

AMERICAN RIVER BANKSHARES

Form 10-Q

August 06, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For  
the  
quarterly period  
ended  
or  
June 30,  
2013

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

For  
the  
transition  
period  
from

Commission File  
Number:  
0-31525

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AMERICAN RIVER BANKSHARES

(Exact name of registrant as specified in its charter)

California

(State or other jurisdiction of incorporation or organization)

68-0352144

(I.R.S. Employer Identification No.)

3100 Zinfandel Drive, Suite 450, Rancho Cordova, California 95670

(Address of principal executive offices)

(Zip Code)

(916) 851-0123

(Registrant's telephone number, including area code)

Not Applicable

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒ (Do not check if a smaller reporting company)

Smaller reporting company ☐

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

Yes ☐ No ☒

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

No par value Common Stock – 8,833,562 shares outstanding at August 6, 2013.

**AMERICAN RIVER BANKSHARES**

**INDEX TO QUARTERLY REPORT ON FORM 10-Q  
FOR THE QUARTER ENDED JUNE 30, 2013**

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**PART I-FINANCIAL INFORMATION****Item 1. Financial Statements.**AMERICAN RIVER BANKSHARES  
CONSOLIDATED BALANCE SHEET  
(Unaudited)

(dollars in thousands)	June 30, 2013	December 31, 2012
<b>ASSETS</b>		
Cash and due from banks	\$ 23,694	\$ 55,461
Interest-bearing deposits in banks	1,000	750
Investment securities:		
Available-for-sale, at fair value	254,644	231,839
Held-to-maturity, at amortized cost	1,497	2,117
Loans and leases, less allowance for loan and lease losses of \$5,680 at June 30, 2013 and \$5,781 at December 31, 2012	247,778	252,118
Premises and equipment, net	1,673	1,888
Federal Home Loan Bank stock	3,248	3,254
Goodwill and other intangible assets	16,321	16,321
Other real estate owned	8,120	12,237
Bank owned life insurance	12,562	12,858
Accrued interest receivable and other assets	7,008	7,546
	\$ 577,545	\$ 596,389
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits:		
Noninterest bearing	\$ 138,463	\$ 151,201
Interest-bearing	329,194	327,055
Total deposits	467,657	478,256
Short-term borrowings	8,000	2,000
Long-term borrowings	8,000	16,000
Accrued interest payable and other liabilities	5,434	6,139

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Total liabilities	489,091	502,395
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, no par value; 20,000,000 shares authorized; none outstanding		
Common stock, no par value; 20,000,000 shares authorized; issued and outstanding – 8,833,562 shares at June 30, 2013 and 9,327,203 shares at December 31, 2012	64,134	67,977
Retained earnings	23,006	21,732
Accumulated other comprehensive income, net of taxes	1,314	4,285
Total shareholders' equity	88,454	93,994
	\$ 577,545	\$ 596,389

See Notes to Unaudited Consolidated Financial Statements

AMERICAN RIVER BANKSHARES  
CONSOLIDATED STATEMENT OF INCOME  
(Unaudited)

(dollars in thousands, except per share data)

For the periods ended June 30,

	Three months	Six months		
	2013	2012	2013	2012

Interest income:

Interest and fees on loans	\$3,516	\$4,238	\$7,158	\$8,554
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Interest on deposits in banks	—	3	1	6
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Interest and dividends on investment securities:

Taxable	805	931	1,593	1,821
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Exempt from Federal income taxes	221	148	441	449
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Dividends	9	4	9	4
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Total interest income	4,551	5,324	9,202	10,834
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Interest expense:

Interest on deposits	301	418	632	853
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Interest on borrowings	74	64	150	131
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Total interest expense	375	482	782	984
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Net interest income	4,176	4,842	8,420	9,850
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Provision for loan and lease losses	100	375	200	955
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Net interest income after provision for loan and lease losses	4,076	4,467	8,220	8,895
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Noninterest income:

Service charges on deposit accounts	147	194	298	390
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Gain on sale of securities	3	11	3	75
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Other noninterest income	298	489	772	922
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Total noninterest income	448	694	1,073	1,387
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Noninterest expense:

Salaries and employee benefits	2,175	2,033	4,393	4,235
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Occupancy	301	299	602	595
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Furniture and equipment	191	202	385	392
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Federal Deposit Insurance Corporation assessments	(16 )	141	110	283
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Expenses related to other real estate owned	195	468	500	842
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Other expense	766	908	1,624	1,816
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Total noninterest expense	3,612	4,051	7,614	8,163
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Income before provision for income taxes	912	1,110	1,679	2,119
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Provision for income taxes	260	265	405	562
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Net income	\$652	\$845	\$1,274	\$1,557
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Basic earnings per share	\$0.07	\$0.09	\$0.14	\$0.16
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Diluted earnings per share	\$0.07	\$0.09	\$0.14	\$0.16
Cash dividends per share	\$0.00	\$0.00	\$0.00	\$0.00

