Tri Counties Bank

1981 Annual Report

Dear Shareholder:

By any measure, 1981 was an outstanding year for Tri Counties Bank. We celebrated our sixth anniversary by doubling the geographic area we serve. We also doubled our number of employees, our total assets, and the earnings of the bank. A major factor in this growth was the merger of Shasta County Bank with Tri Counties Bank. This resulted in a very viable business enterprise.

Tri Counties is now the largest regional community bank in the Northern Sacramento Valley and the adjoining inter-mountain area. Currently, we are well positioned to serve the growth of our area on a sound and profitable basis. In a few short years and with excellent timing, we have earned a prominent and highly visible place in our market.

Dynamic growth needs efficient management. On December 8, 1981, the shareholders of Tri Counties voted to support management's recommendation to organize TriCo Bancshares, a bank holding company. At the present time, we have received approval from the State Banking Department and we are working with other regulatory agencies to obtain necessary approvals of this business entity.

When approved, we will present the Board of Directors with a plan to provide maximum long range gains to our investors. The plan will outline activities that best provide needed services to a growing consumer base. Obviously, our planning and marketing techniques will focus on opportunities that provide the best earning potential.

However, there are three significant situations you should be aware of as an investor in Tri Counties Bank. First, we have experienced a sharp increase in interest expense. This is coupled with the inability to earn a commensurate return on these high cost funds.

Second, we are impacted adversely by unregulated competition from brokerage firms. Money Market Mutual funds presently have substantial advantages in liquidity and reserve requirements that make it extremely difficult to reach our deposit goals. Finally, we have experienced increases in loan losses due to the acquisition of the Shasta County Bank loan portfolio and a substantial downturn in the national economy.

These problems impacted both earnings and growth in 1981 and the effects will continue during 1982. To compensate for these new economic and competitive realities, we have taken several steps. Our loan portfolio has shifted in rate sensitivity and type of loan so that about 50% are now short term, variable rate loans to business. We have also made policy and personnel changes where necessary to assure a high quality loan portfolio throughout our bank in the future.

Tri Counties marketing efforts continue to focus on individual and small business banking services. We are quite optimistic about our ability to serve these two excellent markets. Also, we are hopeful that Federal legislation presently pending will allow us a fully competitive position relative to the Mutual Money Market funds within the next 12 months.

Our prospects in the future look very positive. In the year ahead, we shall be placing greater emphasis on marketing and we expect to add a number of valuable financial services to our holding company. Our bank is a sound institution with experienced management. We are fortunate to be located in Northern California. We have close contact with our customers and a commitment to the communities where we live and work.

We are not a major California or national company —and we don't want to be one. We are the hometown, locally-owned, independent banking institution of the 1980's... Tri Counties Bank.

Sincerely yours,

Robert H. Steveson

Robert H. Steveson
President & Chief
Executive Officer

The following review of our investment shows the dynamic growth we have accomplished:

Year	Banking Location	Total Personnel	Total Assets (Millions)	Profit After Tax
1975	Pillsbury Chico	15	7	$ 28,000
1976	Pillsbury Chico	25	11	167,000
1977	Willows	47	18	126,000
1978	Durham	59	25	195,000
1979	Orland	72	34	215,000
1980	Park Plaza Chico	85	46	207,000
*1981	Burney, Big Valley, Cottonwood, Redding, Palo Cedro, Fall River Mills	186	96	582,000

*Merger with Shasta County Bank

Locally owned and independent, Tri Counties Bank is a regional community bank serving the Northern Sacramento Valley area. In 1981, two events of major importance took place: Shasta County Bank merged with Tri Counties; and TriCo Bancshares, a new holding company, was formed.

Board of Directors

Standing left to right

Fred Hignell III, Principal Partner Real Estate Investment & Development Company, Chico

George Hacke, Investment Account Executive, Chico

Donald Murphy, Vice-President & General Manager Ranch Operation, Nelson

Vernon Fish President Development Company, Chico

Robert Stern President Retail Store Chain, Oroville

Donald Casey, M.D. Retired Physician, Chico

Gerald Compton President Agricultural Flying Service, Richvale

Everett Beich, Owner Mobile Home Sales, Chico

DeWayne Caviness, M.D. Physician and Surgeon, Chico

Sitting left to right

Robert Steveson President Tri Counties Bank, Chico

Wendell Lundberg, Chairman of the Board, Owner Rice and Grain Operations, Richvale

Alex Vereschagin, Jr. Vice-Chairman of the Board, Secretary/Treasurer Petroleum Distribution Company, Orland

J. Herod Hall, M.D. Secretary of the Board, Physician and Surgeon, Chico

Sankey M. Hall, Jr., Partner Funeral Home Services and local cemetery operations, Chico

Wayne Meeks Retired Owner Automobile Dealership, Chico

STRATEGY FOR SUCCESS

Tri Counties success is based on careful planning for the future. After more than two years of management consideration and painstaking analysis of information, the merger became a reality.

As a result of the merger with Shasta County Bank, Tri Counties doubled in size becoming larger, stronger and more stable. Assets rose from $42 million to $96 million and six new branches were added along with about 100 experienced people. The new northern branches are located in Big Valley (Bieber), Redding, Burney, Fall River Mills, Palo Cedro and Cottonwood. The Tri Counties service area still includes the original branches in Orland, Willows and Durham, as well as the Pillsbury branch and the Park Plaza headquarters in Chico.

At the beginning of 1981, a stock issue of 110,000 shares was completed which raised $1 million 990 thousand in capital. When the March 27, 1981 merger was complete, 457 shareholders in Shasta County Bank became noteholders of Tri Counties Bank.

The merger places Tri Counties among the top 100 independent banks in California in terms of size. Robert Steveson, President of Tri Counties Bank, was elected to serve as the 1982 President of the Northern California Association of Independent Bankers where he will provide leadership and help determine policy. He also serves as a member of the Board of Directors for the California Bankers Association.

