

COLUMBIA BANKING SYSTEM INC

Form 10-Q

August 07, 2008

---

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 June 30, 2008.

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number 0-20288

---

COLUMBIA BANKING SYSTEM, INC.  
(Exact name of issuer as specified in its charter)

Washington  
(State or other jurisdiction of  
incorporation or organization)

91-1422237  
(I.R.S. Employer  
Identification Number)

1301 "A" Street  
Tacoma, Washington  
(Address of principal executive offices)

98402-2156  
(Zip Code)

(253) 305-1900

Edgar Filing: COLUMBIA BANKING SYSTEM INC - Form 10-Q

(Issuer's telephone number, including area code)

(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, and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

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

Yes ☐ No ☒

The number of shares of common stock outstanding at July 31, 2008 was 18,151,288

---

---

Table of Contents

TABLE OF CONTENTS

|                                           | Page                                                                                                                    |
|-------------------------------------------|-------------------------------------------------------------------------------------------------------------------------|
| <br><u>PART I — FINANCIAL INFORMATION</u> |                                                                                                                         |
| Item 1.                                   | <u>Financial Statements (unaudited)</u>                                                                                 |
|                                           | <u>Consolidated Condensed Statements of Income - three months and six months ended June 30, 2008 and 2007</u> 1         |
|                                           | <u>Consolidated Condensed Balance Sheets – June 30, 2008 and December 31, 2007</u> 2                                    |
|                                           | <u>Consolidated Condensed Statements of Changes in Shareholders' Equity - six months ended June 30, 2008 and 2007</u> 3 |
|                                           | <u>Consolidated Condensed Statements of Cash Flows - six months ended June 30, 2008 and 2007</u> 4                      |
|                                           | <u>Notes to Unaudited Consolidated Condensed Financial Statements</u> 5                                                 |
| Item 2.                                   | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 12                         |
| Item 3.                                   | <u>Quantitative and Qualitative Disclosures about Market Risk</u> 25                                                    |
| Item 4.                                   | <u>Controls and Procedures</u> 25                                                                                       |
| <br><u>PART II — OTHER INFORMATION</u>    |                                                                                                                         |
| Item 1.                                   | <u>Legal Proceedings</u> 26                                                                                             |
| Item 1A.                                  | <u>Risk Factors</u> 26                                                                                                  |
| Item 2.                                   | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 27                                                   |
| Item 3.                                   | <u>Defaults Upon Senior Securities</u> 27                                                                               |
| Item 4.                                   | <u>Submission of Matters to a Vote of Security Holders</u> 28                                                           |
| Item 5.                                   | <u>Other Information</u> 28                                                                                             |
| Item 6.                                   | <u>Exhibits</u> 29                                                                                                      |
|                                           | <u>Signatures</u> 30                                                                                                    |



Table of Contents

## PART I - FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

## CONSOLIDATED CONDENSED STATEMENTS OF INCOME

Columbia Banking System, Inc.  
(Unaudited)

|                                                               | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|---------------------------------------------------------------|--------------------------------|-----------|------------------------------|-----------|
| (in thousands except per share)                               | 2008                           | 2007      | 2008                         | 2007      |
| <b>Interest Income</b>                                        |                                |           |                              |           |
| Loans                                                         | \$ 37,334                      | \$ 36,224 | \$ 78,637                    | \$ 70,254 |
| Taxable securities                                            | 4,895                          | 4,657     | 9,875                        | 9,442     |
| Tax-exempt securities                                         | 1,999                          | 1,960     | 4,000                        | 3,920     |
| Federal funds sold and deposits in banks                      | 95                             | 414       | 244                          | 785       |
| Total interest income                                         | 44,323                         | 43,255    | 92,756                       | 84,401    |
| <b>Interest Expense</b>                                       |                                |           |                              |           |
| Deposits                                                      | 11,461                         | 13,617    | 26,296                       | 25,776    |
| Federal Home Loan Bank advances                               | 1,995                          | 2,484     | 4,577                        | 5,663     |
| Long-term obligations                                         | 429                            | 513       | 916                          | 1,020     |
| Other borrowings                                              | 164                            | 946       | 366                          | 1,544     |
| Total interest expense                                        | 14,049                         | 17,560    | 32,155                       | 34,003    |
| Net Interest Income                                           | 30,274                         | 25,695    | 60,601                       | 50,398    |
| Provision for loan and lease losses                           | 15,350                         | 329       | 17,426                       | 967       |
| Net interest income after provision for loan and lease losses | 14,924                         | 25,366    | 43,175                       | 49,431    |
| <b>Noninterest Income</b>                                     |                                |           |                              |           |
| Service charges and other fees                                | 3,738                          | 3,293     | 7,306                        | 6,252     |
| Merchant services fees                                        | 2,162                          | 2,124     | 4,078                        | 4,093     |
| Redemption of Visa and Mastercard shares                      | 1,066                          | -         | 3,028                        | -         |
| Gain on sale of investment securities, net                    | -                              | -         | 882                          | -         |
| Bank owned life insurance ("BOLI")                            | 549                            | 451       | 1,054                        | 877       |
| Other                                                         | 1,790                          | 873       | 3,114                        | 1,696     |
| Total noninterest income                                      | 9,305                          | 6,741     | 19,462                       | 12,918    |
| <b>Noninterest Expense</b>                                    |                                |           |                              |           |
| Compensation and employee benefits                            | 12,348                         | 10,848    | 25,744                       | 22,206    |
| Occupancy                                                     | 3,199                          | 2,945     | 6,458                        | 5,782     |
| Merchant processing                                           | 904                            | 884       | 1,770                        | 1,707     |
| Advertising and promotion                                     | 637                            | 657       | 1,218                        | 1,204     |
| Data processing                                               | 783                            | 553       | 1,598                        | 1,120     |
| Legal and professional fees                                   | 765                            | 687       | 714                          | 1,510     |
| Taxes, licenses and fees                                      | 796                            | 703       | 1,547                        | 1,316     |
| Net gain on sale of other real estate owned                   | -                              | -         | (23)                         | -         |
| Other                                                         | 3,935                          | 2,989     | 7,895                        | 5,823     |

