Community Bancorp
Form 10-Q
August 15, 2005
Table of Contents

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION 

Washington, D.C. 20549

## Form 10-Q

$x \quad$ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the quarterly period ended June 30, 2005
.. Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934
for the transition period from $\qquad$ to $\qquad$ .

# COMMUNITY BANCORP 

## (Name of issuer in its charter)

$\qquad$

| Nevada <br> (State or other jurisdiction <br> of incorporation or organization) | 33-0668846 <br> (I.R.S. Employer <br> Identification No.) |
| :---: | :---: |
| 400 S. ${ }^{\text {th }}$ Street, Suite 215, Las Vegas, NV |  |
| (Address of principal executive offices) | $\mathbf{8 9 1 0 1}$ |
| (Zip Code) |  |

Issuer s telephone number: (702) 878-0700

## (Former Address)

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

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15 (d) of the Exchange Act during the past 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 x No "

Check whether or not the Company is an accelerated filer as defined in Exchange Rule Act 12b-2. Yes "No x

Number of shares of common stock outstanding as of July 31, 2005: 6,754,847

## Table of Contents

## COMMUNITY BANCORP

Quarterly Report on Form 10-Q

## Index

|  |  | Page |
| :---: | :---: | :---: |
| Part I. Finan | al Information |  |
| Item 1 | Financial Statements (Unaudited) |  |
|  | Consolidated Balance Sheets June 30, 2005 and December 31, 2004 | 3 |
|  | Consolidated Statements of Income and Comprehensive Income: Three months and six months ended June 30, 2005 and 2004 | 4 |
|  | Consolidated Statements of Cash Flows six months ended June 30, 2005 and 2004 | 5 |
|  | Notes to Unaudited Consolidated Financial Statements | 6 |
| Item 2 | Management s Discussion and Analysis of Financial Condition And Results of Operations | 15 |
| Item 3 | Quantitative and Qualitative Disclosures about Market Risk | 28 |
| Item 4 | Controls and Procedures | 28 |
| Part II. Oth | Information |  |
| Item 1 | Legal Proceedings | 29 |
| Item 2 | Unregistered Sales of Equity Securities and Use of Proceeds | 29 |
| Item 3 | Defaults Upon Senior Securities | 29 |
| Item 4 | Submission of Matters to a Vote of Security Holders | 29 |
| Item 5 | Other Information | 30 |
| Item 6 | Exhibits | 30 |
| Signatures |  | 31 |
| Certification | CEO Pursuant to Section 302 |  |
| Certification | CFO Pursuant to Section 302 |  |
| Certification | rsuant to Section 906 |  |

## Table of Contents

## Community Bancorp and Subsidiary

## Consolidated Balance Sheets

June 30, 2005 and December 31, 2004 (Unaudited)

|  | June 30, 2005 | $\begin{gathered} \text { December 31, } \\ 2004 \end{gathered}$ |
| :---: | :---: | :---: |
|  | (dollars in thousands) |  |
| Assets |  |  |
| Cash and due from banks | \$ 16,142 | \$ 5,328 |
| Federal funds sold | 58,970 | 61,926 |
|  |  |  |
| Cash and cash equivalents | 75,112 | 67,254 |
| Securities available for sale | 83,447 | 82,083 |
| Securities held to maturity (fair market value approximates \$1,671 and \$2,041) | 1,613 | 1,958 |
| Investment in Federal Home Loan Bank (FHLB), Federal Reserve Bank (FRB) and Pacific Coast Bankers |  |  |
| Bank (PCBB) stock | 2,896 | 2,219 |
| Loans, net of allowance for loan losses of \$6,068 and \$6,133 | 462,461 | 395,011 |
| Premises and equipment, net | 9,825 | 8,243 |
| Other real estate owned |  | 2,191 |
| Accrued interest receivable | 2,279 | 2,003 |
| Deferred tax assets, net | 2,557 | 2,112 |
| Bank owned life insurance | 9,444 | 9,194 |
| Other assets | 1,497 | 1,693 |
|  | - | - |
| Total assets | \$ 651,131 | \$ 573,961 |
|  |  |  |
| Liabilities and Stockholders Equity |  |  |
| Deposits: |  |  |
| Non-interest bearing demand | \$ 129,231 | \$ 122,148 |
| Interest bearing: |  |  |
| Demand | 241,762 | 221,542 |
| Savings | 5,032 | 5,829 |
| Time, \$100,000 or more | 58,053 | 60,822 |
| Other time | 69,984 | 65,911 |
| Total deposits | 504,062 | 476,252 |
|  |  |  |
| Short term borrowings | 45,000 | 350 |
| Accrued stock appreciation rights | 2,763 | 2,414 |
| Accrued interest payable and other liabilities | 2,206 | 1,928 |
| Junior subordinated debt | 15,464 | 15,464 |
|  | 65,433 | 20,156 |
|  | $\square$ | - |
| Commitments and Contingencies (Note 5) |  |  |


| Stockholders equity |  |  |  |
| :---: | :---: | :---: | :---: |
| Common stock, par value: \$0.001; shares authorized: 10,000,000 |  |  |  |
| shares issued: 2005: 6,789,222; 2004: 6,782,048 | 7 |  | 7 |
| Additional paid-in capital | 51,295 |  | 51,245 |
| Retained earnings | 31,100 |  | 26,698 |
| Accumulated other comprehensive income (loss) | (302) |  | 174 |
|  | - |  |  |
|  | 82,100 |  | 78,124 |
| Less cost of treasury stock, 34,375 shares | (285) |  | (285) |
| Less notes receivable arising from the exercise of common stock options | (179) |  | (286) |
|  |  |  |  |
| Total stockholders equity | 81,636 |  | 77,553 |
|  |  |  |  |
| Total liabilities and stockholders equity | \$ 651,131 | \$ | 573,961 |

See Notes to Unaudited Consolidated Financial Statements.

## Table of Contents

## Community Bancorp and Subsidiary

## Consolidated Statements of Income and Comprehensive Income

For the three months and six months ended June 30, 2005 and 2004 (Unaudited)

|  | For the three months ended June 30, |  | For the six months ended June 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2005 | 2004 | 2005 | 2004 |
|  | (dollars in thousands, except per share data) |  |  |  |
| Interest and dividend income: |  |  |  |  |
| Loans, including fees | \$8,369 | \$ 6,426 | \$ 15,724 | \$ 12,823 |
| Securities: |  |  |  |  |
| Taxable | 646 | 389 | 1,243 | 760 |
| Non-taxable | 208 | 221 | 420 | 441 |
| Federal funds sold | 410 | 203 | 943 | 261 |
| Dividends | 43 | 16 | 52 | 29 |
|  |  | - | - | - |
| Total interest and dividend income | 9,676 | 7,255 | 18,382 | 14,314 |
|  |  |  |  |  |
| Interest expense on: |  |  |  |  |
| Deposits | 2,051 | 1,554 | 3,993 | 2,967 |
| Short term borrowings | 4 | 13 | 9 | 43 |
| Junior subordinated debt | 251 | 177 | 480 | 356 |
|  | 2,306 | 1,744 | 4,482 | 3,366 |
|  |  | - |  |  |
| Net interest income | 7,370 | 5,511 | 13,900 | 10,948 |
| Provision for loan losses | 91 |  | 91 | 222 |
| Net interest income after provision for loan losses | 7,279 | 5,511 | 13,809 | 10,726 |
| Other income: |  |  |  |  |
| Service charges and other income | 272 | 252 | 514 | 518 |
| Loan brokerage and referral fees | 17 | 78 | 17 | 172 |
| Income from bank owned life insurance | 126 |  | 250 |  |
| Net gain on sales of loans | 4 | 18 | 14 | 27 |
| Net gain on sales of securities |  | 2 |  | 2 |
|  | 419 | 350 | 795 | 719 |
|  |  | - | - |  |
| Other expenses: |  |  |  |  |
| Salaries, wages and employee benefits | 2,574 | 2,165 | 5,062 | 4,270 |
| Stock appreciation rights | 677 | 65 | 349 | 130 |
| Occupancy, equipment \& depreciation | 367 | 373 | 727 | 727 |
| Data processing | 164 | 137 | 315 | 269 |