TRICO BANCSHARES: A STRONG, NEW STRUCTURE

TriCo Bancshares, a new organizational structure, is a holding company that allows possible tax savings for the bank and future growth in related areas. Most major banking institutions in the United States (and California) have been reorganized into holding companies. The Board of Directors believes this reorganization, approved December 8, 1981 by the shareholders, strengthens the bank's competitive position. TriCo Bancshares will be owned by the same Tri Counties shareholders and will be under the direction of the same Board of Directors.

Redding branch

lower right
On completion of the merger, sign changes were made at the six northern branches officially marking Tri Counties' increase from 5 to 11 branches.

lower left
Bob Steveson, seated at the right, listens intently as George Bush, Vice President of the United States, delivers his keynote speech to the Independent Bankers Association of Northern California 1982 conference

The holding company provides more flexibility in acquiring other banking operations and establishing other businesses related to banking. It also provides more alternatives to raising funds required by the bank under changing conditions in financial and monetary markets.

For example, through TriCo Bancshares, the kinds of loans made by finance or mortgage companies can be made or acquired. Additionally, the holding company can act as an investment or financial advisor to investment companies, mortgage or real estate investment trusts; provide portfolio investment advice to private individuals; and make equity or debt investments in corporations for projects designed primarily to promote community welfare.

The formation of TriCo Bancshares enhances the ability of the bank to attract new customers and to continue to satisfy the constantly expanding needs of present customers for banking services.

DATA PROCESSING CENTER EXPANDS

To coordinate increased business activity, a modern Data Processing Center was established. With over 4,000 square feet of floor space, it offers improved organization and faster information processing. The Center opened October 24, 1981 on the Skyway southeast of Chico under the direction of Manager, Larry Hall. Efficient computer processing is used to generate general ledger reports, maintenance reports and activity journals.

Expanded computer facilities in Chico have greatly increased your Bank's data processing capacity.

Many intensive meetings of the board resulted in careful plans being laid for a successful merger with Shasta County Bank.

At the December 8, 1981 special shareholders meeting, shareholders voted unanimously to accept formation of TriCo Bancshares holding company.

Larry Hall, Manager Data Processing Department.

WHAT IS NEW IN CUSTOMER SERVICE?

Providing customers with services they want and need is essential to a well planned banking program. Three new services of special value to customers were added during 1981: The Photo Check Guarantee Card, the Money Facts Service, and the Small Business Guaranteed Loan package.

The Photo Check Guarantee Card provides identification through a full color photograph of each customer permanently embedded in the card. Customers are protected against forgery and merchants are guaranteed for transactions up to $150 in cash or $500 in merchandise. Tri Counties is currently the only bank in the North Valley area with this service.

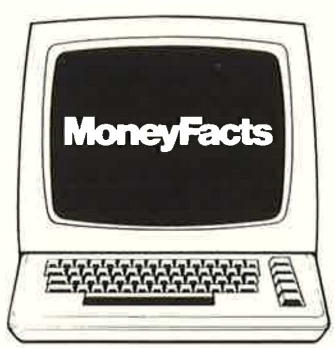
Money Facts is an automated book-keeping service. It offers Cash Control, General Ledger and Personal Finance services to provide commercial clients and individual customers with greater financial management control that has the ease of everyday checking. Tri Counties continues to cooperate with the Small Business Administration, as well as the Farmer's Home Administration, to provide services that help new and established businesses with guaranteed loans. In 1981, a special department was set up to handle the workflow for these loans designed to aid with business construction, the purchase of equipment, facilities and supplies, as well as working capital. Tri Counties has been named a certified lender by the Small Business Administration. This means Tri Counties can provide faster turn around time on loan evaluations and documentation processing than ordinary banks. The department was set up by Tri Counties in order to help strengthen the business community in the North Valley area.

A DYNAMIC MARKETING PROGRAM

Good services are stressed at Tri Counties. But just as important is another aspect of successful banking... marketing the services that the bank has to offer.

In order to acquaint more people with Tri Counties Bank's services, an aggressive marketing program has been developed that includes personal contacts as well as the extensive use of media. Television commercials produced during 1981 were aired throughout Northern California and proved to be very effective. The commercials were used to introduce new services like the Photo Check Guarantee Card and to emphasize regular customer services such as extended drive-up hours. Newspaper and radio advertising was also valuable in reaching our target market.

An especially effective marketing tool is Tri Counties two-projector slide show that combines music, narration and striking visual images to explain the development and purpose of the bank. Developed three years ago, it was revised during 1981 to incorporate the new changes that resulted from the merger and holding company formation. The slide show is very useful for employee training and customer relations.



Personal contact in the community was emphasized through the New Business Development Call Program. All executives and officers of the bank take part in a carefully planned program of personal calls on local businesses to evaluate their needs and to explain Tri Counties services. This program has resulted in the addition of a number of new and important customers.

Another effective innovation was the establishment of a newsletter to encourage communication between the branches. Branchlines, the bank's first newsletter, was published in December to provide an information link for the 11 branch system. The Christmas issue featured Tri Counties history and employee news. The newsletter will be published three times during 1982. The newsletter, the revised slide show, personal calls, TV commercials... all of these marketing techniques are strengthening Tri Counties Bank's position in Northern California.

COMMUNITY SERVICE: A VITAL CONCEPT

Tri Counties growth is based on the fact that people in the local communities surrounding each branch like to do their banking business with a bank they know and trust. Tri Counties has made close ties with surrounding communities through the use of local advisory boards. Two advisory boards, consisting of local citizens who speak for their communities, regularly meet with bank officers to discuss business issues that relate to their area.

The bank also contributes time and money as a public service for special projects. For example, $500 scholarships were given to 12 different graduating high school seniors from communities served by the bank.

Branchline

THE COMPETITIVE EDGE

Many elements combine to create Tri Counties growth and success... a professional approach to planning, effective management, and just plain hard work and stamina. The results say it all.

The merger, along with the formation of TriCo Bancshares, strengthens Tri Counties Bank's competitive position in today's economy. The new Data Processing Center meets present needs and helps prepare the bank for a future where electronic banking will become even more important. Through new customer services, the bank is meeting consumer needs in a continuing effort to best serve the North Valley area.

All these factors, combined with modern marketing techniques and a genuine commitment to community service, have established Tri Counties Bank's reputation for being a good, solid, hometown financial institution—a firm base for continued success.