Edgar Filing: COLUMBIA BANKING SYSTEM INC - Form 10-Q

|                                                              |          |          |           |           |
|--------------------------------------------------------------|----------|----------|-----------|-----------|
| Total noninterest expense                                    | 23,367   | 20,266   | 46,921    | 40,668    |
| Income before income taxes                                   | 862      | 11,841   | 15,716    | 21,681    |
| Provision (benefit) for income taxes                         | (1,074)  | 3,297    | 2,803     | 5,854     |
| Net Income                                                   | \$ 1,936 | \$ 8,544 | \$ 12,913 | \$ 15,827 |
| Net income per common share                                  |          |          |           |           |
| Basic                                                        | \$ 0.11  | \$ 0.53  | \$ 0.72   | \$ 0.98   |
| Diluted                                                      | \$ 0.11  | \$ 0.53  | \$ 0.72   | \$ 0.97   |
| Dividends paid per common share                              | \$ 0.17  | \$ 0.17  | \$ 0.34   | \$ 0.32   |
| Weighted average number of common shares outstanding         | 17,898   | 16,126   | 17,874    | 16,115    |
| Weighted average number of diluted common shares outstanding | 18,021   | 16,258   | 17,998    | 16,261    |

See accompanying notes to unaudited consolidated condensed financial statements.

Table of Contents

## CONSOLIDATED CONDENSED BALANCE SHEETS

Columbia Banking System, Inc.  
(Unaudited)

| (in thousands)                                                                                              | June 30,<br>2008 | December<br>31,<br>2007 |
|-------------------------------------------------------------------------------------------------------------|------------------|-------------------------|
| <b>ASSETS</b>                                                                                               |                  |                         |
| Cash and due from banks                                                                                     | \$ 97,076        | \$ 82,735               |
| Interest-earning deposits with banks                                                                        | 8,552            | 11,240                  |
| Federal funds sold                                                                                          | 10,000           | -                       |
| Total cash and cash equivalents                                                                             | 115,628          | 93,975                  |
| Securities available for sale at fair value<br>(amortized cost of \$554,547 and \$558,685,<br>respectively) | 549,755          | 561,366                 |
| Federal Home Loan Bank stock at cost                                                                        | 17,260           | 11,607                  |
| Loans held for sale                                                                                         | 3,323            | 4,482                   |
| Loans, net of deferred loan fees of (\$3,867) and (\$3,931), respectively                                   | 2,275,719        | 2,282,728               |
| Less: allowance for loan and lease losses                                                                   | 41,724           | 26,599                  |
| Loans, net                                                                                                  | 2,233,995        | 2,256,129               |
| Interest receivable                                                                                         | 12,289           | 14,622                  |
| Premises and equipment, net                                                                                 | 60,558           | 56,122                  |
| Other real estate owned                                                                                     | -                | 181                     |
| Goodwill                                                                                                    | 96,116           | 96,011                  |
| Core deposit intangible, net                                                                                | 6,458            | 7,050                   |
| Other assets                                                                                                | 74,225           | 77,168                  |
| Total Assets                                                                                                | \$ 3,169,607     | \$ 3,178,713            |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                                                 |                  |                         |
| Deposits:                                                                                                   |                  |                         |
| Non-interest bearing                                                                                        | \$ 480,612       | \$ 468,237              |
| Interest-bearing                                                                                            | 1,918,312        | 2,029,824               |
| Total deposits                                                                                              | 2,398,924        | 2,498,061               |
| Short-term borrowings:                                                                                      |                  |                         |
| Federal Home Loan Bank advances                                                                             | 329,000          | 257,670                 |
| Securities sold under agreements to repurchase                                                              | 25,000           | -                       |
| Other borrowings                                                                                            | 5,107            | 5,061                   |
| Total short-term borrowings                                                                                 | 359,107          | 262,731                 |
| Long-term subordinated debt                                                                                 | 25,561           | 25,519                  |
| Other liabilities                                                                                           | 41,745           | 50,671                  |
| Total liabilities                                                                                           | 2,825,337        | 2,836,982               |
| Commitments and contingent liabilities (note 10)                                                            |                  |                         |
| Shareholders' equity:                                                                                       |                  |                         |
| Preferred stock (no par value)                                                                              | -                | -                       |
| Authorized, 2 million shares; none outstanding                                                              |                  |                         |