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| Advertising and public relations | 187 | 133 |  | 263 |  | 214 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Professional fees | 198 | 59 |  | 478 |  | 124 |
| Telephone and postage | 54 | 50 |  | 104 |  | 106 |
| Stationery and supplies | 84 | 60 |  | 157 |  | 119 |
| Insurance | 68 | 56 |  | 127 |  | 108 |
| Loan related | 44 | 67 |  | 76 |  | 105 |
| Director fees | 34 | 31 |  | 123 |  | 105 |
| Foreclosed assets, net | 6 | (18) |  | (187) |  | 97 |
| Software maintenance | 21 | 28 |  | 46 |  | 55 |
| Other | 163 | 223 |  | 424 |  | 422 |
|  |  |  |  |  |  |  |
|  | 4,641 | 3,429 |  | 8,064 |  | 6,851 |
|  | - | - |  | - |  |  |
| Income before income taxes | 3,057 | 2,432 |  | 6,540 |  | 4,594 |
| Income tax expense | 1,037 | 808 |  | 2,138 |  | 1,521 |
| Net income | \$ 2,020 | \$ 1,624 | \$ | 4,402 | \$ | 3,073 |
|  | - |  |  |  |  |  |
| Other comprehensive income: |  |  |  |  |  |  |
| Unrealized gain (loss) on securities available for sale | 274 | $(1,431)$ |  | (476) |  | $(1,004)$ |
| Comprehensive income | \$ 2,294 | \$ 193 | \$ | 3,926 | \$ | 2,069 |
|  | - | - |  |  |  |  |
| Earnings per share: |  |  |  |  |  |  |
| Basic | \$ 0.30 | \$ 0.35 | \$ | 0.65 | \$ | 0.66 |
| Diluted | \$ 0.29 | \$ 0.34 | \$ | 0.64 | \$ | 0.64 |
| Dividends per share | \$ | \$ 0.06 | \$ |  | \$ | 0.06 |

See Notes to Unaudited Consolidated Financial Statements.

## Table of Contents

## Community Bancorp and Subsidiary

## Consolidated Statements of Cash Flows

For the six months ended June 30, 2005 and 2004 (Unaudited)

|  | 2005 | 2004 |
| :---: | :---: | :---: |
|  | (dollars in thousands) |  |
| Cash Flows from Operating Activities: |  |  |
| Net income | \$ 4,402 | \$ 3,073 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |
| Depreciation of premises and equipment | 344 | 358 |
| (Gain) on sale of foreclosed assets | (214) | (14) |
| (Gain) on sale of securities available for sale |  | (2) |
| (Income) from bank owned life insurance | (250) |  |
| Realized (gain) on sales of loans | (14) | (27) |
| Proceeds from sales of loans held for sale | 206 | 439 |
| Originations of loans held for sale | (192) | (412) |
| Deferred taxes | (200) |  |
| Provision for loan losses | 91 | 222 |
| Provision for foreclosed assets |  | 110 |
| Net (accretion) amortization of investment premium and discount | 315 | (37) |
| (Increase) decrease in accrued interest receivable | (276) | 100 |
| Decrease in other assets | 196 | 102 |
| Increase (decrease) in accrued interest payable and other liabilities | 627 | (341) |
|  |  |  |
| Net cash provided by operating activities | 5,035 | 3,571 |
|  | - | - |
| Cash Flows from Investing Activities: |  |  |
| Proceeds from maturities of and principal paydowns on securities held to maturity | 345 | 106 |
| Purchase of securities available for sale | $(12,428)$ | $(15,957)$ |
| Proceeds from maturities of and principal paydowns on securities available for sale | 10,028 | 12,296 |
| Investment in FHLB, FRB and PCBB stock | (677) | (948) |
| Purchase of premises and equipment | $(1,926)$ | (239) |
| Proceeds from sale of foreclosed assets | 2,405 | 445 |
| Net (increase) decrease in loans | $(67,541)$ | 12,057 |
|  |  |  |
| Net cash provided by (used in) investing activities | $(69,794)$ | 7,760 |
|  | - | - |
| Cash Flows from Financing Activities: |  |  |
| Cash dividends paid for fractional shares |  | (4) |
| Net increase (decrease) in short term borrowings | 44,650 | $(10,000)$ |
| Net increase in deposits | 27,810 | 122,246 |
| Proceeds from exercise of common stock options | 157 | 28 |
|  |  | - |
| Net cash provided by financing activities | 72,617 | 112,270 |
|  |  |  |
| Increase in cash and cash equivalents | 7,858 | 123,601 |
| Cash and cash equivalents, beginning of period | 67,254 | 36,005 |

Table of Contents

## Community Bancorp and Subsidiary

## Notes to Unaudited Consolidated Financial Statements

## Note 1. Nature of Business and Summary of Significant Accounting Policies

Nature of business

Community Bancorp (the Company) is a holding company whose subsidiary, Community Bank of Nevada, is a Nevada state chartered bank that provides a full range of commercial and consumer bank products through six branches located in the Las Vegas metropolitan area. The Company s business is concentrated in southern Nevada and is subject to the general economic conditions of this area. Segment information is not presented since all of the Company s revenues are attributable to one operating segment. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and general industry practice.

A summary of the significant accounting policies used by Community Bancorp and its subsidiary are as follows:

## Principles of Consolidation

The consolidated financial statements include the accounts of Community Bancorp and its wholly owned subsidiary, Community Bank of Nevada (the Bank), collectively referred to herein as the Company. Significant intercompany accounts and transactions are eliminated in consolidation.

## Use of estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses.

## Interim financial information

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The accompanying unaudited consolidated financial statements as of June 30, 2005 and 2004 have been prepared in 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 which are, in the opinion of management, necessary for a fair statement of the results for each respective period presented. Such adjustments are of a normal recurring nature. The results of operation in the interim statements are not necessarily indicative of the results that may be expected for any other quarter or for the full year. The interim financial information should be read in conjunction with the Company s Annual Report on Form 10-K. Condensed financial information as of December 31, 2004 has been presented next to the interim consolidated balance sheet for informational purposes.

A consolidated statement of stockholders equity is not included as part of these interim financial statements since there have been no material changes in the capital structure of the Company during the six months ended June 30, 2005.

## Table of Contents

Community Bancorp and Subsidiary

## Notes to Unaudited Consolidated Financial Statements

## Note 1. Nature of Business and Summary of Significant Accounting Policies (continued)

Reclassifications

Certain amounts in the June 30, 2004 consolidated income statement were reclassified to conform to the 2005 presentation, with no effect on previously reported net income or stockholders equity.

## Employee Stock Plans

On May 19, 2005, the stockholders approved the 2005 Equity Based Compensation Plan (the 2005 Plan). The 2005 Plan authorizes the granting of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock awards, restricted stock units, and performance share cash only awards. The 2005 Plan provides for a maximum of fifteen percent of the Company s outstanding shares as of March 24, 2005, and adjusts on each anniversary thereafter to be $15 \%$ of the then outstanding number of shares that may be delivered for awards.

At June 30, 2005, the Company also has a stock-based compensation plan, which is described more fully in Note 9 of the Annual Report. The Company accounts for the plan under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, no stock-based employee compensation cost has been recognized, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share had compensation cost for all of the stock-based compensation plans been determined based on the minimum value approach:

|  | For the three months ended June 30, |  | For the six months ended June 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2005 | 2004 | 2005 | 2004 |
|  | (dollars in thousands, except per share data) |  |  |  |
| Net income: |  |  |  |  |
| As reported | \$ 2,020 | \$ 1,624 | \$ 4,402 | \$ 3,073 |
| Deduct total stock-based employee compensation expense determined under minimum value method for all awards, net of related tax effects | (21) | (16) | (42) | (24) |
| Pro forma | \$ 1,999 | \$ 1,608 | \$ 4,360 | \$ 3,049 |
| Earnings per share: |  |  |  |  |

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As reported

| Basic | $\mathbf{0 0 . 3 0}$ | $\$$ | 0.35 | $\mathbf{\$}$ | $\mathbf{0 . 6 5}$ | $\$$ | 0.66 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Diluted | $\mathbf{\$}$ | $\mathbf{0 . 2 9}$ | $\$$ | 0.34 | $\mathbf{\$}$ | $\mathbf{0 . 6 4}$ | $\mathbf{\$}$ |

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## Table of Contents

## Community Bancorp and Subsidiary

## Notes to Unaudited Consolidated Financial Statements

## Note 2. Earnings Per Share

Basic earnings per share (EPS) represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted EPS reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding options, and are determined using the treasury stock method.

Earnings per common share have been computed based on the following:

For the three months ended


For the six months ended

|  | June 30, |
| :--- | :--- | :--- |

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|  |  |  | ( |
| :--- | :--- | :--- | :--- |
|  |  |  |  |
| Basic EPS | $\$$ | $\mathbf{0 . 6 5}$ | $\$$ |
| Diluted EPS | $\$$ | $\mathbf{0 . 6 4}$ | $\$$ |

## Table of Contents

## Community Bancorp and Subsidiary

## Notes to Unaudited Consolidated Financial Statements

## Note 3. Current Accounting Developments

In December 2004, the Financial Accounting Standards Board (FASB) published FASB Statement No. 123 (revised 2004), Share-Based Payment (FAS 123(R) or the Statement). FAS 123(R) requires that the compensation cost relating to share-based payment transactions, including grants of employee stock options, be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. FAS $123(\mathrm{R})$ permits entities to use any option-pricing model that meets the fair value objective in the Statement.