See notes to Unaudited Consolidated Financial Statements

AMERICAN RIVER BANKSHARES  
CONSOLIDATED STATEMENT OF COMPREHENSIVE (LOSS) INCOME  
(Unaudited)

(dollars in thousands, except per share data)

For the periods ended June 30,

	Three months		Six months	
	2013	2012	2013	2012
Net income	\$652	\$845	\$1,274	\$1,557
Other comprehensive (loss) income:				
Unrealized holding (losses) gains on investment securities arising during the period	(4,517)	761	(4,949)	1,380
Deferred tax expense	1,807	(302 )	1,980	(534 )
Unrealized holding (losses) gains on investment securities arising during the period, net of tax	(2,710)	459	(2,969)	846
Reclassification adjustment for realized gains included in net income	(3 )	(11 )	(3)	(75 )
Tax effect	1	5	1	30
Realized gains, net of tax	(2 )	(6 )	(2 )	(45 )
Total other comprehensive (loss) income	(2,712)	453	(2,971)	801
Comprehensive (loss) income	\$(2,060)	\$1,298	\$(1,697)	\$2,358

See Notes to Unaudited Consolidated Financial Statements



AMERICAN RIVER BANKSHARES  
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
(Unaudited)

(dollars in thousands)	Common Shares	Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance, January 1, 2012	9,890,909	72,016	18,525	3,558	94,099
Net income			3,207		3,207
Other comprehensive income, net of tax:					
Net change in unrealized gains on available-for-sale investment securities				727	727
Net restricted stock awarded and related compensation expense	11,683	110			110
Stock option compensation expense		45			45
Retirement of common stock	(575,389 )	(4,194 )			(4,194)
Balance, December 31, 2012	9,327,203	67,977	21,732	4,285	93,994
Net income			1,274		1,274
Other comprehensive loss, net of tax:					
Net change in unrealized gains on available-for-sale investment securities				(2,971 )	(2,971 )
Net restricted stock award activity and related compensation expense	11,448	50			50
Stock option compensation expense		13			13
Retirement of common stock	(505,089 )	(3,906 )			(3,906 )
Balance, June 30, 2013	8,833,562	\$64,134	\$23,006	\$ 1,314	\$ 88,454
See Notes to Unaudited Consolidated Financial Statements					

AMERICAN RIVER BANKSHARES  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(Unaudited)

(dollars in thousands)

For the six months ended June 30,

	2013	2012
Cash flows from operating activities:		
Net income	\$1,274	\$1,557
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	200	955
Increase (decrease) in deferred loan origination fees, net	16	(70 )
Depreciation and amortization	266	816
Gain on sale and call of investment securities	(3 )	(75 )
Amortization of investment security premiums and discounts, net	2,915	2,060
Gain on life insurance death benefit	(118 )	—
Increase in cash surrender values of life insurance policies	(5 )	(132 )
Stock based compensation expense	63	79
Loss on sale and write-down of other real estate owned	208	373
Decrease in accrued interest receivable and other assets	2,518	403
(Decrease) increase in accrued interest payable and other liabilities	(705 )	1,642
Net cash provided by operating activities	6,629	7,608
Cash flows from investing activities:		
Proceeds from the sale of available-for-sale investment securities	5,822	5,543
Proceeds from matured available-for-sale investment securities	185	665
Proceeds from called available-for-sale investment securities	—	195
Purchases of available-for-sale investment securities	(68,408)	(43,475)
Proceeds from principal repayments for available-for-sale investment securities	31,731	23,284
Proceeds from principal repayments for held-to-maturity investment securities	621	964
Net (increase) decrease in interest-bearing deposits in banks	(250 )	250
Net decrease in loans	3,692	11,886
Proceeds from sale of other real estate	4,529	807
Capitalized additions to other real estate	(187 )	—
Death benefit from life insurance policy	419	—
Net decrease (increase) in FHLB stock	6	(161 )
Purchases of equipment	(51 )	(152 )
Net cash used in investing activities	(21,891)	(194 )
Cash flows from financing activities:		
Net (decrease) increase in demand, interest-bearing and savings deposits	\$(10,067)	\$9,032
Net (decrease) increase in time deposits	(532 )	4,237
Net increase (decrease) in short-term borrowings	6,000	(3,000 )
Net decrease in long-term borrowings	(8,000 )	(2,000 )
Cash paid to repurchase common stock	(3,906 )	(4,194 )