June 30,                      December  
2008                      31,  
2007                      2007

Edgar Filing: COLUMBIA BANKING SYSTEM INC - Form 10-Q

|                                            |        |        |              |              |
|--------------------------------------------|--------|--------|--------------|--------------|
| Common Stock (no par value)                |        |        |              |              |
| Authorized shares                          | 63,034 | 63,034 |              |              |
| Issued and outstanding                     | 18,111 | 17,953 | 228,826      | 226,550      |
| Retained earnings                          |        |        | 114,810      | 110,169      |
| Accumulated other comprehensive income     |        |        | 634          | 5,012        |
| Total shareholders' equity                 |        |        | 344,270      | 341,731      |
| Total Liabilities and Shareholders' Equity |        |        | \$ 3,169,607 | \$ 3,178,713 |

See accompanying notes to unaudited consolidated condensed financial statements.

Table of Contents

## CONSOLIDATED CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Columbia Banking System, Inc.  
(Unaudited)

|                                                                             | Common Stock        |            | Retained   | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Shareholders' |
|-----------------------------------------------------------------------------|---------------------|------------|------------|-------------------------------------------------|------------------------|
| (in thousands)                                                              | Number of<br>Shares | Amount     | Earnings   | (Loss)                                          | Equity                 |
| Balance at January 1, 2007                                                  | 16,060              | \$ 166,763 | \$ 89,037  | \$ (3,453)                                      | \$ 252,347             |
| Comprehensive income:                                                       |                     |            |            |                                                 |                        |
| Net income                                                                  | -                   | -          | 15,827     | -                                               | 15,827                 |
| Other comprehensive loss, net of tax:                                       |                     |            |            |                                                 |                        |
| Net unrealized loss from securities, net<br>of reclassification adjustments | -                   | -          | -          | (4,063)                                         | (4,063)                |
| Net unrealized loss from cash flow<br>hedging instruments                   | -                   | -          | -          | (813)                                           | (813)                  |
| Total comprehensive income                                                  |                     |            |            |                                                 | 10,951                 |
| Issuance of stock under stock option<br>and other plans                     | 64                  | 986        | -          | -                                               | 986                    |
| Stock award compensation expense                                            | 42                  | 368        | -          | -                                               | 368                    |
| Stock option compensation expense                                           | -                   | 92         | -          | -                                               | 92                     |
| Tax benefit associated with stock-based<br>compensation                     | -                   | 192        | -          | -                                               | 192                    |
| Cash dividends paid on common stock                                         | -                   | -          | (5,163)    | -                                               | (5,163)                |
| Balance at June 30, 2007                                                    | 16,166              | \$ 168,401 | \$ 99,701  | \$ (8,329)                                      | \$ 259,773             |
| Balance at January 1, 2008                                                  | 17,953              | \$ 226,550 | \$ 110,169 | \$ 5,012                                        | \$ 341,731             |
| Cumulative effect of change in<br>accounting principle (note 2)             | -                   | -          | (2,137)    | -                                               | (2,137)                |
| Comprehensive income:                                                       |                     |            |            |                                                 |                        |
| Net income                                                                  | -                   | -          | 12,913     | -                                               | 12,913                 |
| Other comprehensive loss, net of tax:                                       |                     |            |            |                                                 |                        |
| Net unrealized loss from securities, net<br>of reclassification adjustments | -                   | -          | -          | (4,816)                                         | (4,816)                |
| Net unrealized gain from cash flow<br>hedging instruments                   | -                   | -          | -          | 438                                             | 438                    |
| Total comprehensive income                                                  |                     |            |            |                                                 | 8,535                  |
| Issuance of stock under stock option<br>and other plans                     | 93                  | 1,399      | -          | -                                               | 1,399                  |
| Stock award compensation expense                                            | 65                  | 739        | -          | -                                               | 739                    |
| Tax benefit associated with stock-based<br>compensation                     | -                   | 138        | -          | -                                               | 138                    |
| Cash dividends paid on common stock                                         | -                   | -          | (6,135)    | -                                               | (6,135)                |
| Balance at June 30, 2008                                                    | 18,111              | \$ 228,826 | \$ 114,810 | \$ 634                                          | \$ 344,270             |

See accompanying notes to unaudited consolidated condensed financial statements.