The Statement is effective at the beginning of the first quarter of 2006 for the Company. As of the effective date, the Company will apply the Statement using a modified version of prospective application. Under that transition method, compensation cost will be recognized for (1) all awards granted after the required effective date and to awards modified, cancelled, or repurchased after that date and (2) the portion of awards granted subsequent to the completion of the Company s initial public offering (IPO) and prior to the effective date for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated for pro forma disclosures under FAS 123(R).

The impact of this Statement on the Company in 2006 and beyond will depend upon various factors, among them being the Company s future compensation strategy. The pro forma compensation costs presented in these and prior financial statements of the Company have been calculated using a minimum value method and may not be indicative of amounts which should be expected in future periods.

## Table of Contents

## Community Bancorp and Subsidiary

## Notes to Unaudited Consolidated Financial Statements

## Note 4. Loans

The composition of the Company s loan portfolio as of June 30, 2005 and December 31, 2004 is as follows:

|  | June 30, 2005 |  | $\begin{aligned} & \text { ember 31, } \\ & 2004 \end{aligned}$ |
| :---: | :---: | :---: | :---: |
|  | (dollars in thousands) |  |  |
| Commercial and industrial | \$ 80,282 | \$ | 59,820 |
| Real estate: |  |  |  |
| Commercial | 162,504 |  | 148,411 |
| Residential | 19,343 |  | 24,097 |
| Construction and land development, including raw land of approximately $\$ 72,612$ for 2005 and $\$ 50,157$ for 2004 | 205,868 |  | 167,154 |
| Consumer and other | 3,110 |  | 3,788 |
|  | 471,107 |  | 403,270 |
| Less: |  |  |  |
| Allowance for loan losses | 6,068 |  | 6,133 |
| Net unearned loan fees and discounts | 2,578 |  | 2,126 |
|  | \$ 462,461 | \$ | 395,011 |

Impaired and nonaccrual loans were $\$ 938,000$ and $\$ 626,000$ as of June 30,2005 , and $\$ 916,000$ and $\$ 966,000$ as of December 31, 2004, respectively. Net charge-offs (recoveries) were $\$ 156,000$ and ( $\$ 52,000$ ) for the six months ended June 30, 2005 and 2004, respectively. For the three months ended June 30, 2005 and 2004, net charge-offs (recoveries) were $\$ 179,000$ and $(\$ 60,000)$, respectively.

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## Table of Contents

## Community Bancorp and Subsidiary

## Notes to Unaudited Consolidated Financial Statements

## Note 5. Commitments and Contingencies

## Financial instruments with off-balance-sheet risk

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. They involve, to varying degrees, elements of credit risk in excess of amounts recognized in the balance sheets.

The Company s exposure to credit loss in the event of nonperformance by the other parties to the financial instruments for these commitments is represented by the contractual amounts of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of the contract amount of the Company s exposure to off-balance-sheet risk as of June 30, 2005 and December 31, 2004 is as follows:

|  | June 30, <br> 2005 |  | mber 31, <br> 2004 |
| :---: | :---: | :---: | :---: |
|  | (dollars in thousands) |  |  |
| Commitments to extend credit, including unsecured commitments of $\$ 18,261$ for 2005 and \$17,136 for 2004 | \$ 164,404 | \$ | 126,550 |
| Credit card commitments, including unsecured amounts of \$1,428 for 2005 and $\$ 1,441$ for 2004 | 1,444 |  | 1,471 |
| Standby letters of credit, including unsecured commitments of $\$ 530$ for 2005 and $\$ 1,122$ for 2004 | 3,386 |  | 1,583 |
|  | - |  |  |
|  | \$ 169,234 | \$ | 129,604 |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. 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, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management $s$ credit evaluation of the party. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate and income-producing commercial properties. As of June 30,2005 the Company has approximately $\$ 419,000$ reflected in other liabilities for off-balance sheet risk associated with commitments to extend credit.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required as the Company deems necessary. Essentially all letters of credit issued have expiration dates within one year. Upon entering into letters of credit, the Company records the related liability at fair value pursuant to FASB Interpretation 45 (FIN 45). Thereafter,

## Table of Contents

Community Bancorp and Subsidiary

## Notes to Unaudited Consolidated Financial Statements

the liability is evaluated pursuant to FASB Statement No. 5 Accounting for Contingencies. As of June 30, 2005 the amount of the liability related to guarantees was approximately $\$ 12,000$.

## Note 5. Commitments and Contingencies (continued)

In connection with standby letters of credit, the Company recognizes the related commitment fee received from the third party as a liability at the inception of the guarantee arrangement pursuant to FIN 45. Commitment fees where the likelihood of exercise of the commitment is remote, are generally recognized as service fee income on a straight line basis over the commitment period. All other commitment fees are deferred over the entire commitment period and are not recognized as service fee income until the expiration of the commitment period.

## Financial instruments with concentrations of credit risk

The Company makes commercial, commercial real estate, residential real estate and consumer loans to customers primarily in southern Nevada. At June 30, 2005, real estate loans accounted for approximately $82 \%$ of total loans. Substantially all of these loans are secured by first liens with an initial loan-to-value ratio of generally not more than $75 \%$. The Company s policy for requiring collateral is to obtain collateral whenever it is available or desirable, depending upon the degree of risk that the Company is willing to take. In addition, approximately $4 \%$ of total loans are unsecured. The Company s loans are expected to be repaid from cash flow or from proceeds from the sale of selected assets of the borrowers.

A substantial portion of the Company s customers ability to honor their contracts is dependent on the economy in the area. The Company s goal is to continue to maintain a diversified loan portfolio that requires the loans to be well collateralized and supported by cash flows.

## Lease Commitments

During March of 2005, the Company entered into a month to month sublease agreement for its San Diego loan production office. This is an operating lease with an unrelated third party with an initial base rent of $\$ 1,400$ per month. The lease may be terminated by either party on not less than thirty days prior written notice.

In June of 2005, the Company entered into a lease agreement for its Phoenix loan production office. This is an operating lease with an unrelated third party with an initial base rent of approximately $\$ 1,200$ per month. The lease agreement ends on December 31, 2005.

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Also in June of 2005, a sixth office was opened at the intersection of Russell Road and Interstate 215 in southwest Las Vegas. The office is leased space for an additional branch, human resources, operation support, internal audit and the real estate lending department. This is an operating lease with an unrelated third party with an initial base rent of approximately $\$ 38,000$ per month beginning in October 2005. For each year following, the rent will be increased by approximately 2\%. The lease expires on October 31, 2015

Table of Contents

Community Bancorp and Subsidiary

## Notes to Unaudited Consolidated Financial Statements

## Note 6. Stock Options and Stock Appreciation Rights

## Stock options

There were no stock options granted or other material activity relating to stock options during the six months ended June 30, 2005. However, in July 2005, the Company granted 55,000 nonqualified stock options and 140,000 incentive stock options with an exercise price equal to the market value of the underlying stock on the grant date of $\$ 31.55$. The nonqualified stock options vest immediately, and the incentive stock options vest $20 \%$ each year over five years. All options expire ten years from the grant date.

## Stock appreciation rights

The Company accounts for stock appreciation rights (SAR) pursuant to FASB Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans. The expense related to the Company s SAR plan was approximately $\$ 349,000$ and $\$ 130,000$ for the six months ended June 30, 2005 and 2004, respectively. For the three months ended June 30, 2005 and 2004, the expense related to the SAR plan was $\$ 677,000$ and $\$ 65,000$, respectively. The total amount in accrued expenses was $\$ 2,763,000$ at June 30, 2005. Approximately $\$ 2,500,000$ of this accrual was paid in July 2005.

There were no grants of stock appreciation rights or other activity relating to the SAR plan during the six months ended June 30, 2005.

## Note 7. Borrowed Funds

The Bank has entered into an agreement under which it can obtain short term advances from the Federal Home Loan Bank (FHLB). The interest rate charged on advances is determined by the FHLB at the time of the advances. Advances are collateralized by a blanket lien on all loans secured by real estate and all business loans. The agreement can be terminated by the FHLB at any time. Advances from the FHLB were $\$ 45,000,000$ and $\$ 0$ at June 30, 2005 and December 31, 2004, respectively. For advances outstanding as of June 30, 2005, the interest rate is $3.37 \%$, and the maturity date is August 1, 2005.

## Note 8. Acquisition

On May 19, 2005, the Company signed a definitive agreement to purchase all of the common stock and equivalents of Bank of Commerce for approximately $\$ 40$ million in cash and common stock. The transaction, which is subject to shareholder approval, is expected to close in the third quarter of 2005.

