000	2.51%	2/11/09
2 year	10,000	4.92%	3/30/09
2 year	11,000	2.67%	2/11/10
	$ 28,000	3.43%	

At December 31, 2007, the Company had collateralized and uncollateralized lines of credit with the Federal Reserve Bank of San Francisco and other correspondent banks aggregating $386.7 million, as well as Federal Home Loan Bank ("FHLB") lines of credit totaling $22.0 million. At December 31, 2007, the Company had total outstanding balances of $32.3 million in borrowings, including $10.4 million in federal funds purchased from correspondent banks at an average rate of 4.2%, and $21.9 million drawn against its FHLB lines of credit. Of the $21.9 million in FHLB borrowings outstanding at December 31, 2007, $11.9 million was in overnight borrowings at an average rate of 3.3%, and the other $10.0 million consists of a two-year FHLB advance at a fixed rate of 4.92% and a maturity date of March 30, 2009. The weighted average cost of borrowings for the year ended December 31, 2007 was 5.17%.

These lines of credit generally have interest rates tied to the Federal Funds rate or are indexed to short-term U.S. Treasury rates or LIBOR. FHLB advances are collateralized by all of the Company's stock in the FHLB and certain qualifying mortgage loans. All lines of credit are on an "as available" basis and can be revoked by the grantor at any time.

6. Supplemental Cash Flow Disclosures

(In thousands)	Six Months Ended June 30, 2008		2007	
Cash paid during the period for:				
Interest	$	9,268	$	10,274
Income Taxes		600		3,724
Noncash investing activities:				
Dividends declared not paid	$	1,534	$	1,499
Loans transferred to foreclosed assets	$	2,522		0
Supplemental disclosures related to acquisitions:				
Deposits			$	69,600
Other liabilities				286
Securities available for sale				(7,414)
Loans, net of allowance for loan losses				(62,426)
Premises and equipment				(728)
Intangibles				(11,085)
Accrued interest and other assets				(3,396)
Stock issued				21,536
Net cash and equivalents acquired			$	6,373

7. Net Income per Common Share

The following table provides a reconciliation of the numerator and the denominator of the basic EPS computation with the numerator and the denominator of the diluted EPS computation:

(In thousands except earnings per share data)	Quarter Ended June 30, 2008	Quarter Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Net income available to common shareholders	$ 2,070	$ 3,308	$ 4,570	$ 6,911
Weighted average shares issued	11,819	12,078	11,832	12,013
Add: dilutive effect of stock options	3	57	4	56
Weighted average shares outstanding adjusted for potential dilution	11,822	12,135	11,836	12,069
Basic earnings per share	$ 0.18	$ 0.27	$ 0.39	$ 0.58
Diluted earnings per share	$ 0.18	$ 0.27	$ 0.39	$ 0.57
Anti-dilutive shares excluded from earnings per share calculation	169	51	109	48

8. Derivative Financial Instruments and Hedging Activities

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

Under the interest rate swap agreement, the Company receives a fixed rate and pays a variable rate based on the Prime Rate ("Prime"). The swap qualifies as a cash flow hedge under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended, and is designated as a hedge of the variability of cash flows the Company receives from certain variable-rate loans indexed to Prime. In accordance with SFAS No. 133, the swap agreement is measured at fair value and reported as an asset or liability on the consolidated balance sheet. The portion of the change in the fair value of the swap that is deemed effective in hedging the cash flows of the designated assets is recorded in accumulated other comprehensive income and reclassified into interest income when such cash flow occurs in the future. Any ineffectiveness resulting from the hedge is recorded as a gain or loss in the consolidated statement of income as part of noninterest income.

The amortizing hedge has a remaining notional value of $198,000 at June 30, 2008, matures in September 2008, and has a duration of approximately two months. As of June 30, 2008, the maximum length of time over which the Company is hedging its exposure to the variability of future cash flows is approximately three months. As of June 30, 2008, the loss amounts in accumulated other comprehensive income associated with these cash flows totaled less than $1,000. During the six months ended June 30, 2008, $5,000 was reclassified from other accumulated comprehensive income into expense, and is reflected as a reduction in interest income.