Table of Contents

## CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

Columbia Banking System, Inc.  
(Unaudited)

| (in thousands)                                                                     | Six Months Ended June 30, |             |
|------------------------------------------------------------------------------------|---------------------------|-------------|
|                                                                                    | 2008                      | 2007        |
| <b>Cash Flows From Operating Activities</b>                                        |                           |             |
| Net Income                                                                         | \$ 12,913                 | \$ 15,827   |
| Adjustments to reconcile net income to net cash provided by operating activities   |                           |             |
| Provision for loan and lease losses                                                | 17,426                    | 967         |
| Deferred income tax benefit                                                        | (429)                     | (960)       |
| Excess tax benefit from stock-based compensation                                   | (138)                     | (192)       |
| Stock-based compensation expense                                                   | 739                       | 460         |
| Depreciation, amortization and accretion                                           | 3,363                     | 3,043       |
| Net realized gain on sale of securities                                            | (882)                     | -           |
| Net realized gain on sale of other real estate and fixed assets                    | (119)                     | (2)         |
| Net change in:                                                                     |                           |             |
| Loans held for sale                                                                | 1,159                     | (1,618)     |
| Interest receivable                                                                | 2,333                     | (800)       |
| Interest payable                                                                   | (2,184)                   | 1,159       |
| Other assets                                                                       | (1,431)                   | (614)       |
| Other liabilities                                                                  | (7,750)                   | (266)       |
| Net cash provided by operating activities                                          | 25,000                    | 17,004      |
| <b>Cash Flows From Investing Activities</b>                                        |                           |             |
| Purchases of securities available for sale                                         | (76,907)                  | (2,388)     |
| Proceeds from sales of securities available for sale                               | 51,358                    | -           |
| Proceeds from principal repayments and maturities of securities available for sale | 30,105                    | 29,554      |
| Proceeds from maturities of securities held to maturity                            | -                         | 250         |
| Loans originated and acquired, net of principal collected                          | 3,717                     | (150,510)   |
| Purchases of premises and equipment                                                | (7,019)                   | (2,691)     |
| Proceeds from disposal of premises and equipment                                   | 114                       | 196         |
| Purchase of FHLB stock                                                             | (5,653)                   | -           |
| Proceeds from termination of cash flow hedging instruments                         | 8,093                     | -           |
| Proceeds from sales of other real estate and other personal property owned         | 204                       | -           |
| Net cash provided by(used in) investing activities                                 | 4,012                     | (125,589)   |
| <b>Cash Flows From Financing Activities</b>                                        |                           |             |
| Net increase(decrease) in deposits                                                 | (99,137)                  | 93,974      |
| Proceeds from Federal Home Loan Bank advances                                      | 1,491,268                 | 1,635,250   |
| Repayment from Federal Home Loan Bank advances                                     | (1,419,938)               | (1,679,350) |
| Net increase in repurchase agreement borrowings                                    | 25,000                    | 50,000      |
| Net increase(decrease) in other borrowings                                         | 46                        | (149)       |
| Cash dividends paid on common stock                                                | (6,135)                   | (5,163)     |

Edgar Filing: COLUMBIA BANKING SYSTEM INC - Form 10-Q

|                                                    |    |         |    |          |
|----------------------------------------------------|----|---------|----|----------|
| Proceeds from issuance of common stock             |    | 1,399   |    | 986      |
| Excess tax benefit from stock-based compensation   |    | 138     |    | 192      |
| Net cash provided by(used in) financing activities |    | (7,359) |    | 95,740   |
| Increase(decrease) in cash and cash equivalents    |    | 21,653  |    | (12,845) |
| Cash and cash equivalents at beginning of period   |    | 93,975  |    | 104,344  |
| Cash and cash equivalents at end of period         | \$ | 115,628 | \$ | 91,499   |
| Supplemental Information:                          |    |         |    |          |
| Cash paid for interest                             | \$ | 34,339  | \$ | 32,844   |
| Cash paid for income tax                           | \$ | 8,652   | \$ | 6,550    |

See accompanying notes to unaudited consolidated condensed financial statements.

Table of Contents

NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Columbia Banking System, Inc.

1. Basis of Presentation and Significant Accounting Policies

(a) Basis of Presentation

The interim unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for condensed interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain financial information and footnotes have been omitted or condensed. The consolidated condensed financial statements include the accounts of the Company, and its wholly owned banking subsidiary Columbia Bank. All intercompany transactions and accounts have been eliminated in consolidation. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of the results for the interim periods presented have been included. The consolidated financial statements and results of operations presented in this report on Form 10-Q include financial information for Mountain Bank Holding Company and Town Center Bancorp, which were merged into Columbia Bank in the third quarter of 2007. The results of operations for the six months ended June 30, 2008 are not necessarily indicative of results to be anticipated for the year ending December 31, 2008. The accompanying interim unaudited consolidated condensed financial statements should be read in conjunction with the financial statements and related notes contained in the Company's 2007 Annual Report on Form 10-K.