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13

## Table of Contents

## Community Bancorp and Subsidiary

## Notes to Unaudited Consolidated Financial Statements

## Note 9. Quarterly Data (Unaudited)

|  | 2005 |  | 2004 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Second <br> Quarter | First <br> Quarter | Fourth <br> Quarter | Third <br> Quarter | Second <br> Quarter | First Quarter |
|  | (dollars in thousands, except per share data) |  |  |  |  |  |
| Interest and dividend income | \$9,676 | \$ 8,706 | \$ 8,171 | \$ 7,553 | \$ 7,255 | \$ 7,059 |
| Interest expense | 2,306 | 2,176 | 1,815 | 1,681 | 1,744 | 1,622 |
| Net interest income | 7,370 | 6,530 | 6,356 | 5,872 | 5,511 | 5,437 |
| Provision for loan losses | 91 |  | 340 | 360 |  | 222 |
| Net interest income, after provision for loan losses | 7,279 | 6,530 | 6,016 | 5,512 | 5,511 | 5,215 |
| Noninterest income | 419 | 376 | 392 | 378 | 350 | 369 |
| Noninterest expenses (1) | 4,641 | 3,423 | 5,424 | 3,671 | 3,429 | 3,422 |
| Income before income taxes | 3,057 | 3,483 | 984 | 2,219 | 2,432 | 2,162 |
| Provision for income taxes | 1,037 | 1,101 | 141 | 714 | 808 | 713 |
| Net income | \$ 2,020 | \$ 2,382 | \$ 843 | \$ 1,505 | \$ 1,624 | \$ 1,449 |
| Earnings per common share: |  |  |  |  |  |  |
| Basic | \$ 0.30 | \$ 0.35 | \$ 0.16 | \$ 0.32 | \$ 0.35 | \$ 0.31 |
| Diluted | \$ 0.29 | \$ 0.35 | \$ 0.16 | \$ 0.31 | \$ 0.34 | \$ 0.31 |

(1) Fourth quarter of 2004 includes approximately $\$ 1.9$ million of expense relating to stock appreciation rights. See Note 9 of the annual report.

Table of Contents

## Item 2.

## MANAGEMENT S DISCUSSION AND ANALYSIS OF

## FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2004, including the audited financial statements contained therein, filed with the Securities and Exchange Commission. Unless the context requires otherwise, the terms Company, us, we, and our refers to Community Bancorp on a consolidated basis.

## FORWARD-LOOKING INFORMATION

Certain statements contained in this document, including, without limitation, statements containing the words believes , anticipates , intends , expects , should, and words of similar import, constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such forward- looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: general economic and business conditions in those areas in which we operate, demographic changes, competition, fluctuations in interest rates, changes in business strategy or development plans, changes in governmental regulation, credit quality, the availability of capital to fund the expansion of our business, and other factors referenced in this Report and other filings with the SEC. We disclaim any obligation to update any such factors or to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

## EXECUTIVE OVERVIEW

The Company reported strong financial results driven by the ongoing economic strength in its market area. Net income for the second quarter of 2005 , was up $24.4 \%$ to $\$ 2.0$ million compared to $\$ 1.6$ million for the comparable quarter last year. Improvement in the Company s net interest margin, the asset sensitivity of the balance sheet and loan growth of $14.9 \%$ period-over-period were all factors contributing to the strong growth in earnings. Our earnings over the past three quarters have been significantly impacted by the expense accrual for Stock Appreciation Rights (SAR) granted in 2000. The financial impact for this quarter was $\$ 677$ thousand.

Non-interest income for the second quarter of 2005 was up $19.7 \%$ to $\$ 419$ thousand compared to the same quarter of 2004. The increase was primarily due to an increase in the cash surrender value of bank owned life insurance purchased in July 2004 partially offset with a decrease in loan brokerage and referral fees.

## Table of Contents

Non-interest expense for the second quarter of 2005 increased by $35.4 \%$ or $\$ 1.2$ million to $\$ 4.6$ million compared to the same quarter in 2004. As noted above the expense increases were primarily attributed to an adjustment to the accrual for SAR based on the fair value of the Company s stock as of June 30, 2005, an increase in salary and employee benefits and an increase in professional fees.

Loan growth was very strong during the second quarter of 2005, increasing $\$ 61.3$ million, primarily in construction, commercial and industrial loans. With the hiring of a Chief Credit Officer in January 2005, we have since been able to hire seven highly regarded lending professionals. This team of lenders, with more than 120 years of collective lending experience, has produced a significant amount of lending opportunities for us, as represented by second quarter results.

A decline in deposits of $5.8 \%$ during the second quarter of 2005 was anticipated based on the advance knowledge of one customer sintended withdrawal.

On May 19, 2005, the Company announced the acquisition of Bank of Commerce, a community bank headquartered in Henderson, Nevada. The merger of Bank of Commerce into Community Bank of Nevada will produce an institution with approximately $\$ 800$ million in assets and nine full service branches. The Company recently received approval of the merger from both the Federal Reserve Bank and the State of Nevada. The transaction, which is subject to shareholder approval, is expected to close in the third quarter.

## Table of Contents

## COMMUNITY BANCORP

Selected Consolidated Financial Highlights (Unaudited)
(In thousands, except share data and ratios)

|  | Three Months Ended June 30, |  |  |  | Six Months Ended June 30, |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 005 |  | 2004 | Change |  | 2005 |  | 2004 | Change |
| Balance Sheet Data (at period end) |  |  |  |  |  |  |  |  |  |  |
| Investment securities |  |  |  |  |  | \$ | 85,060 | \$ | 70,925 | 19.93\% |
| Loans, gross |  |  |  |  |  |  | 471,107 |  | 338,201 | 39.30\% |
| Allowance for loan losses |  |  |  |  |  |  | 6,068 |  | 5,683 | 6.77\% |
| Total assets |  |  |  |  |  |  | 651,131 |  | 577,429 | 12.76\% |
| Total deposits |  |  |  |  |  |  | 504,062 |  | 525,959 | -4.16\% |
| Non-interest bearing deposits |  |  |  |  |  |  | 129,231 |  | 146,330 | -11.69\% |
| Core Deposits (1) |  |  |  |  |  |  | 446,009 |  | 473,431 | -5.79\% |
| Total shareholders equity |  |  |  |  |  |  | 81,636 |  | 34,294 | 138.05\% |
| Income Statement Data |  |  |  |  |  |  |  |  |  |  |
| Interest and dividend income | \$ | 9,676 | \$ | 7,255 | 33.37\% | \$ | 18,382 | \$ | 14,314 | 28.42\% |
| Interest expense |  | 2,306 |  | 1,744 | 32.22\% |  | 4,482 |  | 3,366 | 33.16\% |
| Net interest income |  | 7,370 |  | 5,511 | 33.73\% |  | 13,900 |  | 10,948 | 26.96\% |
| Loan loss provision |  | 91 |  | 0 |  |  | 91 |  | 222 | -59.01\% |
| Net interest income after loan loss provision |  | 7,279 |  | 5,511 | 32.08\% |  | 13,809 |  | 10,726 | 28.74\% |
| Noninterest income |  | 419 |  | 350 | 19.71\% |  | 795 |  | 719 | 10.57\% |
| Noninterest expense |  | 4,641 |  | 3,429 | 35.35\% |  | 8,064 |  | 6,851 | 17.71\% |
| Income before income taxes |  | 3,057 |  | 2,432 | 25.70\% |  | 6,540 |  | 4,594 | 42.36\% |
| Provision for income taxes |  | 1,037 |  | 808 | 28.34\% |  | 2,138 |  | 1,521 | 40.57\% |
| Net income | \$ | 2,020 | \$ | 1,624 | 24.38\% | \$ | 4,402 | \$ | 3,073 | 43.25\% |
| Share Data (2) |  |  |  |  |  |  |  |  |  |  |
| Basic earnings per common share | \$ | 0.30 | \$ | 0.35 | -14.29\% | \$ | 0.65 | \$ | 0.66 | -1.52\% |
| Diluted earnings per common share | \$ | 0.29 | \$ | 0.34 | -14.71\% | \$ | 0.64 | \$ | 0.64 | 0.00\% |
| Book value per common share |  |  |  |  |  | \$ | 12.08 | \$ | 7.34 | 64.58\% |
| Basic average shares outstanding |  | 52,678 |  | 661,650 | 44.86\% |  | 6,750,973 |  | 658,699 | 44.91\% |
| Fully Diluted average shares outstanding |  | 69,685 |  | 794,721 | 43.28\% |  | 6,870,482 |  | 783,170 | 43.64\% |
| Key Ratios |  |  |  |  |  |  |  |  |  |  |
| Return on average total shareholders equity |  | 9.99\% |  | 19.29\% | -48.21\% |  | 11.03\% |  | 18.78\% | -41.27\% |
| Return on average total assets |  | 1.32\% |  | 1.22\% | 8.20\% |  | 1.44\% |  | 1.23\% | 17.07\% |
| Net interest spread |  | 4.31\% |  | 3.83\% | 12.53\% |  | 4.05\% |  | 4.06\% | -0.25\% |
| Net interest margin (3) |  | 5.09\% |  | 4.32\% | 17.89\% |  | 4.79\% |  | 4.57\% | 4.81\% |
| Total revenue (net int inc + non int inc) | \$ | 7,789 | \$ | 5,861 | 32.90\% | \$ | 14,695 | \$ | 11,667 | 25.95\% |
| Efficiency ratio (4) |  | 59.58\% |  | 58.51\% | 1.83\% |  | 54.88\% |  | 58.72\% | -6.55\% |
| Asset Quality Ratios |  |  |  |  |  |  |  |  |  |  |
| Non-performing loans to total loans (5) |  |  |  |  |  |  | 0.13\% |  | 0.95\% | -86.32\% |
| Allowance for loan losses to total loans |  |  |  |  |  |  | 1.29\% |  | 1.68\% | -23.23\% |
| Non-performing assets (6) |  |  |  |  |  |  | 626 |  | 3,870 | -83.82\% |
| Non-performing assets to total assets |  |  |  |  |  |  | 0.10\% |  | 0.67\% | -85.07\% |