The Company performed a quarterly analysis of the effectiveness of the interest rate swap agreement at June 30, 2008. As a result of a correlation analysis, the Company has determined that the swap remains highly effective in achieving

offsetting cash flows attributable to the hedged risk during the term of the hedge and, therefore, continues to qualify for hedge accounting under the guidelines of SFAS No. 133. However, during the second quarter of 2006, the Company determined that the underlying loans being hedged were paying off faster than the notional value of the hedge instrument was amortizing. This difference between the notional value of the hedge and the underlying hedged assets is considered an “overhedge” pursuant to SFAS No. 133 guidelines and may constitute ineffectiveness if the difference is other than temporary. The Company determined during 2006 that the difference was other than temporary and, as a result, reclassified a net total of $75,000 of the pretax hedge loss reported in other comprehensive income into earnings during 2006. As of June 30, 2008, the notional value of the hedge was still in excess of the value of the underlying loans being hedged by approximately $133,000, but had improved from the $1.3 million difference existing at December 31, 2007. As a result, the Company recorded a pretax hedge gain related to swap ineffectiveness of approximately $9,100 during the six months ended June 30, 2008. Amounts recognized as hedge ineffectiveness gains or losses are reflected in noninterest income.

9. *Common Stock Repurchase Plan*

Since August 2001, the Company’s Board of Directors has approved three separate consecutive plans to repurchase, as conditions warrant, up to approximately 5% of the Company’s common stock on the open market or in privately negotiated transactions. The duration of the stock repurchase programs has been open-ended and the timing of purchases depends on market conditions. As each new stock repurchase plan was approved, the previous plan was cancelled.

On May 16, 2007, the Board of Directors approved a third stock repurchase plan to repurchase, as conditions warrant, up to 610,000 shares of the Company's common stock on the open market or in privately negotiated transactions. The repurchase plan represents approximately 5.00% of the Company's currently outstanding common stock. The duration of the program is open-ended and the timing of purchases will depend on market conditions. Concurrent with the approval of the new repurchase plan, the Company canceled the remaining 75,733 shares available under the previous 2004 repurchase plan.

During the year ended December 31, 2007, 512,332 shares were repurchased at a total cost of $10.1 million and an average per share price of $19.71. Of the shares repurchased during 2007, 166,660 shares were repurchased under the previous 2004 plan at an average cost of $20.46 per shares, and 345,672 shares were repurchased under the 2007 plan at an average cost of $19.35 per shares.

During the six months ended June 30, 2008, 64,200 shares were repurchased at a total cost of $978,000 and an average per share price of $15.23.

10. *Stock Based Compensation*

On January 1, 2006 the Company adopted the disclosure provisions of Financial Accounting Standards Board (FASB) Statement No. 123 R, “Accounting for Share-Based Payments”. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on the grant-date fair value of the award. The fair value is amortized over the requisite service period (generally the vesting period).

Included in salaries and employee benefits for the six months ended June 30, 2008 and 2007 is $61,000 and $93,000 of share-based compensation, respectively. The related tax benefit on share-based compensation recorded in the provision for income taxes was not material to either quarter.

A summary of the Company’s options as of January 1, 2008 and changes during the six months ended June 30, 2008 is presented below.

	2005 Plan	Weighted Average Exercise Price	1995 Plan	Weighted Average Exercise Price
Options outstanding January 1, 2008	176,500	$ 17.14	36,000	$ 11.21
Exercised during the period	0	—	(8,000)	8.75
Forfeited during the period	0	—	(12,000)	11.53
Options outstanding June 30, 2008	176,500	$ 17.14	16,000	$ 12.21
	62,900	$ 17.05	14,000	$ 12.21

Options exercisable at June 30, 2008

As of June 30, 2008 and 2007, there was $162,000 and $317,000, respectively, of total unrecognized compensation expense related to nonvested stock options. This cost is expected to be recognized over a weighted average period of approximately 1.00 years and 1.50 years, respectively. The Company received $70,000 and $510,000 in cash proceeds on options exercised during the six months ended June 30, 2008 and 2007, respectively. No tax benefits were realized on stock options exercised during the six months ended June 30, 2008 or 2007, because all options exercised during the periods were incentive stock options.

	Period Ended June 30, 2008	Period Ended June 30, 2007
Weighted average grant-date fair value of stock options granted	n/a	$ 4.51
Total fair value of stock options vested	$ 106,295	$ 103,346
Total intrinsic value of stock options exercised	$ 55,000	$ 1,517,000

The Company determines fair value at grant date using the Black-Scholes-Merton pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying stock and the expected dividend yield and the risk-free interest rate over the expected life of the option.