(b) Significant Accounting Policies

The significant accounting policies used in preparation of our consolidated financial statements are disclosed in our 2007 Annual Report on Form 10-K. There have not been any other changes in our significant accounting policies compared to those contained in our 2007 10-K disclosure for the year ended December 31, 2007.

2. Accounting Pronouncements Recently Issued or Adopted

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, The Hierarchy of Generally Accepted Accounting Principles ("SFAS 162"). This statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles ("GAAP") in the United States (the GAAP hierarchy). This Statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. Adoption of SFAS 162 is not expected to have any effect on the Company's financial condition or results of operations.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133 ("SFAS 161"). This Statement requires enhanced disclosures about an entity's derivative and hedging activities and is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company plans to apply the enhanced disclosure provisions of SFAS 161 to all derivative and hedging activities.

On January 1, 2008, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States of America, and expands disclosures about fair value measurement. For further information, see Note 6 of the Notes to Unaudited Consolidated Condensed Financial Statements.

On January 1, 2008, the Company began applying the consensus reached by the Emerging Issues Task Force in Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements ("EITF 06-4"). EITF 06-4 provides recognition guidance regarding liabilities and related compensation costs for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods. The Company recognized the effects of applying the consensus through a change in accounting principle with a cumulative-effect charge to retained earnings of \$2.1 million, net of income taxes of \$1.2 million. During the second quarter of 2008 the Company entered into transactions whereby certain current and former officers of the Company agreed to terminate the split-dollar portion of their bank owned life insurance policies in exchange for individual life insurance policies. In the second quarter of 2008 the Company recognized the net effect of those transactions as a reduction of compensation expense totaling \$107,000.

Table of Contents

## 3. Earnings per share

The following table sets forth the computation of basic and diluted earnings per share for the six months ended June 30, 2008 and 2007 (in thousands, except for per share data):

|                                                                                                  | For The Three Months<br>Ended |           | For The Six Months<br>Ended |           |
|--------------------------------------------------------------------------------------------------|-------------------------------|-----------|-----------------------------|-----------|
| (in thousands except per share)                                                                  | 6/30/2008                     | 6/30/2007 | 6/30/2008                   | 6/30/2007 |
| Net Income                                                                                       | \$ 1,936                      | \$ 8,544  | \$ 12,913                   | \$ 15,827 |
| Weighted average common shares outstanding (for basic calculation)                               | 17,898                        | 16,126    | 17,874                      | 16,115    |
| Dilutive effect of outstanding common stock options and nonvested restricted shares              | 123                           | 132       | 124                         | 146       |
| Weighted average common stock and common equivalent shares outstanding (for diluted calculation) | 18,021                        | 16,258    | 17,998                      | 16,261    |
| Earnings per common share - basic                                                                | \$ 0.11                       | \$ 0.53   | \$ 0.72                     | \$ 0.98   |
| Earnings per common share - diluted                                                              | \$ 0.11                       | \$ 0.53   | \$ 0.72                     | \$ 0.97   |

Potential dilutive shares are excluded from the computation of earnings per share if their effect is anti-dilutive. For the three and six month periods ended June 30, 2008, there were 36,981 anti-dilutive shares outstanding related to options to acquire common stock. There were no anti-dilutive shares outstanding related to options to acquire common stock for the same periods last year.

## 4. Dividends

On January 24, 2008, the Company declared a quarterly cash dividend of \$0.17 per share, payable on February 20, 2008 to shareholders of record as of the close of business on February 6, 2008. On April 24, 2008, the Company declared a quarterly cash dividend of \$0.17 per share, payable on May 21, 2008, to shareholders of record at the close of business May 7, 2008. Subsequent to quarter end, on July 24, 2008, the Company declared a quarterly cash dividend of \$0.17 per share, payable on August 20, 2008, to shareholders of record at the close of business August 6, 2008. The payment of cash dividends is subject to Federal regulatory requirements for capital levels and other restrictions. In addition, the cash dividends paid by Columbia Bank to the Company are subject to both Federal and State regulatory requirements.

## 5. Business Segment Information

The Company is managed along two major lines of business: commercial banking and retail banking. The treasury function of the Company, included in the "Other" category, although not considered a line of business, is responsible for the management of investments and interest rate risk. In addition, the provision for loan and lease losses is included in the "Other" category. On April 1, 2008, the Bank of Astoria banking subsidiary was merged into the Columbia Bank banking subsidiary. This change in internal organizational structure also changes the composition of the Company's reportable segments. Accordingly, segment results for the Bank of Astoria are now included in the Retail Banking segment. Prior period segment reporting has been restated to reflect this change.