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| Net charge off $s$ to average loans | $\mathbf{0 . 0 4 \%}$ | $(-0.01 \%)$ | $-500.00 \%$ |
| :--- | :--- | :--- | :--- |
| Capital Ratios  <br> Average shareholders equity to average <br> assets $\mathbf{1 3 . 0 5 \%}$ | $\mathbf{6 . 5 5 \%}$ | $\mathbf{9 9 . 2 4 \%}$ |  |
| Leverage ratio | $\mathbf{1 5 . 8 8 \%}$ | $8.64 \%$ | $83.80 \%$ |
| Total risk-based capital ratio | $\mathbf{1 8 . 7 0 \%}$ | $13.82 \%$ | $35.31 \%$ |

Notes:
(1) Core deposits include all demand, interest bearing demand, savings plus time deposits of amounts less than $\$ 100,000$.
(2) Adjusted to reflect a 5:1 stock split declared in September 2004.
(3) Net interest margin represents net interest income as a percentage of average interest-earning assets.
(4) Efficiency ratio is noninterest expense (excluding loan loss provision) divided by (net interest income + noninterest income).
(5) Nonperforming loans are defined as loans that are past due 90 days or more plus loans placed in non-accrual status and restructured loans.
(6) Nonperforming assets are defined as loans that are past due 90 days or more, nonaccrual loans and other real estate owned.

## Table of Contents

## Key Factors in Evaluating Financial Condition and Operating Performance

As a community bank holding company, we focus on several key factors including:

Return to Our Shareholders;

Return on Average Assets;

Asset Quality;

Asset Growth; and

Operating Efficiency.

Return to Our Shareholders. Our return to our shareholders is measured in the form of return on average equity, or ROE. Our net income increased $24.4 \%$, to $\$ 2.0$ million for the quarter ended June 30 , 2005 from $\$ 1.6$ million for the same period in 2004. Improvement in the Company s net interest margin, the asset sensitivity of the balance sheet and loan growth of $14.9 \%$ period-over-period were all factors contributing to the strong growth in earnings. Basic and diluted earnings per share (EPS) for the quarter ended June 30, 2005 was $\$ 0.30$ and $\$ 0.29$ respectively, down from $\$ 0.35$ and $\$ 0.34$ for the quarter ended June 30, 2004. This decrease in EPS was partially due to an increase in weighted average shares outstanding as a result of our Initial Public Offering (IPO). With the additional capital from the IPO in December of 2004, our ROE for the quarter ended June 30, 2005 decreased to $10.0 \%$ compared to $19.3 \%$ for the same period in 2004.

Return on Average Assets. Our return on average assets, or ROA, is a measure we use to compare our performance with other banks and bank holding companies. Our ROA for the quarter ended June 30, 2005 was $1.32 \%$ compared to $1.22 \%$ for the same period in 2004.

Asset Quality. For all banks and bank holding companies, asset quality has a significant impact on the overall financial condition and results of operations. Asset quality is measured in terms of non-performing loans and assets as a percentage of total loans and total assets, and net charge-offs as a percentage of average loans. These measures are key elements in estimating the future earnings of a company. Non-performing loans totaled $\$ 626$ thousand as of June 30, 2005 compared to $\$ 3.2$ million at June 30, 2004. Non-performing loans as a percentage of total loans decreased to $.13 \%$ as of June 30, 2005 compared to $.95 \%$ at June 30, 2004. Non-performing assets were $\$ 626$ thousand as of June 30, 2005 compared to $\$ 3.9$ million as of June 30, 2004. Non-performing assets as a percent of total assets were $.10 \%$ as of June 30,2005 compared to $.67 \%$ at June 30, 2004. Net charge-offs to average loans was $.04 \%$ for the six months ended June 30, 2005 and net recoveries to average loans of $.01 \%$ for the same period in 2004.

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Asset Growth. As revenues from both net interest income and non-interest income are a function of asset size, the continued growth in assets has a direct impact on increasing net income and EPS. The majority of our assets are loans, and the majority of our liabilities are deposits, therefore the ability to generate loans and deposits are fundamental to our asset growth. Total assets increased $12.8 \%$ to $\$ 651.1$ million as of June 30,2005 from $\$ 577.4$ million as of June 30, 2004. Total deposits decreased $4.2 \%$ to $\$ 504.1$ million as of June 30, 2005 compared to $\$ 526.0$ million as of June 30, 2004. Gross loans increased $39.3 \%$ to $\$ 471.1$ million as of June 30, 2005 compared to $\$ 338.2$ million as of June 30, 2004.

## Table of Contents

Operating Efficiency. Operating efficiency is the measure of how efficiently earnings before taxes are generated as a percentage of revenue. Our efficiency ratio (operating expenses divided by net interest income plus non-interest income) increased slightly to $59.6 \%$ for the second quarter of 2005 compared to $58.5 \%$ for the same period in 2004.

## CRITICAL ACCOUNTING POLICIES

Our accounting policies are integral to understanding the financial results reported. Our most complex accounting policies require management s judgment to ascertain the valuation of assets, liabilities, commitments and contingencies. We have established detailed policies and control procedures that are intended to ensure valuation methods are well controlled and applied consistently from period to period. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. The following is a brief description of our current accounting policies involving significant management valuation judgments.

Allowance for Loan Losses. The allowance for loan losses represents our best estimate of the probable losses inherent in the existing loan portfolio. The allowance for loan losses is increased by the provision for loan losses charged to expense and reduced by loans charged off, net of recoveries.

We evaluate our allowance for loan losses quarterly. We believe that the allowance for loan losses, or ALLL, is a critical accounting estimate because it is based upon management $s$ assessment of various factors affecting the collectibility of the loans, including current economic conditions, past credit experience, delinquency status, the value of the underlying collateral, if any, and a continuing review of the portfolio of loans. For a discussion of the allowance and our methodology, see Financial Condition Provision/Allowance for Loan Loss.

Like all financial institutions, we maintain an ALLL based on a number of quantitative and qualitative factors, including levels and trends of past due and non-accrual loans, asset classifications, loan grades, change in volume and mix of loans, collateral value, historical loss experience, peer group loss experience, size and complexity of individual credits and economic conditions. Provisions for loan losses are provided on both a specific and general basis. Specific allowances are provided for impaired credits for which the expected/anticipated loss is measurable. General valuation allowances are based on a portfolio segmentation based on risk grading, with a further evaluation of various quantitative and qualitative factors noted above.

We incorporate statistics provided through the FDIC regarding loss percentages experienced by banks in the western United States, as well as an internal five-year loss history to establish potential risk based on collateral type securing each loan. As an additional comparison, we examine local peer group banks to determine the nature and scope of their losses to date. Such examination provides a geographic-and size-specific flavor for trends in the local banking community. Finally, we closely examine each credit graded Special Mention and below to individually assess the appropriate loan loss reserve for a particular credit.

We periodically review the assumptions and formulae by which additions are made to the specific and general valuation allowances for losses in an effort to refine such allowances in light of the current status of the factors described above.

Although we believe the level of the allowance as of June 30, 2005 was adequate to absorb probable losses in the loan portfolio, a decline in local economic, or other factors, could result in increasing losses that cannot be reasonably predicted at this time.