As part of the New Business Development Call Program, Keith Orme, manager of Park Plaza Branch, Chico, calls on Phil Sunseri from Sunseri Construction of Chico, to learn about Phil's operation and help him plan his banking needs.

ACCOUNTANTS' REPORT

To the Board of Directors and Shareholders
Tri Counties Bank
Chico, California

We have examined the consolidated balance sheets of Tri Counties Bank and subsidiary as of December 31, 1981 and 1980, and the related consolidated statements of income, changes in shareholders' equity, and changes in financial position for each of the three years in the period ended December 31, 1981. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Tri Counties Bank and subsidiary as of December 31, 1981 and 1980, and the consolidated results of their operations and changes in their financial position for each of the three years in the period ended December 31, 1981, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

Sacramento, California
February 10, 1982

CONSOLIDATED BALANCE SHEETS
December 31, 1981 and 1980

Assets	**1981**	1980
Cash and due from banks	**$ 5,947,654**	$ 3,146,214
Time certificates of deposit	**—**	700,000
Federal funds sold	**—**	2,000,000
Investment securities	**10,369,215**	8,878,090
Loans:		
Commercial	**30,980,750**	9,481,804
Consumer installment	**16,580,280**	8,134,396
Real estate mortgages	**14,892,266**	8,607,695
Real estate construction	**5,334,366**	1,397,200
	67,787,662	27,621,095
Allowance for loan losses	**(626,356)**	(73,084)
Unearned discount	**(292,267)**	(257,627)
Net loans	**66,869,039**	27,290,384
Premises and equipment, net	**6,552,724**	2,353,927
Accrued interest receivable	**2,100,207**	583,172
Other assets	**4,874,067**	836,177
Total assets	**$96,712,906**	$45,787,964

Liabilities and Shareholders' Equity	**1981**	1980
Deposits:		
Demand	**$27,120,313**	$13,095,092
Savings	**20,002,490**	10,098,536
Time certificates of deposit	**25,294,420**	7,281,002
Time deposits, $100,000 and over	**3,281,569**	4,930,216
Public time	**7,856,655**	4,270,714
Total deposits	**83,555,447**	39,675,560
Accrued interest payable and other liabilities	**1,796,810**	509,817
Deferred income taxes	**422,854**	258,930
Long-term debt	**4,862,423**	586,199
Contingent liabilities and commitments (Note 13)		
Total liabilities	**90,637,534**	41,030,506
Shareholders' equity:		
Common stock, no par value; authorized shares - 1,333,333; issued and outstanding shares, 1981 - 685,852; 1980 - 501,177	**5,288,610**	2,897,225
Common stock subscribed	**—**	1,290,955
Undivided profits	**786,762**	569,278
Total shareholders' equity	**6,075,372**	4,757,458
Total liabilities and shareholders' equity	**$96,712,906**	$45,787,964

The accompanying notes are an integral part of the financial statements.

CONSOLIDATED STATEMENTS OF INCOME

for the years ended December 31, 1981, 1980 and 1979

Interest Income	**1981**	1980	1979
Interest and fees on loans	**$ 9,660,221**	$3,443,240	$2,466,110
Interest on investment securities:			
Taxable	**1,123,629**	597,557	389,222
Tax-exempt municipal obligations	**44,562**	45,783	28,145
Interest on time deposits and Federal funds sold	**101,165**	139,884	81,892
Total interest income	**10,929,577**	4,226,464	2,965,369
Interest Expense			
Interest on deposits:			
Demand deposits (N.O.W. accounts)	**172,997**	—	—
Savings deposits	**945,760**	517,584	482,311
Time certificates of deposit	**2,744,620**	732,165	227,757
Time deposits, $100,000 and over	**548,418**	440,160	216,404
Public time deposits	**986,756**	447,329	266,656
	5,398,551	2,137,238	1,193,128
Interest on short-term borrowings	**181,928**	25,536	29,061
Interest on long-term debt	**311,988**	—	—
Total interest expense	**5,892,467**	2,162,774	1,222,189
Net interest income	**5,037,110**	2,063,690	1,743,180
Provision for loan losses	**530,286**	61,000	78,000
Net interest income after provision for loan losses	**4,506,824**	2,002,690	1,665,180
Other income:			
Service charges	**667,046**	302,069	176,337
Gain on sale of loans	**300,000**	—	—
Total other income	**967,046**	302,069	176,337
Other expenses:			
Salaries and employee benefits	**2,430,365**	1,054,405	789,224
Equipment and data processing expense	**685,919**	245,863	201,258
Occupancy expense	**376,762**	203,738	89,610
Advertising	**160,206**	36,808	23,914
Other operating expenses	**1,214,624**	565,374	380,639
	4,867,876	2,106,188	1,484,645
Income before provision for income taxes and securities transactions	**605,994**	198,571	356,872
Provision for income taxes	**113,206**	19,245	142,003
Income before securities transactions	**492,788**	179,326	214,869
Securities transactions, less applicable income taxes of $46,428 in 1981 and $35,215 in 1980	**42,412**	32,165	—
Net income	**$ 535,200**	$ 211,491	$ 214,869
Earnings per share:			
Income before securities transactions	**$ .70**	$ .32	$ .38
Securities transactions, less related income taxes	**.05**	.06	—
Net income	**$ .75**	$ .38	$ .38

The accompanying notes are an integral part of the financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
for the years ended December 31, 1981, 1980 and 1979