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Net cash (used in) provided by financing activities	\$(16,505)	\$4,075
(Decrease) increase in cash and cash equivalents	(31,767)	11,489
Cash and cash equivalents at beginning of year	55,461	23,768
Cash and cash equivalents at end of period	\$23,694	\$35,257
See Notes to Unaudited Consolidated Financial Statements		

AMERICAN RIVER BANKSHARES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013

1. CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of management, the unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the consolidated financial position of American River Bankshares (the "Company") at June 30, 2013 and December 31, 2012, the results of its operations and statement of comprehensive income for the three and six month periods ended June 30, 2013 and 2012, its cash flows for the six-month periods ended June 30, 2013 and 2012 and its statement of changes in shareholders' equity for the year ended December 31, 2012 and the six months ended June 30, 2013 in conformity with accounting principles generally accepted in the United States of America.

Certain disclosures normally presented in the notes to the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The Company believes that the disclosures are adequate to make the information not misleading. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2012 annual report on Form 10-K. The results of operations for the three-month and six-month periods ended June 30, 2013 may not necessarily be indicative of the operating results for the full year.

In preparing such financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan and lease losses, the provision for taxes, the valuation of goodwill and the estimated fair value of investment securities, impaired loans and other real estate owned.

Management has determined that since all of the banking products and services offered by the Company are available in each branch office of American River Bank, all branch offices are located within the same economic environment and management does not allocate resources based on the performance of different lending or transaction activities, it is appropriate to aggregate all of the branch offices and report them as a single operating segment. No client accounts for more than ten percent (10%) of revenues for the Company or American River Bank.

2. STOCK-BASED COMPENSATION

*Equity Plans*

On March 17, 2010, the Board of Directors adopted the 2010 Equity Incentive Plan (the "2010 Plan"). The 2010 Plan was approved by the Company's shareholders on May 20, 2010. In 2000, the Board of Directors adopted and the Company's shareholders approved a stock option plan (the "2000 Plan"), under which 261,521 options remain outstanding at June 30, 2013. At June 30, 2013, there were 17,329 stock options and 27,259 restricted shares outstanding and the total number of authorized shares that remain available for issuance under the 2010 Plan was 1,435,581. The 2010 Plan provides for the following types of stock-based awards: incentive stock options; nonqualified stock options; stock appreciation rights; restricted stock; restricted performance stock; unrestricted Company stock; and performance units. Awards granted under the 2000 Plan were either incentive stock options or nonqualified stock options. Under the 2010 Plan, the awards may be granted to employees and directors under incentive and nonstatutory agreements and other awards agreements. The 2010 Plan and the 2000 Plan (collectively the "Plans") require that the option price may not be less than the fair market value of the stock at the date the option is granted. The option awards under the Plans expire on dates determined by the Board of Directors, but not later than

ten years from the date of award. The vesting period is generally five years; however, the vesting period can be modified at the discretion of the Company's Board of Directors. Outstanding option awards under the Plans are exercisable until their expiration, however, no new options will be awarded under the 2000 Plan. New shares are issued upon exercise of an option.

The grant date fair value of awards is determined by the market price of the Company's common stock on the date of grant and is recognized ratably as compensation expense or director expense over the vesting periods. The shares of common stock granted pursuant to such agreements vest in increments over one to five years from the date of grant. The shares awarded to employees and directors under the restricted stock agreements vest on the applicable vesting dates only to the extent the recipient of the shares is then an employee or a director of the Company or one of its subsidiaries, and each recipient will forfeit all of the shares that have not vested on the date his or her employment or service is terminated.

**Equity Compensation**

For the three-month periods ended June 30, 2013 and 2012, the compensation cost recognized for equity compensation was \$36,000 and \$46,000, respectively. The recognized tax benefit for equity compensation expense was \$14,000 for the three-month periods ended June 30, 2013 and 2012, respectively. For the six-month periods ended June 30, 2013 and 2012, the compensation cost recognized for equity compensation was \$69,000 and \$79,000, respectively. The recognized tax benefit for equity compensation expense was \$22,000 for the six-month periods ended June 30, 2013 and 2012, respectively.

At June 30, 2013, the total compensation cost related to nonvested stock option awards not yet recorded was \$39,000. This amount will be recognized over the next 4.0 years and the weighted average period of recognizing these costs is expected to be 1.6 years. At June 30, 2013, the total compensation cost related to restricted stock awards not yet recorded was \$195,000. This amount will be recognized over the next 4.0 years and the weighted average period of recognizing these costs is expected to be 1.3 years.