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## Table of Contents

Available for Sale Securities. Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities, requires that available-for-sale securities be carried at fair value. We believe this is a critical accounting estimate in that the fair value of a security is based on quoted market prices or if quoted market prices are not available, fair values are extrapolated from the quoted prices of similar instruments. Management utilizes the services of a reputable third party vendor to assist with the determination of estimated fair values. Adjustments to the available-for-sale securities fair value impact the consolidated financial statements by increasing or decreasing assets and stockholders equity.

## RESULTS OF OPERATIONS

Net Interest Income. Net interest income, the Company s largest source of operating income, is derived from interest, dividends and fees received on interest earning assets, less interest expense incurred on interest bearing liabilities. The most significant impact on the Company s net interest income between periods is derived from the interaction of changes in the volume of and rates earned or paid on interest earning assets and interest bearing liabilities (spread). The volume of loans, investment securities and other interest earning assets, compared to the volume of interest bearing deposits and indebtedness, combined with the spread, produces changes in the net interest income between periods.

## Table of Contents

The following table presents, for the periods indicated, condensed average balance sheet information for the Company, together with interest income and yields earned on average interest earning assets as well as interest expense and rates paid on average interest bearing liabilities.

For the three months ended June 30,

|  | 2005 |  |  | 2004 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Average <br> Balance | Interest | Average <br> Yield or <br> Cost (7) | Average <br> Balance | Interest | Average Yield or Cost (7) |
|  | (Dollars in thousands) |  |  |  |  |  |
| Assets |  |  |  |  |  |  |
| Interest-earning assets: |  |  |  |  |  |  |
| Loans (1) (2) (3) | \$ 430,874 | \$ 8,369 | 7.77\% | \$ 354,559 | \$ 6,426 | 7.25\% |
| Investment Securities - Taxable | 66,686 | 646 | 3.87\% | 49,878 | 389 | 3.12\% |
| Investment Securities - Non-taxable (3) | 22,364 | 208 | 3.72\% | 23,401 | 221 | 3.78\% |
| Federal funds sold | 56,162 | 410 | 2.92\% | 80,082 | 203 | 1.01\% |
| Other investments (4) | 2,469 | 43 | 6.97\% | 2,186 | 16 | 2.93\% |
|  |  | - | - | - |  |  |
| Total interest-earning assets | 578,555 | 9,676 | 6.69\% | 510,106 | 7,255 | 5.69\% |
| Non-earning assets: |  |  |  |  |  |  |
| Cash and due from banks | 15,810 |  |  | 15,305 |  |  |
| Unearned loan fees | $(2,347)$ |  |  | $(1,576)$ |  |  |
| Allowance for loan losses | $(6,010)$ |  |  | $(5,662)$ |  |  |
| Other assets | 24,323 |  |  | 15,703 |  |  |
| Total assets | \$ 610,331 |  |  | \$ 533,876 |  |  |
| Liabilities and Stockholders Equity |  |  |  |  |  |  |
| Interest-bearing Liabilities: |  |  |  |  |  |  |
| Deposits |  |  |  |  |  |  |
| Interest-bearing demand | \$ 21,749 | \$ 47 | 0.86\% | \$ 20,716 | \$ 14 | 0.27\% |
| Money Market | 225,187 | 1,214 | 2.16\% | 198,371 | 706 | 1.42\% |
| Savings | 5,737 | 7 | 0.49\% | 6,047 | 2 | 0.13\% |
| Time certificates of deposit | 119,591 | 783 | 2.62\% | 130,601 | 832 | 2.55\% |
|  |  | - |  | - | - | - |
| Total interest-bearing deposits | 372,264 | 2,051 | 2.20\% | 355,735 | 1,554 | 1.75\% |
| Short-term borrowings | 495 | 4 | 3.23\% | 4,286 | 13 | 1.21\% |
| Junior subordinated debt | 15,464 | 251 | 6.49\% | 15,464 | 177 | 4.58\% |
|  |  |  |  | - |  |  |
| Total interest-bearing liabilities | 388,223 | 2,306 | 2.38\% | 375,485 | 1,744 | 1.86\% |
| Non-interest-bearing liabilities |  |  |  |  |  |  |
| Demand deposits | 136,585 |  |  | 122,063 |  |  |
| Other liabilities | 4,640 |  |  | 2,290 |  |  |
| Total liabilities | 529,448 |  |  | 499,838 |  |  |
| Stockholders equity | 80,883 |  |  | 34,038 |  |  |
| Total liabilities and stockholders equity | \$ 610,331 |  |  | \$ 533,876 |  |  |
| Net interest income |  | \$ 7,370 |  |  | \$ 5,511 |  |


|  |  |  |
| :--- | :--- | :--- |
| Net interest spread (5) | $4.31 \%$ | $3.83 \%$ |
| Net interest margin (6) | $5.09 \%$ | $4.32 \%$ |

(1) Includes average non-accrual loans of $\$ 626$ thousand in 2005 and $\$ 3.2$ million in 2004.
(2) Net loan fees of $\$ 1.1$ million and $\$ 847$ thousand are included in the yield computations for 2005 and 2004, respectively.
(3) Yields on loans and securities have not been adjusted to a tax-equivalent basis.
(4) Includes Federal Reserve Bank stock, Federal Home Loan Bank stock and Pacific Coast Bankers Bank stock.
(5) Net interest spread represents the average yield earned on interest earning assets less the average rate paid on interest bearing liabilities.
(6) Net interest margin is computed by dividing net interest income by total average earning assets.
(7) Annualized.

Table of Contents

|  | For the six months ended June 30, |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2005 |  |  | 2004 |  |  |
|  | Average <br> Balance | Interest |  | Average <br> Balance | Interest |  |
|  | (Dollars in thousands) |  |  |  |  |  |
| Assets |  |  |  |  |  |  |
| Interest - earning assets: |  |  |  |  |  |  |
| Loans (1) (2) (3) | \$ 418,144 | \$ 15,724 | 7.52\% | \$ 354,044 | \$ 12,823 | 7.24\% |
| Investment Securities - Taxable | 65,338 | 1,243 | 3.80\% | 47,232 | 760 | 3.22\% |
| Investment Securities - Non-taxable (3) | 22,429 | 420 | 3.75\% | 23,256 | 441 | 3.79\% |
| Federal funds sold | 71,598 | 943 | 2.63\% | 51,982 | 261 | 1.00\% |
| Other investments (4) | 2,359 | 52 | 4.41\% | 2,177 | 29 | 2.66\% |
|  |  | - | - |  | - |  |
| Total interest-earning assets | 579,868 | 18,382 | 6.34\% | 478,691 | 14,314 | 5.98\% |
| Non-earning assets: |  |  |  |  |  |  |
| Cash and due from banks | 15,644 |  |  | 14,374 |  |  |
| Unearned loan fees | $(2,216)$ |  |  | $(1,552)$ |  |  |
| Allowance for loan losses | $(6,068)$ |  |  | $(5,586)$ |  |  |
| Other assets | 24,305 |  |  | 13,563 |  |  |
| Total assets | \$ 611,533 |  |  | \$ 499,490 |  |  |
|  | - |  |  | - |  |  |
| Liabilities and Stockholders Equity |  |  |  |  |  |  |
| Interest-bearing Liabilities: |  |  |  |  |  |  |
| Deposits |  |  |  |  |  |  |
| Interest-bearing demand | \$ 21,721 | \$ 93 | 0.86\% | \$ 17,852 | \$ 26 | 0.29\% |
| Money Market | 229,020 | 2,369 | 2.07\% | 169,327 | 1,148 | 1.36\% |
| Savings | 5,666 | 14 | 0.49\% | 5,791 | 4 | 0.14\% |
| Time certificates of deposit | 120,531 | 1,517 | 2.52\% | 135,057 | 1,789 | 2.65\% |
|  | - |  | - | - | - | - |
| Total interest-bearing deposits | 376,938 | 3,993 | 2.12\% | 328,027 | 2,967 | 1.81\% |
| Short-term borrowings | 334 | 9 | 5.39\% | 7,144 | 43 | 1.20\% |
| Junior subordinated debt | 15,464 | 480 | 6.21\% | 15,464 | 356 | 4.60\% |
|  |  |  |  |  |  |  |
| Total interest-bearing liabilities | 392,736 | 4,482 | 2.28\% | 350,635 | 3,366 | 1.92\% |
| Non-interest-bearing liabilities |  |  |  |  |  |  |
| Demand deposits | 134,606 |  |  | 114,826 |  |  |
| Other liabilities | 4,336 |  |  | 1,303 |  |  |
|  |  |  |  |  |  |  |
| Total liabilities | 531,678 |  |  | 466,764 |  |  |
| Stockholders equity | 79,855 |  |  | 32,726 |  |  |
| Total liabilities and stockholders equity | \$ 611,533 |  |  | \$ 499,490 |  |  |
|  | - |  |  | $\longrightarrow$ |  |  |
| Net interest income |  | \$ 13,900 |  |  | \$ 10,948 |  |
|  |  | - |  |  | - |  |
| Net interest spread (5) |  |  | 4.06\% |  |  | 4.06\% |
| Net interest margin (6) |  |  | 4.79\% |  |  | 4.57\% |

(1) Includes average non-accrual loans of $\$ 779$ thousand in 2005 and $\$ 3.5$ million in 2004.
(2) Net loan fees of $\$ 1.9$ million and $\$ 1.6$ million are included in the yield computations for 2005 and 2004, respectively.
(3) Yields on loans and securities have not been adjusted to a tax-equivalent basis.
(4) Includes Federal Reserve Bank stock, Federal Home Loan Bank stock and Pacific Coast Bankers Bank stock.
(5) Net interest spread represents the average yield earned on interest earning assets less the average rate paid on interest bearing liabilities.
(6) Net interest margin is computed by dividing net interest income by total average earning assets.
(7) Annualized.