The Company generates segment results that include balances directly attributable to business line activities. The financial results of each segment are derived from the Company's general ledger system. Overhead, including sales and back office support functions and other indirect expenses are not allocated to the major lines of business. Goodwill resulting from business combinations is included in the Retail Banking segment. Since the Company is not

specifically organized around lines of business, most reportable segments comprise more than one operating activity.

The principal activities conducted by commercial banking are the origination of commercial business relationships, private banking services and real estate lending. Retail banking includes all deposit products, with their related fee income, and all consumer loan products as well as commercial loan products offered in the Company's branch offices.

Effective January 1, 2008 the Company implemented a more robust internal funds transfer pricing methodology. Internal funds transfer pricing refers to the process we utilize to give an earnings credit to a branch or revenue center for the deposit funds they generate while providing an earnings charge to the centers that use deposit funds to make loans. The implementation of this methodology changed the basis of measurement for segment net interest income as presented in the tables below. Generally, this methodology had the effect of increasing net interest income for the commercial banking segment with a corresponding decrease in net interest income for the retail banking segment. The increase in net interest

Table of Contents

income for the commercial banking segment is driven primarily by the earnings credit for deposit funds generated within that segment. In prior years, the retail banking segment benefited from the earnings credit for deposit funds generated by the commercial banking segment. Segment net interest income after provision for loan and lease losses for the current quarter is not directly comparable to the same line item in the first quarter of last year as the prior quarter cannot practicably be restated.

The organizational structure of the Company and its business line financial results are not necessarily comparable with information from other financial institutions. Financial highlights by lines of business are as follows:

## Condensed Statements of Income:

| Three Months Ended June 30, 2008                              |                       |                   |            |              |
|---------------------------------------------------------------|-----------------------|-------------------|------------|--------------|
| (in thousands)                                                | Commercial<br>Banking | Retail<br>Banking | Other      | Total        |
| Net interest income                                           | \$ 13,088             | \$ 14,556         | \$ 2,630   | \$ 30,274    |
| Provision for loan and lease losses                           |                       |                   | (15,350)   | (15,350)     |
| Net interest income after provision for loan and lease losses | 13,088                | 14,556            | (12,720)   | 14,924       |
| Noninterest income                                            | 829                   | 2,321             | 6,155      | 9,305        |
| Noninterest expense                                           | (3,271)               | (7,901)           | (12,195)   | (23,367)     |
| Income (loss) before income taxes                             | 10,646                | 8,976             | (18,760)   | 862          |
| Income tax benefit                                            |                       |                   |            | 1,074        |
| Net income                                                    |                       |                   |            | \$ 1,936     |
| Total assets                                                  | \$ 1,460,556          | \$ 1,057,061      | \$ 651,990 | \$ 3,169,607 |

| Three Months Ended June 30, 2007                              |                       |                   |            |              |
|---------------------------------------------------------------|-----------------------|-------------------|------------|--------------|
| (in thousands)                                                | Commercial<br>Banking | Retail<br>Banking | Other      | Total        |
| Net interest income                                           | \$ 6,947              | \$ 19,043         | \$ (295)   | \$ 25,695    |
| Provision for loan and lease losses                           |                       |                   | (329)      | (329)        |
| Net interest income after provision for loan and lease losses | 6,947                 | 19,043            | (624)      | 25,366       |
| Noninterest income                                            | 725                   | 2,023             | 3,993      | 6,741        |
| Noninterest expense                                           | (2,575)               | (6,553)           | (11,138)   | (20,266)     |
| Income (loss) before income taxes                             | 5,097                 | 14,513            | (7,769)    | 11,841       |
| Income tax provision                                          |                       |                   |            | (3,297)      |
| Net income                                                    |                       |                   |            | \$ 8,544     |
| Total assets                                                  | \$ 1,354,301          | \$ 667,325        | \$ 639,320 | \$ 2,660,946 |

Table of Contents

|                                                                  | Six Months Ended June 30, 2008 |                   |            |              |
|------------------------------------------------------------------|--------------------------------|-------------------|------------|--------------|
| (in thousands)                                                   | Commercial<br>Banking          | Retail<br>Banking | Other      | Total        |
| Net interest income                                              | \$ 26,720                      | \$ 30,607         | \$ 3,274   | \$ 60,601    |
| Provision for loan and lease losses                              |                                |                   | (17,426)   | (17,426)     |
| Net interest income after provision for loan and<br>lease losses | 26,720                         | 30,607            | (14,152)   | 43,175       |
| Noninterest income                                               | 2,002                          | 4,565             | 12,895     | 19,462       |
| Noninterest expense                                              | (5,967)                        | (17,099)          | (23,855)   | (46,921)     |
| Income (loss) before income taxes                                | 22,755                         | 18,073            | (25,112)   | 15,716       |
| Income tax provision                                             |                                |                   |            | (2,803)      |
| Net income                                                       |                                |                   |            | \$ 12,913    |
| Total assets                                                     | \$ 1,460,556                   | \$ 1,057,061      | \$ 651,990 | \$ 3,169,607 |