**Equity Plans Activity****Stock Options**

There were no stock options awarded during the three and six-month periods ended June 30, 2013. There were 17,329 stock options awarded during the three and six-month periods ended June 30, 2012 at an average exercise price of \$7.07. The weighted average grant date fair value of options granted for the three and six-month periods ended June 30, 2012 was \$2.31. A summary of option activity under the Plans as of June 30, 2013 and changes during the period then ended is presented below:

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000)
Outstanding at January 1, 2013	305,670	\$ 16.71	4.0 years	\$ —
Granted	—	—	—	—
Exercised	—	—	—	—
Cancelled	26,820	11.68	—	—
Outstanding at June 30, 2013	278,850	\$ 17.20	3.6 years	\$ 20
Vested at June 30, 2013	256,299	\$ 18.04	3.2 years	\$ 4
Non-vested at June 30, 2013	22,551	\$ 7.63	7.6 years	\$ 16

**Restricted Stock**

There were 11,448 shares of restricted stock awarded during the three- and six-month periods ended June 30, 2013. The 11,448 restricted common shares will vest one year from the date of the award. There were 16,207 shares of restricted stock awarded during the three- and six-month periods ended June 30, 2012. Of the 16,207 restricted common shares, 9,898 vested one year from the date of the award and 6,309 will vest over five years at 20% per year from the date of the award. Grant date fair value is determined by the market price of the Company's common stock on the date of grant (\$7.86 on May 16, 2013 and \$7.07 on May 16, 2012).



There were 11,158 restricted awards that were fully vested during the three and six-month periods ended June 30, 2013 and zero restricted awards that were fully vested during the three and six-month periods ended June 30, 2012. There were zero awards that had been forfeited during the three and six-month periods ended June 30, 2013 and zero and 3,246 awards that had been forfeited during the three and six-month periods ended June 30, 2012. The intrinsic value of nonvested restricted stock at June 30, 2013 was \$224,000.

		Weighted Average Grant Date Fair Value
Restricted Stock	Shares	
Nonvested at January 1, 2013	26,969	\$ 6.79
Awarded	11,448	7.86
Less: Vested	11,158	7.07
Less: Cancelled	—	—
Nonvested at June 30, 2013	27,259	\$ 7.12

#### **Other Equity Awards**

There were no stock appreciation rights; restricted performance stock; unrestricted Company stock; or performance units awarded during the three or six month periods ended June 30, 2013 or 2012.

The intrinsic value used for stock options and restricted stock was derived from the market price of the Company's common stock of \$8.22 as of June 30, 2013.

### **3. COMMITMENTS AND CONTINGENCIES**

In the normal course of business there are outstanding various commitments to extend credit which are not reflected in the financial statements, including loan commitments of approximately \$25,328,000 and standby letters of credit of approximately \$6,149,000 at June 30, 2013 and loan commitments of approximately \$26,518,000 and standby letters of credit of approximately \$6,506,000 at December 31, 2012. Such commitments relate primarily to real estate construction loans, revolving lines of credit and other commercial loans. However, all such commitments will not necessarily culminate in actual extensions of credit by the Company during 2013 as some of these are expected to expire without being fully drawn upon.

Standby letters of credit are commitments issued to guarantee the performance or financial obligation of a client to a third party. These guarantees are issued primarily relating to purchases of inventory, insurance programs, performance obligations to government agencies, or as security for real estate rents by commercial clients and are typically short-term in nature. Credit risk is similar to that involved in extending loan commitments to clients and accordingly, evaluation and collateral requirements similar to those for loan commitments are used. The majority of all such commitments are collateralized. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at June 30, 2013 or December 31, 2012.

### **4. EARNINGS PER SHARE COMPUTATION**

Basic earnings per share is computed by dividing net income by the weighted average common shares outstanding for the period (8,893,367 and 9,050,669 shares for the three-month and six-month periods ended June 30, 2013, and 9,518,897 and 9,671,083 for the three-month and six-month periods ended June 30, 2012). Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options or restricted stock, result in the issuance of common stock. Diluted earnings per share is computed by dividing net income by the weighted average common shares outstanding for the period plus the dilutive effect of stock based awards. There were 4,758 and 3,983, respectively, dilutive shares for the three-month and six-month periods ended



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June 30, 2013 and 13,306 and 11,794, respectively, dilutive shares for the three-month and six-month periods ended June 30, 2012. Earnings per share is retroactively adjusted for stock dividends and stock splits, if applicable, for all periods presented.