## Table of Contents

Net Interest Income. Net interest income increased 33.7\%, for the quarter ended June 30, 2005 and $27.0 \%$ for the six months ended June 30, 2005 as compared to the same periods in 2004, as interest earned on higher loan volumes outweighed the effect of a higher cost of funds. During the second quarter of 2005 , the yield on earning assets increased to $6.68 \%$ for the current quarter, as compared to $5.99 \%$ in the immediately preceding quarter and $5.69 \%$ a year ago. The cost of total interest-bearing liabilities increased to $2.38 \%$ for the current quarter, as compared to $2.19 \%$ in the immediately preceding quarter and $1.86 \%$ a year ago. The net interest margin ratio increased to $5.09 \%$ for the quarter ended June 30,2005 as compared to $4.49 \%$ in the immediately preceding quarter and $4.32 \%$ a year ago. The increase in net interest margin is attributed to loan growth and the Federal Reserve s recent rise in short-term rates. The Federal Reserve has increased short-term interest rates nine times within the past year.

Primarily as a result of higher loan volume, total interest and dividend income increased $\$ 2.4$ million (or $33.1 \%$ ) for the quarter ended June 30 , 2005 and $\$ 4.0$ million (or $28.3 \%$ ) for the six month period ending June 30, 2005. Average loans as a percentage of interest-earning assets increased to $74.4 \%$ from $70.0 \%$ in the immediately preceding quarter and $69.5 \%$ a year ago. Increased volumes of interest bearing deposits, in conjunction with increased interest rates, total interest expense increased to $\$ 1.1$ million (or $33.2 \%$ ) for the six months, and $\$ 562$ thousand (or $32.2 \%$ ) for the three months, ending June 30, 2005.

The table below sets forth, for the periods indicated, a summary of the changes in interest income and interest expense and the amount of change attributable to variances in volume, rates and the combination of volume and rates based on the relative changes of volume and rates.

Three months ended June 30,

|  | 2005 compared with 2004 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Net Change | Rate | Volume | Mix |
|  | (dollars in thousands) |  |  |  |
| Loans | \$ 1,943 | \$ 461 | \$ 1,383 | \$ 99 |
| Investment securities - Taxable | 257 | 95 | 130 | 32 |
| Investment securities - Non-taxable | (13) | (5) | (8) | 0 |
| Federal funds sold | 207 | 382 | (61) | (114) |
| Other investments | 27 | 22 | 2 | 3 |
|  | - | - | - | - |
| Total interest income | 2,421 | 955 | 1,446 | 20 |
| Interest expense: |  |  |  |  |
| Interest-bearing demand | 33 | 31 | 1 | 1 |
| Money market | 508 | 363 | 96 | 49 |
| Savings | 5 | 5 | 0 | 0 |
| Time certificates of deposit | (49) | 24 | (70) | (2) |
| Short-term borrowings | (9) | 29 | (11) | (27) |
| Junior subordinated debt | 74 | 74 | 0 | 0 |
| Total interest expense | 563 | 526 | 16 | 21 |
| Net interest income | \$ 1,858 | \$ 429 | \$ 1,430 | \$ (1) |

## Table of Contents

Six Months Ended June 30, 2005

|  | Compared to Six Months Ended June 30, 2004 |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Net <br> Change |  | Rate | Volume |  | Mix |
|  | (dollars in thousands) |  |  |  |  |  |
| Loans | \$ 2,901 | \$ | 490 | \$ 2,322 |  | 89 |
| Investment Securities - Taxable | 483 |  | 139 | 291 |  | 53 |
| Investment Securities - Non-taxable | (21) |  | (5) | (16) |  | 0 |
| Federal funds sold | 682 |  | 424 | 98 |  | 160 |
| Other investments | 23 |  | 19 | 2 |  | 2 |
|  | - |  | - | - |  | - |
| Total interest income | 4,068 |  | 1,067 | 2,697 |  | 304 |
| Interest expense: |  |  |  |  |  |  |
| Interest-bearing demand | 67 |  | 50 | 6 |  | 11 |
| Money Market | 1,221 |  | 603 | 405 |  | 213 |
| Savings | 10 |  | 10 | 0 |  | 0 |
| Time certificates of deposit | (272) |  | (90) | (192) |  | 10 |
| Short-term borrowings | (34) |  | 170 | (41) |  | (163) |
| Junior subordinated debt | 124 |  | 124 | 0 |  | 0 |
| Total interest expense | 1,116 |  | 867 | 178 |  | 71 |
| Net interest income | \$ 2,952 |  | 200 | \$ 2,519 |  | 233 |

Noninterest Income. Non-Interest income increased $19.7 \%$ for the three months and $10.6 \%$ for the six months ended June 30, 2005 as compared to the same period in 2004. The increase for both periods was primarily due to an increase in cash surrender value of bank owned life insurance purchased in July 2004 partially offset with a decrease in loan brokerage and referral fees.

Noninterest Expense. Non-Interest Expense increased 35.4\% for the three months and $17.7 \%$ for the six months ended June 30, 2005. Expense increases for both periods were primarily attributed to the adjustment to the accrual for stock appreciation rights based on the fair value of the Company s stock as of June 30, 2005, an increase in salary and employee benefits and an increase in professional fees. The salary and employee benefits increased with the successful hiring of a Chief Credit Officer in January 2005 followed by seven experienced lenders during the first half of 2005. Professional fees increased in order to ensure compliance with laws and regulations that the Company is now subject to since becoming publicly traded.

Income Tax Expense. The Company s effective federal income tax rate was $34 \%$ and $33 \%$ for the three months and six months ended June 30, 2005, respectively.

## Table of Contents

## FINANCIAL CONDITION

Loans. Total loans increased $\$ 67.8$ million, or $16.8 \%$, to $\$ 471.1$ million as of June 30, 2005 from $\$ 403.3$ million as of December 31, 2004.

Loan growth was very strong, increasing $39.3 \%$ to $\$ 471.1$ million from a base of $\$ 338.2$ million a year ago. Construction loans experienced the highest growth within our portfolio, growing from $\$ 122.8$ million at June 30, 2004 to $\$ 205.9$ at June 30, 2005, followed by commercial real estate loans which grew from $\$ 121.7$ million at June 30, 2004 to $\$ 162.5$ at June 30, 2005 and commercial loans which grew from $\$ 64.3$ million at June 30, 2004 to $\$ 80.3$ million at June 30, 2005.

The Company s credit quality continued to improve with non-performing loans at just $0.13 \%$ of total loans, while net charge-offs for the quarter were $\$ 179$ thousand. The allowance for loan losses was $1.29 \%$ of outstanding loans at quarter end.

Deposits. Total deposits increased $\$ 27.8$ million, or $5.8 \%$, to $\$ 504.1$ million as of June 30, 2005 from $\$ 476.3$ million as of December 31, 2004 with interest bearing demand showing the largest increase, growing from $\$ 222$ million to $\$ 242$ million followed by an increase in non-interest bearing demand which grew from $\$ 122$ million to $\$ 129$ million.

Short Term Borrowings. Total borrowings of $\$ 45$ million as of June 30, 2005 consisted of a thirty day FHLB advance made in anticipation of short term funding requirements.

## ASSET QUALITY

Non-performing Assets. Non-performing assets include loans past due 90 days or more and that are still accruing interest, nonaccrual loans, loans renegotiated in troubled debt restructurings and other real estate owned (OREO).