	Common Stock		Common Stock Subscribed				
	Number of Shares	Amount	Number of Shares	Amount	Capital Surplus	Undivided Profits	Total
Balance, January 1, 1979	293,152	$1,465,760	—	$ —	$1,377,750	$153,506	$2,997,016
Transfer of capital surplus to common stock account		1,377,750			(1,377,750)		—
Net income for the year						214,869	214,869
Balance, December 31, 1979	293,152	2,843,510	—	—	—	368,375	3,211,885
Four-for-three stock split, less cash paid for fractional shares	97,437					(5,187)	(5,187)
Exercise of stock options	10,649	53,715					53,715
25% stock dividend,* less cash paid for fractional shares	99,939					(5,401)	(5,401)
Common stock subscribed			67,945	1,290,955			1,290,955
Net income for the year						211,491	211,491
Balance, December 31, 1980	501,177	2,897,225	67,945	1,290,955	—	569,278	4,757,458
Sale of common stock (including receipts applicable to stock subscribed at December 31, 1980), less issue costs of $99,990	110,000	1,990,010	(67,945)	(1,290,955)			699,055
Exercise of Stock options	12,700	91,500					91,500
10% stock dividend, less cash paid for fractional shares	61,975	309,875				(317,716)	(7,841)
Net income for the year						535,200	535,200
Balance, December 31, 1981	685,852	$5,288,610	—	$ —	$ —	$786,762	$6,075,372

*Accounted for as a stock split

The accompanying notes are an integral part of the financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION
for the years ended December 31, 1981, 1980 and 1979

	1981	1980	1979
Resources provided:			
Operations:			
Net Income	**$ 535,200**	$ 211,491	$ 214,869
Noncash items:			
Depreciation and amortization	**562,653**	110,019	62,565
Provision for loan losses	**530,286**	61,000	78,000
Provision for deferred income taxes	**163,924**	123,434	27,580
Gain on sale of loans	**(300,000)**	—	—
Provided by operations	**1,492,063**	505,944	383,014
Increase in liabilities and shareholders' equity:			
Deposits	**5,183,761**	9,721,510	7,344,903
Accrued interest payable and other liabilities	—	—	652,430
Long-term debt incurred to acquire Shasta County Bank	**3,718,146**	—	—
Other long-term obligation	—	586,199	—
Proceeds from common stock transactions:			
Common stock issued and subscribed, net	**699,055**	1,290,955	—
Exercise of stock options and other, net	**83,659**	43,127	—
Decrease in assets:			
Federal funds sold	**2,000,000**	—	1,100,000
Time certificates of deposit	**700,000**	—	—
Investment securities	**2,635,334**	—	—
	$16,512,018	$12,147,735	$9,480,347
Resources used:			
Acquisition of Shasta County Bank:			
Loans, net	**$32,448,880**	$ —	$ —
Premises and equipment	**4,130,958**	—	—
Investment securities	**4,126,459**	—	—
Deposits	**(38,696,126)**	—	—
Other assets and liabilities, net	**3,226,303**	—	—
	5,236,474		
Increase in assets:			
Cash and due from banks	**$ 1,324,274**	$ 1,825,250	$ 160,763
Time certificates of deposit	—	700,000	—
Federal funds sold	—	1,300,000	—
Investment securities	—	1,322,247	2,209,317
Loans, net	**7,708,811**	5,664,986	5,696,866
Premises and equipment	**348,349**	585,862	950,408
Accrued interest receivable and other assets	**1,352,533**	497,864	462,993
Decrease in liabilities:			
Accrued interest payable and other liabilities	**541,577**	251,526	—
	$16,512,018	$12,147,735	$9,480,347

The accompanying notes are an integral part of the financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Summary of Significant Accounting Policies:

Principles of Consolidation

The consolidated financial statements include the accounts of the Bank and its wholly owned subsidiary after elimination of all significant intercompany accounts and transactions.

Investment Securities

Investment securities are carried at cost increased by accretion of discounts and decreased by amortization of premiums. Gains and losses (determined on a specific identification basis) on sales and exchanges of investment securities are presented, net of applicable income taxes, separately in the statement of income.

Loans

Loans are stated net of undisbursed funds. Interest on commercial and real estate loans is accrued principally on a simple-interest basis. Interest on installment loans made prior to July 1978 is recognized principally using the sum-of-the-months-digits method. Interest on installment loans made commencing in July 1978 and thereafter is accrued on a simple-interest basis.

Interest is not accrued if, in management's judgment, principal amounts are considered doubtful of collection.

Certain loans which are guaranteed by an agency of the U.S. government are pledged as collateral for U.S. government deposits held by the Bank. At December 31, 1981, approximately $428,000 of such loans were pledged.

Allowance for Loan Losses

The allowance for loan losses represents management's recognition of the assumed risks of extending credit and its evaluation of the overall quality of the loan portfolio. Although it is not possible to anticipate loan losses with complete accuracy, the evaluation of the quality of the loan portfolio includes such factors as the borrower's financial condition and repayment history, the value of any existing collateral, and the existence of third-party guarantees. Other factors considered by management include past loan loss experience and external business and economic conditions beyond the borrower's control. The allowance for loan losses is increased by provisions for loan losses charged to operating expense and recoveries of previously charged-off loans, and is reduced for net loan losses.

Intangible Assets

Intangible assets (included in other assets) are comprised of "core deposits" and the unallocated excess purchase price over fair value of net assets acquired in connection with the acquisition of Shasta County Bank (Note 11). Core deposits represent the present value of the expected future benefits to be realized from the acquired bank's deposit base, comprised principally of demand and savings deposits.

Core deposits, as determined above, are being amortized over 10 years using the straight-line method. Management believes that the life of the unallocated excess purchase price arising from the acquisition is indeterminate, and therefore, is being amortized over 40 years using the straight-line method.

Premises and Equipment

Premises (including those acquired under a capital lease) and equipment are stated at cost less accumulated depreciation and amortization. Land is carried at cost. Depreciation and amortization expense is computed using the straight-line method over the following estimated useful lives:

Bank premises	30 to 40 years
Furniture and equipment	3 to 10 years

Improvements and major renewals are capitalized, and maintenance and repairs are charged to operating expenses. Gains and losses from disposal of Bank premises and equipment are included in current operations.

Premises under capital lease are amortized over the lease term, excluding renewal options.

Income Taxes

The provision for income taxes includes amounts attributable to all significant timing differences between revenues and expenses reported for financial statement purposes and for income tax purposes, after excluding nontaxable revenues and nondeductible expenses. The principal timing differences result from the use of the cash method of accounting for tax purposes, recognition of gain or loss on sale of participation loans, and differences in the method of calculating the provision for loan losses.