The weighted average assumptions used in the pricing model are noted in the table below. The expected term of options granted is derived using the simplified method, which is based upon the average period between vesting term and expiration term of the options. The risk free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected volatility is based on the historical volatility of the Bank's stock over a period commensurate with the expected term of the options. The Company believes that historical volatility is indicative of expectations about its future volatility over the expected term of the options.

For options vested as of January 1, 2006 or granted after January 1, 2006, and valued in accordance with FAS 123R, the Company expenses the fair value of the option on a straight-line basis over the vesting period for each separately vesting portion of the award. The Company estimates forfeitures and only recognizes expense for those shares expected to vest. Based upon historical evidence, the Company has determined that because options are granted to a limited number of key employees rather than a broad segment of the employee base, expected forfeitures, if any, are not material.

	June 30, 2008	June 30, 2007
Risk Free Interest Rate	—	4.53%
Expected Dividend Yield	—	2.47%
Expected Life in Years	—	6.50 Years
Expected Price Volatility	—	20.63%

The Black-Scholes-Merton option valuation model requires the input of highly subjective assumptions, including the expected life of the stock based award and stock price volatility. The assumptions listed about represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, the Company's recorded stock-based compensation expense could have been materially different from that previously reported by the Company. In addition, the Company is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. The Company's current expected forfeiture rate is zero. If the Company's actual forfeiture rate is materially different from the estimate, the share-based compensation expense could be materially different.

11. Taxes – FIN48

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN48), on January 1, 2007. FIN 48 clarifies SFAS No. 109, "Accounting for Income Taxes," to indicate a criterion that an individual tax position would have to meet for some or all of the income tax benefit to be recognized in a taxable entity's financial statements. Under the guidelines of FIN48, an entity should recognize the financial statement benefit of a tax position if it determines that it is *more likely than not* that the position will be sustained on examination. The term, "more likely than not", means a likelihood of more than 50 percent. In assessing whether the more-likely-than-not criterion is met, the entity should assume that the tax position will be reviewed by the applicable

taxing authority and all available information is known to the taxing authority.

The Company and a subsidiary file income tax returns in the U.S federal jurisdiction, and several states within the U.S. There are no filings in foreign jurisdictions. The Company is not currently aware of any tax jurisdictions where the Company or any subsidiary is subject examination by federal, state, or local taxing authorities before 2001. The Internal Revenue Service (IRS) has not examined the Company's or any subsidiaries federal tax returns since before 2001, and the Company currently is not aware of any examination planned or contemplated by the IRS. The California Franchise Tax Board (FTB) concluded an audit of the Company's 2004 state tax return during the fourth quarter of 2007, resulting in a disallowance of approximately $19,000 related to Enterprise Zone loan interest deductions taken during 2004. The $19,000 was recorded as a component of tax expense for the year ended December 31, 2007.

During the second quarter of 2006, the FTB issued the Company a letter of proposed adjustments to, and assessments for, (as a result of examination of the tax years 2001 and 2002) certain tax benefits taken by the REIT during 2002. The Company continues to review the information available from the FTB and its financial advisors and believes that the Company's position has merit. The Company is pursing its tax claims and will defend its use of these entities and transactions. The Company will continue to assert its administrative protest and appeal rights pending the outcome of litigation by another taxpayer presently in process on the REIT issue in the Los Angeles Superior Court (City National v. Franchise Tax Board).

The Company reviewed its REIT tax position as of January 1, 2007 (adoption date) and again during subsequent quarters since that time in light of the adoption of FIN48. The Bank, with guidance from advisors believes that the case has merit with regard to points of law, and that the tax law at the time allowed for the deduction of the consent dividend. However, the Bank, with the concurrence of advisors, cannot conclude that it is "more than likely" (as defined in FIN48) that the Bank will prevail in its case with the FTB. As a result of the implementation of FIN48, the Company recognized approximately a $1.3 million increase in the liability for unrecognized tax benefits (included in other liabilities), which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. The adjustment provided at adoption included penalties proposed by the FTB of $181,000 and interest totaling $210,000. During the year ended December 31, 2007, and the six months ended June 30, 2008, the Company recorded an additional $87,000 and $43,000, respectively in interest liability pursuant to the provisions of FIN48. The Company had approximately $522,000 accrued for the payment of interest and penalties at June 30, 2008. Subsequent to the initial adoption of FIN48, it is the Company's policy to recognize interest expense related to unrecognized tax benefits, and penalties, as a component tax expense. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in 000's):