The following table sets forth information regarding non-performing assets as of the dates indicated:

|  | June 30, 2005 | $\begin{gathered} \text { December 31, } \\ 2004 \end{gathered}$ |
| :---: | :---: | :---: |
| Non-accrual loans, not restructured | 626 | 966 |
| Accruing loans past due 90 days or more |  | 2 |
| Restructured loans |  |  |
|  | - | - |
| Total non-performing loans (NPLs) | 626 | 968 |
| OREO |  | 2,191 |

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| Total non-performing assets (NPAs) | 626 | 3,159 |
| :--- | :--- | :--- |
| Selected ratios |  |  |
| NPLs to total loans | $0.13 \%$ | $0.24 \%$ |
| NPAs to total loans and OREO | $0.13 \%$ | $0.78 \%$ |
| NPAs to total assets | $0.10 \%$ | $0.55 \%$ |

Non-performing assets decreased $\$ 2.5$ million, or $80.2 \%$, to $\$ 626$ thousand as of June 30,2005 as compared to $\$ 3.2$ million as of December 31, 2004 primarily due to the sale of three OREO properties during the six months ended June 30, 2005.

## Table of Contents

Provision/Allowance for Loan Losses. The Company performs a quarterly assessment of the risks inherent in its loan portfolio, as well as a detailed review of each significant asset with identified weaknesses. Based on the most recent analysis of the allowance for loan losses and a thorough review by Segmentation, Risk Grading, Peer Group, and Economic Conditions, and considering the mitigating factors of each method, it is believed that the Segmentation Methodology more accurately reflects embedded risks inherent in the loan portfolio for the most recent quarter end. In light of this evaluation a provision of $\$ 91$ thousand was taken during the first half of 2005. The allowance for loan losses was $\$ 6.1$ million, or $1.29 \%$ of total loans, as of June 30, 2005 as compared to $\$ 5.7$ million, or $1.68 \%$ of total loans, at June 30, 2004.

The following table sets forth information regarding the Company $s$ allowance for loan losses as of and for the periods indicated.


## Table of Contents

## CAPITAL RESOURCES

The Company s total stockholder s equity at June 30,2005 was $\$ 81.6$ million, an increase of $\$ 4.1$ million from December 31, 2004. The increase resulted from earnings retention partially offset by unrealized holding losses on available-for-sale investment securities. At June 30, 2005, the Company and its bank subsidiary each exceeded the well-capitalized requirements issued by the Federal Reserve Board.

## LIQUIDITY MANAGEMENT

The ability to have readily available funds sufficient to repay fully maturing liabilities is of primary importance to depositors, creditors and regulators. Our liquidity, represented by cash and due from banks, federal funds sold and available-for-sale securities, is a result of our operating, investing and financing activities and related cash flows. In order to ensure funds are available at all times, we devote resources to projecting on a monthly basis the amount of funds that will be required and maintain relationships with a diversified customer base so funds are accessible. Liquidity requirements can also be met through short-term borrowings or the disposition of short-term assets. We have borrowing lines at correspondent banks totaling $\$ 19.0$ million. In addition, our total borrowing capacity at the FHLB as of June 30, 2005 was $\$ 79.6$ million which includes $\$ 71.2$ million under the FHLB Blanket Lien Program and $\$ 6.4$ million in securities pledged to the FHLB. As of June 30, 2005 we also had $\$ 3.6$ million securities pledged to the FRB Discount window. As of June 30, 2005 we had $\$ 57.3$ million in securities available to be sold or pledged to the FHLB and/or FRB Discount Window. Based on our short term funding needs a thirty day FHLB advance was made on June 30, 2005 of $\$ 45$ million.

We have a formal liquidity policy, and in the opinion of management, our liquid assets are considered adequate to meet our cash flow needs for loan funding and deposit cash withdrawal for the next $60-90$ days. At June 30, 2005, we had $\$ 158.6$ million in liquid assets comprised of $\$ 75.1$ million in cash and cash equivalents (including fed funds sold of $\$ 59.0$ million) and $\$ 83.4$ million in available-for-sale securities.

On a long term basis, our liquidity will be met by changing the relative distribution of our asset portfolios, i.e., reducing investment or loan volumes, or selling or encumbering assets. Further, we will increase liquidity by soliciting higher levels of deposit accounts through promotional activities and/or borrowing from our correspondent banks as well as the Federal Home Loan Bank of San Francisco. At the current time, our long-term liquidity needs primarily relate to funds required to support loan originations and commitments and deposit withdrawals. All of these needs can currently be met by cash flows from investment payments and maturities, and investment sales if the need arises.

Our liquidity is comprised of three primary classifications: cash flows from operating activities; cash flows provided by (or used in) investing activities; and cash flows provided by financing activities. Net cash provided by operating activities has consisted primarily of net income adjusted for changes in certain other asset and liability accounts and certain non-cash income and expense items such as the loan loss provision, investment and other amortizations and depreciation. At June 30, 2005 net cash provided by operating activities was $\$ 5.0$ million, compared to net cash provided by operating activities of $\$ 3.6$ million for the same period in 2004.

## Table of Contents

Our primary investing activities are the origination of real estate, commercial and consumer loans and purchase and sale of securities. Our net cash provided by and used in investing activities has been primarily influenced by our loan activity. Net (increase) decrease in loans for the periods ended June 30, 2005 and 2004, were ( $\$ 67.5$ ) million and $\$ 12.1$ million, respectively.

Net cash provided by (used in) all investing activities for the periods ended June 30, 2005 and 2004 was ( $\$ 69.8$ ) million and $\$ 7.8$ million, respectively. At June 30, 2005 we had outstanding loan commitments of $\$ 165.8$ million and outstanding letters of credit of $\$ 3.4$ million. We anticipate that we will have sufficient funds available to meet current loan commitments.

Net cash provided by financing activities for the periods ended June 30, 2005 and 2004 was $\$ 72.6$ million and $\$ 112.3$ million, respectively. These amounts consisted of a net increase in deposits for each respective period and an increase in short term borrowings of $\$ 45$ million. The increase in 2005 was partially due to one large short term deposit of $\$ 27.1$ million, which was reduced to $\$ 9.1$ million in April 2005. The short term borrowing consisted of a thirty day FHLB advance made based on short term funding needs.

## Item 3.

## Quantitative and Qualitative Disclosures

## About Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates. The Company s market risk arises principally from interest rate risk in lending, deposit and borrowing activities. Management actively monitors and manages its interest rate risk exposure. Management considers interest rate risk to be a significant market risk, which could have the largest material effect on the Company sfinancial condition and results of operations.

There has not been any material change in the market risk disclosure contained in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2004.

## Item. 4

## Controls and Procedures

As of the end of the period covered by this report, the Company s management, including the Chief Executive Officer and Chief Financial Officer evaluated the Company s disclosure controls and procedures as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act ). Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures are effective. There were no significant changes in the Company sinternal controls over financial reporting that occurred during the quarter ending June 30, 2005 that have materially affected or are reasonably likely to materially affect the Company s internal control over financial reporting.

In designing and evaluating disclosure controls and procedures, the Company s management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable, not absolute, assurances of achieving the desired control objectives and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

## Table of Contents

## PART II

## OTHER INFORMATION

## Item 1. Legal Proceedings

There have been no material changes in legal proceedings as described in the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

## Item 3. Defaults upon Senior Securities

None.

## Item 4. Submission of Matters to a Vote of Security Holders

The following items were submitted to the security holders for approval at the Annual Meeting held on May 19, 2005:

1. Election of the following six persons to the Board of Directors of the Company to serve for a one year term and until their successors are elected and qualified:

The results of the vote were as follows:

|  | For | Withheld |  |
| :--- | ---: | ---: | ---: |
|  |  | 22,974 |  |
| Noall J. Bennett | $5,893,053$ | $2,797,278$ | 118,749 |
| Charles R. Norton | $5,758,578$ | 157,449 |  |
| Jacob D. Bingham | $5,761,578$ | 154,449 |  |
| Gary W. Stewart | $5,893,053$ | 22,974 |  |
| Edward M. Jamison | $5,783,278$ | 132,749 |  |

2. Approval of the Company s 2005 Equity Based Compensation Plan:

The plan was approved and the results of the vote were as follows:
In favor ..... 3,699,569
Against ..... 499,621
Abstain ..... 11,060
Broker non-votes ..... 1,705,777

## Table of Contents

## Item 5. Other Information

None

## Item 6. Exhibits

Exhibits
31.1 Section 13a-14(a) Certification
31.2 Section 13a-14(a) Certification

32 Certification Pursuant to 18 U.S.C. Section 1350, as adopted to Section 906 of the Sarbanes-Oxley Act of 2002 from the Company s Chief Executive Officer and Chief Financial Officer (attached as an exhibit and incorporated herein by reference).

## Table of Contents

## ( SIGNATURES)

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

|  | Community Bancorp <br> (Registrant) |
| :--- | :--- |
| Date : August 12, 2005 | /s/ Edward M. Jamison <br> Edward M. Jamison <br> President and Chief Executive Officer |
| Date : August 12, 2005 | /s/ Cathy Robinson |
| Cathy Robinson |  |
| Executive Vice President, Chief Financial Officer |  |

31