Investment tax credits are applied to reduce the provision for federal income taxes in the year such credits arise.

Other Real Estate Owned

Other real estate owned consists primarily of real estate acquired through foreclosure in satisfaction of borrower obligations. Other real estate owned is stated at the lower of net realizable value or the amount of the debt discharged (including any accrued interest) plus costs of foreclosure. Losses indicated at the time of foreclosure are charged to the allowance for loan losses. Valuation adjustments made subsequent to the date of acquisition and expenses incurred during the property's holding period are charged to current operations.

Other real estate owned amounted to $638,000 at December 31, 1981, and is included in other assets.

Earnings Per Share

Earnings per share computations are based on the weighted average number of shares and common equivalent shares outstanding during the year after retroactive adjustments for stock dividends and stock splits. Common equivalent shares include the effects of the assumed conversion of outstanding capital notes, including elimination of related interest expense, net of tax (where such conversion would have a dilutive effect on net income), outstanding stock options utilizing the treasury-stock method, and shares of common stock subscribed. Shares used in the computation of earnings per share were 888,678, 561,130 and 563,816 for 1981, 1980, and 1979, respectively. Fully diluted earnings per share are not presented because the effects of such computations are not material.

Note 2—Investment Securities

A summary of the adjusted book and market values of investment securities is as follows:

	1981		1980	
	Adjusted Book Value (1)	**Market Value**	Adjusted Book Value (1)	Market Value
U.S. Treasury	**$3,362,547**	**$3,074,817**	3,391,309	3,197,461
Other U.S. government agencies	**5,653,853**	**5,332,307**	3,853,685	3,510,181
State and local agencies	**784,907**	**784,144**	784,891	784,891
Tax-exempt municipal obligations	**567,908**	**497,603**	848,205	787,787
	$10,369,215	**$9,688,871**	$8,878,090	$8,280,320

(1) Cost adjusted for accretion of discounts and amortization of premiums.

At December 31, 1981, securities with face and market values of $9,330,000 and $8,598,038, respectively, were pledged as collateral for certain public deposits as required by law.

The Bank intends to hold its investments to maturity, and therefore, a valuation allowance has not been provided for the excess of adjusted book value over market value.

Note 3—Allowance for Loan Losses

Transactions in the allowance for loan losses were as follows:

	1981	1980
Balance, beginning of year	**$73,084**	$76,010
Provision charged to operations	**530,286**	61,000
Allowance for losses on loans acquired from Shasta County Bank	**350,000**	—
Loans charged off	**(357,126)**	(88,571)
Recoveries of loans previously charged off	**30,112**	24,645
Balance, end of year	**$626,356**	$73,084

Loans classified as nonaccrual amounted to approximately $402,000 and $31,740 at December 31, 1981 and 1980, respectively.

On February 10, 1982, the Bank entered into a debt restructuring agreement with one of its borrowers whereby the Bank acquired title to certain real properties in satisfaction of the borrowers outstanding loans to the Bank. Based on current rates at the time of the restructuring, annual interest on these loans approximated $400,000. The real properties will be classified as other real estate owned.

Note 4—Premises and Equipment

Premises and equipment are comprised of:

	1981	1980
Bank premises (including $831,188 acquired under capital lease)	**$4,762,320**	$1,835,068
Furniture, fixtures, and equipment	**1,419,168**	597,113
	6,181,488	2,432,181
Less accumulated:		
Depreciation	**(472,265)**	(220,979)
Amortization of capital lease	**(52,312)**	(23,088)
	5,656,911	2,188,114
Land	**895,813**	165,813
	$6,552,724	$2,353,927

Depreciation and amortization of premises and equipment amounted to $281,000, $110,000, and $63,000 in 1981, 1980, and 1979, respectively.

Note 5—Income Taxes

The provisions for income taxes included in the statements of income are comprised of:

	1981	1980	1979
Taxes applicable to income before securities transactions, net of tax credits:			
Federal	$ 53,477	$ (12,873)	$100,360
State	59,729	32,118	41,643
	113,206	19,245	142,003
Taxes applicable to securities transactions	46,428	35,215	—
	$ 159,634	$ 54,460	$142,003
Current:			
Federal	$ (4,890)	$ (69,174)	$ 68,834
State	600	200	45,589
	(4,290)	(68,974)	114,423
Deferred:			
Federal	94,490	87,296	31,526
State	69,434	36,138	(3,946)
	163,924	123,434	27,580
	$ 159,634	$ 54,460	$142,003

The tax effects of the principal elements of timing differences which give rise to deferred income taxes are as follows:

	1981	1980	1979
Items applied to reduce deferred income taxes:			
Net operating loss	$(346,420)	$ —	$ —
Tax credits	(91,051)	(32,010)	—
Accrual income deferred for tax purposes, net	550,919	139,500	(9,000)
Provision for loan losses	(107,698)	14,600	20,200
Gain (loss) on sale of participation loans, net	133,980	(5,300)	(8,500)
Use of accelerated depreciation methods for tax	29,763	—	—
Restoration of deferred taxes, applicable to utilization of prior years' tax credits	—	—	23,600
Other differences	(5,569)	6,644	1,280
	$ 163,924	$123,434	$ 27,580

A reconciliation of the Federal statutory tax rate to the Bank's effective tax rate is as follows:

	1981	1980	1979
Federal statutory income tax rate	46.0%	46.0%	46.0%
State income taxes, net of federal tax benefit	6.3	6.3	6.3
Investment tax credits	(13.1)	(14.1)	(3.7)
Amortization of excess tax basis on assets acquired in merger	(8.5)	—	—
Tax-exempt interest on municipal obligations	(5.9)	(7.9)	(3.6)
Tax bracket rate differential	(5.5)	(7.2)	(5.4)
Other	3.7	(2.6)	.2
Effective tax rate	23.0%	20.5%	39.8%

Investment tax credits utilized to reduce estimated federal income tax expense for the years ended December 31, 1981, 1980 and 1979, were $91,051, $37,583 and $13,226, respectively.

The Bank has a net operating loss carryforward of approximately $465,000 and tax credits of $250,000 available to offset future federal income taxes on its federal income tax returns. The net operating loss carryforward and tax credits expire in varying amounts through 1986 and 1996, respectively.