## 5. INVESTMENT SECURITIES

The amortized cost and estimated fair values of investment securities at June 30, 2013 and December 31, 2012 consisted of the following (dollars in thousands):

Available-for-Sale

	June 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities	\$222,822	\$ 3,467	\$ (2,141 )	\$224,148
Obligations of states and political subdivisions	28,062	910	(151 )	28,821
Corporate bonds	1,506	70	—	1,576
Equity securities:				
Corporate stock	64	35	—	99
	\$252,454	\$ 4,482	\$ (2,292 )	\$254,644

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities	\$195,444	\$ 5,661	\$ (590 )	\$200,515
Obligations of states and political subdivisions	27,682	1,974	—	29,656
Corporate bonds	1,507	87	—	1,594
Equity securities:				
Corporate stock	64	10	—	74
	\$224,697	\$ 7,732	\$ (590 )	\$231,839

Net unrealized gains on available-for-sale investment securities totaling \$2,190,000 were recorded, net of \$876,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at June 30, 2013. Proceeds and gross realized gains from the sale and call of available-for-sale investment securities for the three-month period ended June 30, 2013 totaled zero and zero, respectively, and for the six-month period ended June 30, 2013 totaled \$5,822,000 and \$3,000, respectively. There were no transfers of available-for-sale investment securities for the three- and six-month periods ended June 30, 2013.

Net unrealized gains on available-for-sale investment securities totaling \$4,285,000 were recorded, net of \$2,857,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2012. Proceeds and gross realized gains from the sale and call of available-for-sale investment securities for the three-month period ended June 30, 2012 totaled \$830,000 and \$11,000, respectively, and for the six-month period ended June 30, 2012 totaled \$5,738,000 and \$75,000, respectively. There were no transfers of available-for-sale investment securities for the three- and six-month periods ended June 30, 2012.

Held-to-Maturity

June 30, 2013

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	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities	\$ 1,497	\$ 89	\$ —	\$ 1,586

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December 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
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Debt securities:

Mortgage-backed securities \$ 2,117 \$ 138 \$ — \$ 2,255

There were no sales or transfers of held-to-maturity investment securities for the periods ended June 30, 2013 and June 30, 2012. Investment securities with unrealized losses at June 30, 2013 and December 31, 2012 are summarized and classified according to the duration of the loss period as follows (dollars in thousands):

		2013			
		Less than 12 Months		12 Months or More	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
		Total			
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

Available-for-Sale

Debt securities:

Mortgage-backed securities	\$83,494	\$ (2,141 )	—	—	\$83,494	\$ (2,141 )
Obligations of states and political subdivisions	4,282	(151 )	—	—	4,282	(151 )
	\$87,776	\$ (2,292 )	\$ —	\$ —	\$87,776	\$ (2,292 )

		2012			
		Less than 12 Months		12 Months or More	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
		Total			
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

Available-for-Sale

Debt securities:

Mortgage-backed securities	\$37,440	\$ (590 )	—	—	\$37,440	\$ (590 )
	\$37,440	\$ (590 )	\$ —	\$ —	\$27,440	\$ (590 )

There were no held-to-maturity investment securities with unrealized losses as of June 30, 2013 or December 31, 2012.

At June 30, 2013, the Company held 216 securities of which 40 were in a loss position for less than twelve months and none were in a loss position for twelve months or more. Of the 40 securities in a loss position, 35 are mortgage-backed securities and five are obligations of states and political subdivisions. At December 31, 2012, the Company held 196 securities of which 16 were in a loss position for less than twelve months and none were in a loss position for twelve months or more. All 16 securities in a loss position were mortgage-backed securities.

The unrealized loss on the Company's investments in mortgage-backed securities, obligations of states and political subdivisions, and corporate bonds, is primarily driven by interest rates. Because the decline in market value is attributable to a change in interest rates and not credit quality, and because the Company has the ability and intent to hold these investments until recovery of fair value, which may be until maturity, management does not consider these investments to be other-than-temporarily impaired.

The amortized cost and estimated fair values of investment securities at June 30, 2013 by contractual maturity are shown below (dollars in thousands).