|                                                                  | Six Months Ended June 30, 2007 |                   |            |              |
|------------------------------------------------------------------|--------------------------------|-------------------|------------|--------------|
| (in thousands)                                                   | Commercial<br>Banking          | Retail<br>Banking | Other      | Total        |
| Net interest income                                              | \$ 13,403                      | \$ 37,782         | \$ (787)   | \$ 50,398    |
| Provision for loan and lease losses                              |                                |                   | (967)      | (967)        |
| Net interest income after provision for loan and<br>lease losses | 13,403                         | 37,782            | (1,754)    | 49,431       |
| Noninterest income                                               | 1,360                          | 3,895             | 7,663      | 12,918       |
| Noninterest expense                                              | (5,378)                        | (12,759)          | (22,531)   | (40,668)     |
| Income (loss) before income taxes                                | 9,385                          | 28,918            | (16,622)   | 21,681       |
| Income tax provision                                             |                                |                   |            | (5,854)      |
| Net income                                                       |                                |                   |            | \$ 15,827    |
| Total assets                                                     | \$ 1,354,301                   | \$ 667,325        | \$ 639,320 | \$ 2,660,946 |

Table of Contents

## 6. Fair Value Accounting and Measurement

SFAS 157 defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value. We hold fixed and variable rate interest bearing securities, investments in marketable equity securities and certain other financial instruments, which are carried at fair value. Fair value is determined based upon quoted prices when available or through the use of alternative approaches, such as matrix or model pricing, when market quotes are not readily accessible or available.

The valuation techniques are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our own market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1 – Quoted prices for identical instruments in active markets that are accessible at the measurement date

Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 – Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable.

Fair values are determined as follows:

Certain preferred stock securities at fair value are priced using quoted prices for identical instruments in active markets and are classified within level 1 of the valuation hierarchy.

Other securities at fair value are priced using matrix pricing based on the securities' relationship to other benchmark quoted prices, and under the provisions of SFAS 157 are considered a Level 2 input method.

Interest rate swap positions are valued in models, which use as their basis, readily observable market parameters and are classified within level 2 of the valuation hierarchy

The following table sets forth the Company's financial assets and liabilities that were accounted for at fair values as of June 30, 2008 by level within the fair value hierarchy. As required by SFAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

|                               |                  | Fair Value Measurements at Reporting Date                                        |                                                           |                                                    |
|-------------------------------|------------------|----------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                               |                  | Using                                                                            |                                                           |                                                    |
|                               |                  | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs (Level<br>2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| (in thousands)                | June 30,<br>2008 |                                                                                  |                                                           |                                                    |
| <b>Assets</b>                 |                  |                                                                                  |                                                           |                                                    |
| Securities available for sale | \$ 549,755       | \$ 20,238                                                                        | \$ 529,517                                                | \$ -                                               |
| Interest rate swap agreements | \$ 3,151         | \$ -                                                                             | \$ 3,151                                                  | \$ -                                               |

Liabilities

|                               |    |       |    |   |    |       |    |   |
|-------------------------------|----|-------|----|---|----|-------|----|---|
| Interest rate swap agreements | \$ | 3,151 | \$ | - | \$ | 3,151 | \$ | - |
|-------------------------------|----|-------|----|---|----|-------|----|---|

Table of Contents

## 7. Comprehensive Income (Loss)

The components of comprehensive income (loss) are as follows:

| (in thousands)                                                                                                                         | Three Months Ended<br>June 30, |          |
|----------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|----------|
|                                                                                                                                        | 2008                           | 2007     |
| Net income as reported                                                                                                                 | \$ 1,936                       | \$ 8,544 |
| Unrealized loss from securities:                                                                                                       |                                |          |
| Net unrealized holding loss from available for sale securities arising during the period, net of tax of \$3,712 and \$3,782            | (6,737)                        | (6,851)  |
| Reclassification adjustment of net (gain)loss from sale of available for sale securities included in income, net of tax of \$0 and \$0 | -                              | -        |
| Net unrealized loss from securities, net of reclassification adjustment                                                                | (6,737)                        | (6,851)  |
| Unrealized loss from cash flow hedging instruments:                                                                                    |                                |          |
| Net unrealized loss from cash flow hedging instruments arising during the period, net of tax of \$0 and \$480                          | -                              | (881)    |
| Reclassification adjustment of net (gain)loss included in income, net of tax of \$124 and \$(5)                                        | (225)                          | 10       |
| Net unrealized loss from cash flow hedging instruments                                                                                 | (225)                          | (871)    |
| Total comprehensive income (loss)                                                                                                      | \$ (5,026)                     | \$ 822   |