Note 6—Long-term Debt

Long-term debt at December 31, 1981 and 1980 consisted of:

	1981	1980
9½% convertible, subordinated capital notes payable in annual installments of $592,184, including interest, with balance due March 27, 1988. Notes are convertible into common stock at $13.82 per share (subject to certain adjustments as defined in the Note agreement) beginning March 27, 1982. Notes may be prepaid in whole or in part at par value any time after March 27, 1982, subject to the prior right of conversion.	**$3,718,146**	$ —
9% subordinated capital notes due April 1, 1989, with interest payable semiannually. Notes may be prepaid in whole or in part at any time.	**150,000**	—
10% mortgage payable in monthly installments of $3,818, including interest, through December 1, 2003, collateralized by a first deed of trust on certain bank permises.	**406,714**	—
Capital lease obligation applicable to Bank's main office permises; effective interest cost of 12%; payable through December 1, 2009.	**587,563**	586,199
	$4,862,423	$586,199

The aggregate maturities of long-term debt, excluding the capital lease obligation, are as follows:

1982	$ 244,338
1983	267,609
1984	293,084
1985	320,988
1986	351,562
1987 and after	2,797,279

Annual principal payments under the 9½% convertible, subordinated capital notes are subject to the maintenance of certain capitalization levels and prior consent of the Bank's regulatory authorities under the laws of the California Financial Code and Federal Deposit Insurance Act.

Future minimum annual lease payments remaining under the capital lease obligation are as follows:

1982	$ 73,600
1983	73,600
1984	73,600
1985	74,100
1986	74,600
1987 and after	1,958,800
Net minimum lease payments	2,328,300
Less: amount representing interest	1,740,737
Present value of net minimum lease payments	$ 587,563

Note 7—Employment Agreement

The Bank has an employment agreement with its president through January 1, 1986, which provides for an annual incentive bonus based on 4% of net income and for reimbursement of his ordinary and necessary business expenses applicable to the Bank.

Note 8—Pension Plan

The Bank has established a defined benefit pension plan for the benefit of substantially all of its employees. The Bank's policy is to fund pension costs accrued. Total pension expense in 1981, 1980 and 1979 was approximately $65,000, $60,000 and $45,000, respectively, which includes amortization of past service cost over 30 years. The plan was amended effective January 1, 1981, in connection with the acquisition of Shasta County Bank. During 1981, the formula for future service benefits was changed, and certain actuarial assumptions were revised to more accurately reflect the plan's actual and anticipated experience. The combined effect of these changes was to reduce the provision for pension expense from approximately 15% of covered payroll in 1980 to approximately 5% of covered payroll in 1981.

Accumulated plan benefits and plan net assets at January 1, 1981, the latest plan valuation date, are summarized below:

Actuarial present value of accumulated plan benefits:	
Vested	$ 7,200
Nonvested	18,700
Total	$ 25,900
Net assets available for plan benefits	$107,400

The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was six percent.

Note 9—Common Stock Transactions

Capital Surplus

In December 1979, the Board of Directors approved a change in the par value of the Bank's common stock from $5.00 per share to no par value. In connection with this change, the Bank's capital surplus account was transferred to and combined with its common stock account.

Stock Options

The Bank has a stock option plan covering 27,350 shares of its common stock. The plan, which terminates in 1985, provides for the granting of options to key employees of the Bank, entitling them to purchase shares of common stock at fair market value on the date the option is granted. Optionees, option prices, and dates of grant and exercise are determined by the Board of Directors of the Bank. The options are exercisable no later than five years from the date of grant and are not transferable by the holder, other than by will or the laws of descent and distribution. The options lapse immediately upon the earlier of the termination of employment, one year after the optionee's death, or the termination date of the option.

Transactions in 1981 and 1980 related to stock options were as follows:

	Shares Available for Grant	Options Outstanding Shares	Price Per Share	Total
Balance, January 1, 1980	17,038	38,787	$3.59-$ 6.76	$210,000
Options exercised in 1980		(14,505)	3.59- 6.76	(53,715)
Options granted in 1980	(13,750)	13,750	13.82	190,000
Balance, December 31, 1980	3,288	38,032	5.38- 13.82	346,285
Options exercised in 1981	—	(13,970)	5.38- 13.82	(91,500)
Options terminated in 1981	688	(688)	13.82	(9,500)
Balance, December 31, 1981	3,976	23,374*	$6.76-$13.82	$245,285

*All exercisable at December 31, 1981.

There were no transactions under the plan during 1979. All transactions in 1981 and 1980 are reflected after retroactive adjustment for the stock split and stock dividends declared during those years.

No charges to income are made in connection with transactions under this plan.

Stock Dividend

In December 1981, the Bank declared a 10% stock dividend to its stockholders. To capitalize this dividend, a transfer from undivided profits to common stock was made equal to $5 for each share to be issued in payment thereof.

Note 10—Related Party Transactions

Certain directors and officers of the Bank and companies with which they are associated were customers of, and had banking transactions with, the Bank in the ordinary course of the Bank's business. It is the Bank's policy that all loans and commitments to lend to officers and directors be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other borrowers. As of December 31, 1981, the total amount of outstanding loans to these parties aggregated approximately $1,184,000.

Note 11—Acquisition of Shasta County Bank

Effective March 27, 1981, the Bank acquired all of the outstanding capital stock of Shasta County Bank in a transaction accounted for as a purchase. The total purchase price was $5,236,474 payable at the closing, $1,518,328 in cash and by the issuance of $3,718,146 in 9½% convertible, subordinated capital notes (Note 6). The unallocated excess of the purchase price over the fair value of the net assets acquired of approximately $1,400,000 will be amortized over forty years using the straight-line method.

The 1981 financial statements include the results of operations of Shasta County Bank subsequent to the date of acquisition. The following information reflects the pro forma results of operations for the years ended December 31, 1981 and 1980, as if such acquisition had occurred on January 1, 1980.