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year	\$825	\$828		
After one year through five years	3,384	3,512		
After five years through ten years	11,618	12,066		
After ten years	13,741	13,991		
	29,568	30,397		
Investment securities not due at a single maturity date:				
Mortgage-backed securities	222,822	224,148	\$1,497	\$1,586
Corporate stock	64	99	—	—
	\$252,454	\$254,644	\$1,497	\$1,586

Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

## 6. IMPAIRED AND NONPERFORMING LOANS AND LEASES AND OTHER REAL ESTATE OWNED

At June 30, 2013 and December 31, 2012, the recorded investment in nonperforming loans and leases was approximately \$5,364,000 and \$5,474,000, respectively. Nonperforming loans and leases include all such loans and leases that are either placed on nonaccrual status or are 90 days past due as to principal or interest but still accrue interest because such loans are well-secured and in the process of collection. The Company considers a loan to be impaired when, based on current information and events, it is probable that it will be unable to collect all amounts due (principal and interest) according to the contractual terms of the original loan agreement. At June 30, 2013, the recorded investment in loans and leases that were considered to be impaired totaled \$20,603,000, which includes \$5,288,000 in nonaccrual loans and leases and \$15,315,000 in performing loans and leases. Of the total impaired loans of \$20,603,000, loans totaling \$9,259,000 were deemed to require no specific reserve and loans totaling \$11,344,000 were deemed to require a related valuation allowance of \$1,495,000. At December 31, 2012, the recorded investment in loans and leases that were considered to be impaired totaled \$26,553,000 and had a related valuation allowance of \$1,595,000. If interest had been accruing on the nonperforming loans, such income would have approximated \$109,000 and \$200,000 for the three months ended June 30, 2013 and 2012, respectively, and approximated \$168,000 and \$472,000 for the six months ended June 30, 2013 and 2012, respectively.

At June 30, 2013 and December 31, 2012, the recorded investment in other real estate owned (“OREO”) was \$8,120,000 and \$12,237,000, respectively. For the three months ended March 31, 2013, the Company sold six properties with balances of \$3,743,000 for a loss of \$93,000 and added a single property to OREO with a net book value totaling \$432,000. The single property is improved land with a long-term lease for a self-storage facility in Sonoma County. For the three months ended June 30, 2013, the Company sold one property with a balance of \$805,000 for a gain of \$22,000 and did not add any new OREO property.

The Company periodically obtains property valuations to determine whether the recorded book value is considered fair value. During the second quarter of 2013, this valuation process resulted in the Company reducing the book value of four properties by \$137,000 all of which was charged to OREO expense.

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The June 30, 2013 OREO balance of \$8,120,000 consists of fourteen properties including four commercial real estate properties in the total amount of \$3,265,000, six residential land properties in the total amount of \$3,896,000, two commercial land properties in the total amount of \$689,000 and two residential real estate properties in the total amount of \$270,000.

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Nonperforming loans and leases and OREO at June 30, 2013 and December 31, 2012 are summarized as follows:

(in thousands)	June 30, 2013	December 31, 2012		
Nonaccrual loans and leases that are current to terms (less than 30 days past due)	\$ 1,183	\$ 1,514		
Nonaccrual loans and leases that are past due	4,181	3,960		
Loans and leases past due 90 days and accruing interest	—	—		
Other real estate owned	8,120	12,237		
Total nonperforming assets	\$ 13,484	\$ 17,111		
Nonperforming loans and leases to total loans and leases	2.12	% 2.12		%
Total nonperforming assets to total assets	2.33	% 2.97		%

Impaired loans and leases as of and for the periods ended June 30, 2013 and December 31, 2012 are summarized as follows:

(in thousands)	As of June 30, 2013			As of December 31, 2012		
	Unpaid			Unpaid		
	Recorded	Principal	Related	Recorded	Principal	Related
	Investmen	Balance	Allowance	Investmen	Balance	Allowance
With no related allowance recorded:						
Commercial	\$670	\$ 690	\$ —	\$1,248	\$1,407	\$ —
Real estate-commercial	8,297	9,082	—	10,882	11,603	—
Real estate-construction	256	256	—	263	263	—
Consumer	36	109	—	37	109	—
Subtotal	\$9,259	\$ 10,137	\$ —	\$12,430	\$13,382	\$ —

With an allowance recorded:

Commercial	\$1,588	\$ 1,588	\$ 543	\$1,580	\$1,580	\$ 480
Real estate-commercial	5,586	5,902	593	8,223	8,287	786
Real estate-multi-family	1,666	1,758	118	1,681	1,774	122
Real estate-residential	2,370	2,461	217	2,429	2,483	179
Consumer	134	134	24	210	210	28
Subtotal	\$11,344	\$ 11,843	\$ 1,495	\$14,123	\$14,334	\$ 1,595

Total:

Commercial	\$2,258	\$ 2,277	\$ 543	\$2,828	\$2,987	\$ 480
Real estate-commercial	13,883	14,985	593	19,105	19,890	786
Real estate-multi-family	1,666	1,758	118	1,681	1,774	122
Real estate-construction	256	256	—	263	263	—
Real estate-residential	2,370	2,461	217	2,429	2,483	179
Consumer	170	243	24	247	319	28
	\$20,603	\$ 21,980	\$ 1,495	\$26,553	\$27,716	\$ 1,595