Balance at January 1, 2008	$ 1,385
Additions for tax provisions of prior years	43
Balance at June 30, 2008	$ 1,428

12. Fair Value Adjustments - Junior Subordinated Debt/Trust Preferred Securities

Effective January 1, 2007, the Company elected early adoption of SFAS No.159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115". The Company also adopted the provisions of SFAS No. 157, "Fair Value Measurements", effective January 1, 2007, in conjunction with the adoption of SFAS No. 159. SFAS No. 159 generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. Upon adoption of SFAS No. 159, the Company elected the fair value measurement option for all the Company's pre-existing junior subordinated debentures issued under the Company's wholly-owned trust, USB Capital Trust I. The junior subordinated debt issued under USB Capital Trust I was ultimately redeemed during July 2007, and USB Capital Trust I was dissolved. The Company also elected the fair value option pursuant to

SFAS No. 159 for subsequent junior subordinated debt issued under USB Capital Trust II formed during July 2007. The rate paid on the junior subordinated debt issued under USB Capital Trust II is 3-month LIBOR plus 129 basis points, and is adjusted quarterly.

At June 30, 2008 the Company performed a fair value measurement analysis on its junior subordinated debt pursuant to SFAS No. 157 using a valuation model approach that had been utilized in previous periods because of the absences of quoted market prices. Because the trust preferred markets became effectively inactive during the first quarter of 2008 due to increasing credit concerns in the capital markets, management used unobservable pricing spreads to 3-month LIBOR in the fair value determination of its junior subordinated debt. Management utilized a similar market spread from 3-month LIBOR to that used for the fourth quarter of 2007 when observable data were more available. Management believes this market spread is still indicative of those used by market participants.

The fair value calculation performed at June 30, 2008 resulted in a pretax loss adjustment of $39,000 for the quarter ended June 30, 2008, and a cumulative pretax gain adjustment $501,000 for the six months ended June 30, 2008. The cumulative gain adjustment is the result of a 191 basis point decline in the 3-month LIBOR base rate between December 31, 2007 and June 30, 2008. At June 30, 2008, the total cumulative fair value gain recorded on the balance sheet for was $2.9 million. Upon initial adoption of SFAS No. 159, fair value adjustments were reflected in retained earnings. Fair value gains and losses subsequent to initial adoption of SFAS No. 159 are reflected as a component of noninterest income.

13. Fair Value Measurements– Adoption of SFAS No. 157

Effective January 1, 2007, the Company adopted SFAS 157, "Fair Value Measurements", concurrent with its early adoption of SFAS No. 159. SFAS No. 157 clarifies the definition of fair value, describes methods used to appropriately measure fair value in accordance with generally accepted accounting principles and expands fair value disclosure requirements. This statement applies whenever other accounting pronouncements require or permit fair value measurements.

The fair value hierarchy under SFAS No. 157 prioritizes the inputs to valuation techniques used to measure fair value into three broad levels (Level 1, Level 2, and Level 3). Level 1 inputs are unadjusted quoted prices in active markets (as defined) for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability, and reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk).

The Company performs fair value measurements on certain assets and liabilities as the result of the application of accounting guidelines and pronouncements that were relevant prior to the adoption of SFAS No. 157. Some fair value measurements, such as for available-for-sale securities and interest rate swaps are performed on a recurring basis, while others, such as impairment of loans, goodwill and other intangibles, are performed on a nonrecurring basis.