	1980	1980
Interest and other income	**$13,521,000**	$10,178,000
Income before securities transactions	**$ 535,000**	$ 234,000
Net income	**$ 284,000**	$ 302,000
Earnings per share:		
Income before securities transactions	**$ .78**	$ .42
Net income	**$ .41**	$ .54

Note 12—Formation of Bank Holding Company

On December 8, 1981, the stockholders of Tri Counties Bank approved a plan of corporate reorganization whereby the Bank will become a wholly owned subsidiary of a newly formed bank holding company, TriCo Bancshares. On the effective date of the reorganization, each share of the Bank's common stock then outstanding will be converted into one share of TriCo Bancshares common stock.

The reorganization will not become effective until all required regulatory approvals and tax rulings have been obtained by the Bank. Management anticipates that such approvals and rulings will be received, and the reorganization consummated in approximately May 1982.

Note 13—Contingent Liabilities and Commitments

The Bank is a defendant in several legal proceedings arising out of the normal conduct of its business. Management of the Bank, based on its review with outside legal counsel of the developments of these matters, is of the opinion that the ultimate aggregate liability, if any, resulting from these pending proceedings will not have a material adverse effect on the Bank's financial position or results of operations.

In the normal course of business, the Bank has various commitments to extend credit under standby letters of credit and lines of credit which are not reflected in the accompanying consolidated financial statements. Letters of credit in the approximate amount of $1,800,000 were outstanding at December 31, 1981.

STOCK PRICES AND DIVIDEND INFORMATION

The following table summarizes dividend information and those trades of the Bank's common stock of which the Bank has knowledge, setting forth the high and low sales prices for the periods indicated. The prices indicated below may not necessarily represent actual transactions. The amounts have been adjusted to reflect the four-for-three stock split effected in February 1980, the 25% stock dividend declared in October 1980, and the 10% stock dividend declared in December 1981.

	Sales Price of the Bank's Common Stock		**Stock Dividends and Splits**
Quarter Ended:	**High**	**Low**	
March 31, 1979	$ 9.08	$ 9.08	
June 30, 1979	9.41	9.41	
September 30, 1979	9.77	9.76	
December 31, 1979	10.09	10.09	
March 31, 1980	13.46	10.19	97,437 shares (four-for-three split)
June 30, 1980	13.64	13.46	
September 30, 1980	16.00	13.46	
December 31, 1980	20.00	16.00	99,939 shares (25% stock dividend)*
March 31, 1981	17.28	17.28	
June 30, 1981	17.28	16.37	
September 30, 1981	17.28	16.82	
December 31, 1981	17.28	15.91	61,975 shares (10% stock dividend)

*Accounted for as a stock split

MANAGEMENT'S DISCUSSION AND ANALYSIS OF SUMMARY OF OPERATIONS

The following is a summary of operations for the five years ended December 31, 1981 and management's discussion and analysis of the significant changes in income and expense accounts presented therein for the most recent two years—each as compared with its respective prior period. This information should be read in conjunction with the financial statements and notes related thereto appearing elsewhere in this Annual Report.

	Year Ended December 31, (Stated in thousands, except per share amounts)				
Interest Income:	**1981**	**1980**	**1979**	**1978**	**1977**
Interest, fees and profits from loans	$ 9,660	$3,443	$2,466	$1,733	$1,085
Interest on investment securities	1,168	643	417	315	260
Interest on time deposits and federal funds sold	101	140	82	87	13
Total interest income	10,929	4,226	2,965	2,135	1,358
Interest Expense:					
Interest on deposits	5,398	2,137	1,193	713	445
Interest on short-term borrowings	182	26	29	13	11
Interest on long-term debt	312	—	—	—	—
Total interest expense	5,892	2,163	1,222	726	456
Net interest income	5,037	2,063	1,743	1,409	902
Provision for loan losses	530	61	78	44	11
Net interest income after provision for loan losses	4,507	2,002	1,665	1,365	891
Other income	967	302	176	141	86
Other expenses:					
Salaries and employee benefits	2,430	1,054	789	595	419
Other operating expenses	2,438	1,052	695	558	371
	4,868	2,106	1,484	1,153	790
Income before provision for income taxes, securities transactions, and extraordinary item	606	198	357	353	187
Provision for income taxes	113	19	142	146	49
Income before securities transactions and extraordinary item	493	179	215	207	138
Securities transactions, less applicable income taxes	42	32	—	(32)	5
Income before extraordinary item	535	211	215	175	143
Extraordinary item - reduction of federal income taxes arising from carryforward of net operating losses	—	—	—	—	9
Net income	$ 535	$ 211	$ 215	$ 175	$ 152
Earnings per share:*					
Primary earnings per share:					
Income before securities transactions	$ .70	$ .32	$ .38	$ .40	$ .47
Securities transactions, less related income taxes	.05	.06	—	(.06)	.02
Extraordinary item	—	—	—	—	.03
Net income	$ .75	$ .38	$ .38	$ .34	$ .52
Earnings per share, assuming full dilution:					
Income before securities transactions	$ .70	$ .32	$ .38	$ .39	$ .47
Securities transactions, less related income taxes	.05	.06	—	(.06)	.02
Extraordinary item	—	—	—	—	.03
Net income	$ .75	$ .38	$ .38	$ .33	$ .52

*Amounts are stated after retroactive adjustments for 45% stock dividend in 1977 (accounted for as a stock split), a 5% stock dividend in 1978, a four-for-three stock split effected in February 1980, a 25% stock dividend in October 1980 (accounted for as a stock split), and a 10% stock dividend in 1981.

General

The changes in income and expense accounts between 1980 and 1981 are partly due to normal bank growth and continued high interest rates but they are largely due to the merger of the six branch Shasta County Bank into Tri Counties Bank. On the date of the merger, loans increased from $28,656,000 to $61,105,000 or 113%, while deposits increased from $33,412,000 to $72,108,000 or 116%. By year end, total interest income has increased 159% over 1980 with total loans increasing 145%. Total interest bearing accounts had risen 112% (excluding NOW accounts) but interest expense had increased 153%. Both the interest income figure and the interest expense figure reflect the high rates experienced during 1981. Total other income rose from $302,000 in 1980 to $967,000 in 1981, an increase of 220%. $300,000 of this increase was attributable to gains on sales of loans through the SBA Real Estate Department. Other expenses increased 131% from 1980 to 1981.