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The following table presents the average balance related to impaired loans and leases for the periods indicated (in thousands):

	Average Recorded Investments for the three months ended		Average Recorded Investments for the six months ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
Commercial	\$ 2,388	\$ 5,256	\$ 2,339	\$ 5,123
Real estate-commercial	15,877	17,743	14,146	15,899
Real estate-multi-family	1,675	1,187	1,673	1,228
Real estate-construction	260	1,937	259	1,852
Real estate-residential	2,403	2,253	2,400	1,543
Leases	—	4	—	—
Agriculture	—	395	—	495
Consumer	210	457	175	212
Total	\$ 22,813	\$ 29,232	\$ 20,992	\$ 26,352

The following table presents the interest income recognized on impaired loans and leases for the periods indicated (in thousands):

	Interest Income Recognized for the three months ended		Interest Income Recognized for the six months ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
Commercial	\$ 16	\$ 23	\$ 32	\$ 74
Real estate-commercial	85	210	293	330
Real estate-multi-family	20	15	39	30
Real estate-construction	4	—	7	—
Real estate-residential	29	25	52	45
Consumer	1	3	2	8
Total	\$ 155	\$ 276	\$ 425	\$ 487

## 7. TROUBLED DEBT RESTRUCTURINGS

At June 30, 2013, there were 25 loans and leases that were considered to be troubled debt restructurings. Of these loans and leases, 11 were modified and are currently performing (less than ninety days past due) totaling \$4,620,000 and 14 are considered nonperforming (and included in the \$5,364,000 discussed in Note 6), totaling \$3,728,000. Of the 14 TDRs considered nonperforming, seven are current to the modified terms. At December 31, 2012, there were 42 loans and leases that were considered to be troubled debt restructurings. Of these loans and leases, 29 were modified and are currently performing (less than ninety days past due) totaling \$14,906,000 and 13 are considered nonperforming (and included in the \$5,474,000 discussed in Note 6), totaling \$2,461,000. Of the 13 TDRs considered nonperforming, six are current to the modified terms. At June 30, 2013 and December 31, 2012, there were no unfunded commitments on those loans considered troubled debt restructures. See also “Impaired Loans and Leases” in Item 2 - Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

The Company has allocated \$945,000 and \$1,575,000 of specific reserves to loans whose terms have been modified as troubled debt restructurings as of June 30, 2013 and December 31, 2012.



During the six-month period ended June 30, 2013, the terms of four loans were modified as a troubled debt restructuring. The modifications of the terms of these loans were extensions of the maturity date and/or interest rates lower than the original loan rate.

The following table presents loans by class modified as troubled debt restructurings during the three months ended June 30, 2013 (dollars in thousands):

	Number of Loans	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Real estate – commercial	3	\$ 762	\$ 722
Total	3	\$ 762	\$ 722

The following table presents loans by class modified as troubled debt restructurings during the six months ended June 30, 2013 (dollars in thousands):

	Number of Loans	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Real estate – commercial	4	\$ 1,200	\$ 1,160
Total	4	\$ 1,200	\$ 1,160

The troubled debt restructurings described above increased the allowance for loan and lease losses by \$100,000 and resulted in \$40,000 in charge-offs during the six months ended June 30, 2013.

The following table presents loans by class modified as troubled debt restructurings during the three months ended June 30, 2012 (dollars in thousands):

	Number of Loans	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial	4	\$ 646	\$ 646
Real estate – commercial	4	1,299	1,299
Real estate – multi-family	1	274	274
Total	9	\$ 2,219	\$ 2,219

The following table presents loans by class modified as troubled debt restructurings during the six months ended June 30, 2012 (dollars in thousands):

	Number of Loans	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial	5	\$ 693	\$ 693
Real estate – commercial	6	3,509	3,509
Real estate – multi-family	2	539	539
Real estate – residential	3	921	808
Other – agriculture	1	410	410
Other – consumer	2	31	31
Total	19	\$ 6,103	\$ 5,990

The troubled debt restructurings described above increased the allowance for loan and lease losses by \$96,000 and resulted in charge-offs of \$113,000 during the six months ended June 30, 2012.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the period indicated (dollars in thousands):

Six months ended June 30, 2013	Number of Loans	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Commercial	1	\$ 513
Total	1	\$ 513

Three months ended June 30, 2012	Number of Loans	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Real estate-commercial	2	\$ 1,097
Consumer	1	5
Total	3	\$ 1,102

Six months ended June 30, 2012	Number of Loans	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Real estate – commercial	6	\$ 2,357
Commercial	1	863

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Consumer

1

5

Total

8

\$ 3,225

There were no payment defaults on troubled debt restructurings within 12 months following the modification for the three months ended June 30, 2013.