The following tables summarize the Company's assets and liabilities that were measured at fair value on a recurring and non-recurring basis as of June 30, 2008 (in 000's):

Description of Assets	June 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
AFS Securities	$ 98,260		$ 98,260	
Investment in Bank equity securities	315	$ 315		
Interest Rate Swap	(0)		(0)	
Impaired Loans (non-recurring)	4,377			$ 4,377
Core deposit intangibles (non-recurring)	1,495			1,495
Total	$ 104,447	$ 315	$ 98,260	$ 5,872

Description of Liabilities	June 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Junior subordinated debt	$ 12,741			$ 12,741

Total	$	12,741	$	0	$	0	$	12,741

The following tables summarize the Company's assets and liabilities that were measured at fair value on a recurring basis as of December 31, 2007 (in 000's):

Description of Assets	December 31, 2007	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
AFS Securities	$ 89,415	$ 89,415		
Interest Rate Swap	(12)		$ (12)	
Impaired Loans (non-recurring)	6,298		4,185	$ 2,113
Total	$ 95,701	$ 89,415	$ 4,173	$ 2,113

Description of Liabilities	December 31, 2007	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Junior subordinated debt	$ 13,341		$ 13,341	
Total	$ 13,341	$ 0	$ 13,341	$ 0

Available for sale securities are valued based upon open-market price quotes obtained from reputable third-party brokers that actively make a market in those securities. Market pricing is based upon specific CUSIP identification for each individual security. To the extent there are observable prices in the market, the mid-point of the bid/ask price is used to determine fair value of individual securities. If that data is not available for the last 30 days, a level 2-type matrix pricing approach based on comparable securities in the market is utilized. Level-2 pricing may include using a spread forward from the last observable trade or may use a proxy bond like a TBA mortgage to come up with a price for the security being valued. Changes in fair market value are recorded in other comprehensive income as the securities are available for sale.

Investment in Bank equity securities is classified as available for sale and is valued based upon open-market price quotes obtained from an active stock exchange. Changes in fair market value are recorded in other comprehensive income.

The fair value of interest rate swap contracts is based on the discounted net present value of the swap using third party dealer quotes. Changes in fair market value are recorded in other comprehensive income, and changes resulting from ineffectiveness are recorded in current earnings.

Fair value measurements for impaired loans are performed pursuant to SFAS No. 114, and are based upon either collateral values supported by appraisals, or observed market prices. The change in fair value of impaired assets that were valued based upon level three inputs was approximately $37,000 and $203,000 for the six months ended June 30, 2008, and year ended December 31, 2007, respectively. This loss is not recorded directly as an adjustment to current earnings or comprehensive income, but rather as an adjustment component in determining the overall adequacy of the loan loss reserve. Such adjustments to the estimated fair value of impaired loans may result in increases or decreases to the provision for credit losses recorded in current earnings.

The fair value of the junior subordinated debt was determined based upon a valuation discounted cash flows model utilizing observable market rates and credit characteristics for similar instruments. In its analysis, the Company used characteristics that distinguish market participants generally use, and considered factors specific to (a) the liability, (b) the principal (or most advantageous) market for the liability, and (c) market participants with whom the reporting entity would transact in that market. For the six month period ended June 30, 2008, management utilized a similar market spread from 3-month LIBOR to that used for the fourth quarter of 2007 when observable data were more available. The Company believes this adjustment is significant enough to the fair value determination of the junior

subordinated debt as to make them Level 3 inputs as of March 31, 2008 and June 30, 2008. The junior subordinated debt was classified as Level 2 as of December 31, 2007.

The nonrecurring fair value measurements performed during the quarter ended March 31, 2008 resulted in a pretax fair value impairment adjustment of $624,000 ($364,000 net of tax) to the core deposit intangible asset .The adjustment is reflected as a component of noninterest expense for the quarter ended March 31, 2008.

The following tables provide a reconciliation of assets and liabilities at fair value using significant unobservable inputs (Level 3) on a recurring and non-recurring basis during the periods ended June 30, 2008 and 2007 (in 000's):

	6/30/2008 Impaired Loans and CDI	6/30/2007 Impaired Loans	6/30/2007 Business Combinations
Reconciliation of Assets:			
Beginning balance	$ 2,211	$ 1,521	$ 0
Total gains or (losses) included in earnings (or changes in net assets)	(570)	(203)	9,910
Transfers in and/or out of Level 3	4,231	85	68,748
Ending balance	$ 5,872	$ 1,403	$ 78,658
The amount of total gains or (losses) for the period included in earnings (or changes in net assets) attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	$ 74	$ (203)	$ 9,910

	6/30/2008 Junior Sub Debt	6/30/2007 Business Combinations
Reconciliation of Liabilities:		
Beginning balance	$ 0	$ 0
Total gains or (losses) included in earnings (or changes in net assets)	(501)	