Interest, Fees, and Profits From Loans

Interest fees and profits from loans increased from $2,466,000 in 1979 to $3,443,000 in 1980 to $9,660,000 in 1981 due principally because total net loans increased from $21,686,000 in 1979 to 27,290,000 in 1980 and to $66,869,000 in 1981.

Interest on Investment Securities

Interest on investment securities rose to $1,168,000 in 1981, an increase of 82% from 1980 which increased 54% from 1979. Total investment securities rose from $7,556,000 in 1979 to $8,878,000 in 1980 and to $10,369,000 in 1981.

Interest on Time Deposits and Federal Funds Sold

Interest on time deposits and federal funds sold (excess reserves) decreased to $101,000 in 1981 from $140,000 in 1980 compared to the income figure of $82,000 for 1979. Although interest rates on federal funds continued to be high in 1981, the Bank's loan to deposit ratio was greater than that in 1980, leaving it with less funds to invest on a daily basis.

Interest on Deposits

Interest expense on deposits increased to $5,398,000 in 1981 from $2,137,000 in 1980 and from $1,193,000 in 1979. For the same periods of time, interest bearing deposits increased to $56,435,000 (not including NOW accounts) from $26,580,000 and $19,657,000. Interest expense increased 153% over the 1980 expense which had increased 79% over the 1979 expense figure. Comparatively, interest bearing deposits for 1981 increased 112% (not including NOW accounts) from 1980 while the increase between 1980 and 1979 was 35%. The interest expense reflects the high interest rates in 1981 and the advent of NOW accounts which accounted for $173,000 of the year's expenses.

Interest on Short Term Borrowings

Interest expense on short term borrowings rose from $26,000 in 1980 to $182,000 in 1981 after decreasing 10% between 1979 and 1980. The increase is due to the amount of interest charged the Bank by the Federal Reserve Bank for the use of treasury, tax and loan funds (note option) and is also due in part to the Bank's purchase of federal funds during the year to offset the high loan to deposit ratio.

Interest on Long Term Borrowings

Long term borrowing interest expense for 1981 was $312,000 which was substantially attributable to the convertible capital notes issued in the Shasta County Bank merger. The Bank has had no previous experience with long term debt.

Reserve for Loan Losses
Provision for loan losses increased to $530,000 in 1981 compared to $61,000 in 1980 and $78,000 in 1979. This increase was necessary for two reasons. Number one, at the time of the merger of Shasta County Bank total loans increased 113%. Number two, due to the economic slowdown in 1981, management felt it necessary to maintain a greater loan loss reserve until the economy demonstrates some improvement.

Other Income
Other income increased to $967,000 from $302,000 in 1980 and compared to $176,000 in 1979. $300,000 of this income was the gain on the sale of SBA loans. The remaining $667,000 income which represents a 121% increase over 1980 is attributable to an increased number of checking accounts and service charges.

Salaries and Employee Benefits
Salaries and employee benefits were $789,000 in 1979, increasing to $1,054,000 in 1980 and again increasing to $2,430,000 in 1981. Although this amounts to an increase of 131% from 1980 to 1981, the number of employees doubled at the time of the Bank merger. Overall staffing has been reduced since the merger date but additional key personnel have been necessary due to the increased size of the Bank.

Other Operating Expenses
Other operating expenses include occupancy, equipment, data processing and advertising. The total expense for 1981 was $2,438,000 which was a 132% increase over the 1980 expense of $1,052,000. The 1980 expense has increased 51% from 1979. The 1981 increase can be attributed largely to the merger which required conversion of data processing systems, the occupancy expense of six additional locations and concentrated advertising to promote the merger and our check guarantee card.

Provision for Income Taxes
The effective tax rate for federal and state income taxes was 23.0% in 1981. For the years of 1980 and 1979 the effective tax rate was 20.5% and 39.8%, respectively. The decrease in the effective tax rate for the year 1980 compared to 1979 was due to the use of investment tax credits.

Securities Transactions
Certain securities transactions resulted in a gain in 1981 of $42,000 as compared to $32,000 in 1980 and no gain in 1979. During 1981, management elected to sell certain securities to take advantage of periodically declining interest rates.

Net Income
Net income increased 154% from 1980 to 1981. This high percentage can be attributed to the acquisition of Shasta County Bank and to the increase in loan rates and fees dictated by the 1981 economy. In 1980 compared to 1979, net income declined 1.9%.

Income Per Share
Income per share rose 97% in 1981 and was unchanged from 1979 to 1980. The $.75 per share earnings in 1981 is attributed to the Bank merger which increased the Bank's earning power, but did not increase the Bank's shareholder base.

Administration

Robert H. Steveson	President & Chief Executive Officer
D.V. Carter	Executive Vice President
Joan Jones	Senior Vice President & Cashier
James Mabry	Vice President
Janet K. Hannis	Executive Secretary
Larry Hall	Manager, Data Processing Department
Fred Bryant	Compliance Officer
Fred Drake	Auditor

Financial Reports

The Bank will provide to any interested party, without charge, a copy of the Bank's Annual Report for 1981 on Form F-2 filed with the Federal Deposit Insurance Corporation. The report may be obtained by written request to: Corporate Secretary, Tri Counties Bank, 780 Mangrove Avenue, Chico, CA 95926.

Managers

Park Plaza Branch/Chico
Keith Orme
Manager

Pillsbury Branch/Chico
Jim Burnell
Manager

Durham Office
Gary Jorgenson
Manager

Orland Office
James Cowee
Manager

Willows Office
Carroll Taresh
Manager

Bieber Office
Don Colvin
Manager

Cottonwood Office
John Barker
Manager

Palo Cedro Office
Antoine le Conge
Manager

Fall River Valley Office
Charles Parrott
Manager

Burney Office
Robert Jones
Manager

Redding Office
Ron Bee
Manager
Terry Dobrowsky
SBA Department
Manager

Locations

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& Park Plaza Branch
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Willows, CA 95988
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Burney, CA 96013
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