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# 8. ALLOWANCE FOR LOAN AND LEASE LOSSES

The Company's loan and lease portfolio allocated by management's internal risk ratings as of June 30, 2013 and December 31, 2012 are summarized below:

June 30, 2013 (dollars in thousands)	Credit Risk Profile by Internally Assigned Grade				
	Real Estate				
	Commercial	Commercial	Multi-family	Construction	Residential
Grade:					
Pass	\$23,411	\$137,096	\$ 8,105	\$ 2,476	\$ 12,764
Watch	1,340	14,052	1,169	3,406	3,519
Special mention	553	16,309	431	596	1,292
Substandard	1,508	13,128	510	—	787
Doubtful	242	—	—	—	—
Total	\$27,054	\$180,585	\$ 10,215	\$ 6,478	\$ 18,362

	Credit Risk Profile by Internally Assigned Grade			
	Other Credit Exposure			
	Leases	Agriculture	Consumer	Total
Grade:				
Pass	\$ 1,172	\$ 2,810	\$ 6,343	\$194,177
Watch	—	—	25	23,511
Special mention	—	397	130	19,708
Substandard	—	—	133	16,066
Doubtful	—	—	—	242
Total	\$ 1,172	\$ 3,207	\$ 6,631	\$253,704

December 31, 2012 (dollars in thousands)	Credit Risk Profile by Internally Assigned Grade				
	Real Estate				
	Commercial	Commercial	Multi-family	Construction	Residential
Grade:					
Pass	\$25,670	\$134,969	\$ 7,018	\$ 3,049	\$ 13,283
Watch	1,994	14,613	1,181	3,262	2,518
Special mention	653	16,041	441	607	1,163
Substandard	1,804	14,503	515	—	737
Doubtful	690	—	—	—	—
Total	\$30,811	\$180,126	\$ 9,155	\$ 6,918	\$ 17,701

	Credit Risk Profile by Internally Assigned Grade			
	Other Credit Exposure			
	Leases	Agriculture	Consumer	Total
Grade:				
Pass	\$ 1,506	\$ 2,938	\$ 7,696	\$196,129
Watch	—	—	251	23,819
Special mention	—	402	153	19,460

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Substandard	3	—	469	18,031
Doubtful	—	—	—	690
Total	\$ 1,509	\$ 3,340	\$ 8,569	\$258,129

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The allocation of the Company's allowance for loan and lease losses and by portfolio segment and by impairment methodology are summarized below:

June 30, 2013 (dollars in thousands)	Com- mercial	Real Estate Com- mercial	Multi- Family	Construc- tion	Other Residential	Leases	Agri- culture	Consumer	Unallocat-	Total
<u>Allowance for Loan and Lease Losses</u>										
Beginning balance, January 1, 2013	\$ 1,351	\$ 2,526	\$ 238	\$ 594	\$ 477	\$ 3	\$ 87	\$ 262	\$ 243	\$ 5,781
Provision for loan losses	(158 )	402	9	(172 )	115	—	4	(87 )	87	200
Loans charged off	(11 )	(355 )	—	—	(38 )	—	—	(5 )	—	(409 )
Recoveries	97	11	—	—	—	—	—	—	—	108
Ending balance, June 30, 2013	\$ 1,279	\$ 2,584	\$ 247	\$ 422	\$ 554	\$ 3	\$ 91	\$ 170	\$ 330	\$ 5,680
Ending balance: Individually evaluated for impairment	\$ 543	\$ 593	\$ 118	\$ —	\$ 217	\$ —	\$ —	\$ 24	\$ —	\$ 1,495
Ending balance: Collectively evaluated for impairment	\$ 736	\$ 1,991	\$ 129	\$ 422	\$ 337	\$ 3	\$ 91	\$ 146	\$ 330	\$ 4,185
<u>Loans</u>										
Ending balance	\$ 27,054	\$ 180,585	\$ 10,215	\$ 6,478	\$ 18,362	\$ 1,172	\$ 3,207	\$ 6,631	\$ —	\$ 253,704
Ending balance: Individually evaluated for impairment	\$ 2,258	\$ 13,883	\$ 1,665	\$ 256	\$ 2,370	\$ —	\$ —	\$ 171	\$ —	\$ 20,603
Ending balance: Collectively evaluated for impairment	\$ 24,796	\$ 166,702	\$ 8,550	\$ 6,222	\$ 15,992	\$ 1,172	\$ 3,207	\$ 6,460	\$ —	\$ 233,101
<u>Allowance for Loan and Lease Losses</u>										