| (in thousands)                                                                                                                     | Six Months Ended<br>June 30, |           |
|------------------------------------------------------------------------------------------------------------------------------------|------------------------------|-----------|
|                                                                                                                                    | 2008                         | 2007      |
| Net income as reported                                                                                                             | \$ 12,913                    | \$ 15,827 |
| Unrealized loss from securities:                                                                                                   |                              |           |
| Net unrealized holding loss from available for sale securities arising during the period, net of tax of \$2,345 and \$2,267        | (4,245)                      | (4,063)   |
| Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of \$311 and \$0 | (571)                        | -         |
| Net unrealized loss from securities, net of reclassification adjustment                                                            | (4,816)                      | (4,063)   |
| Unrealized gain(loss) from cash flow hedging instruments:                                                                          |                              |           |
| Net unrealized gain(loss) from cash flow hedging instruments arising during the period, net of tax of \$(425) and \$451            | 739                          | (826)     |
| Reclassification adjustment of net (gain)loss included in income, net of tax of \$166 and \$(7)                                    | (301)                        | 13        |
| Net unrealized gain(loss) from cash flow hedging instruments                                                                       | 438                          | (813)     |
| Total comprehensive income                                                                                                         | \$ 8,535                     | \$ 10,951 |

## 8. Allowance for Loan and Lease Losses and Unfunded Loan Commitments and Letters of Credit

The following table presents activity in the allowance for loan and lease losses for the three and six months ended June 30, 2008 and 2007:

Edgar Filing: COLUMBIA BANKING SYSTEM INC - Form 10-Q

| (in thousands)               | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|------------------------------|--------------------------------|-----------|------------------------------|-----------|
|                              | 2008                           | 2007      | 2008                         | 2007      |
| Beginning balance            | \$ 27,914                      | \$ 20,819 | \$ 26,599                    | \$ 20,182 |
| Provision charged to expense | 15,350                         | 329       | 17,426                       | 967       |
| Loans charged off            | (1,688)                        | (175)     | (2,903)                      | (326)     |
| Recoveries                   | 148                            | 366       | 602                          | 516       |
| Ending balance               | \$ 41,724                      | \$ 21,339 | \$ 41,724                    | \$ 21,339 |

Table of Contents

Changes in the allowance for unfunded loan commitments and letters of credit are summarized as follows:

| (in thousands)                                                              | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |        |
|-----------------------------------------------------------------------------|--------------------------------|--------|------------------------------|--------|
|                                                                             | 2008                           | 2007   | 2008                         | 2007   |
| Beginning balance                                                           | \$ 349                         | \$ 339 | \$ 349                       | \$ 339 |
| Net changes in the allowance for unfunded commitments and letters of credit | 110                            | -      | 110                          | -      |
| Ending balance                                                              | \$ 459                         | \$ 339 | \$ 459                       | \$ 339 |

## 9. Goodwill and Intangible Assets

The Company had \$96 million in goodwill at June 30, 2008 and December 31, 2007. At June 30, 2008 and December 31, 2007, the Company had a core deposit intangible (“CDI”) asset of \$6.5 million and \$7.1 million, respectively. In accordance with SFAS No. 142, “Goodwill and Other Intangible Assets”, goodwill is not amortized but is reviewed for potential impairment at the reporting unit level during the third quarter on an annual basis and between annual tests if events or circumstances indicate a potential impairment. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. The CDI is evaluated for impairment if events and circumstances indicate a possible impairment. The CDI is amortized on an accelerated basis over an estimated life of approximately 10 years. Amortization expense related to the CDI was \$296,000 and \$96,000 for the three months ended June 30, 2008 and June 30, 2007 and \$592,000 and \$192,000 for the six months ended June 30, 2008 and June 30, 2007, respectively. The CDI amortization expense is included in other noninterest expense on the consolidated condensed statements of income.

## 10. Commitments and Contingent Liabilities

On March 18, 2008 Visa, Inc. (“Visa”) completed its initial public offering (“IPO”). On March 31, 2008 Visa funded a litigation escrow account with \$3.0 billion from the IPO proceeds. Based on the Company’s Visa USA membership percentage, the expected economic benefit to the Company from this escrow account is \$889,200. Accordingly, the Company recognized a recapture of previously accrued legal expense of \$889,200. This recapture is included in the legal and professional services line item of the consolidated condensed statements of income and is a reduction of the \$1.8 million Visa litigation liability the Company accrued during the fourth quarter of 2007. The Company’s remaining Visa litigation reserve of approximately \$888,000, which is included in other liabilities on the consolidated condensed balance sheets, will be subject to ongoing review and adjusted accordingly as information on Visa’s litigation matters emerges.

## Table of Contents

### Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion should be read in conjunction with the unaudited consolidated condensed financial statements of Columbia Banking System, Inc. (referred to in this report as "we", "our", and "the Company") and notes thereto presented elsewhere in this report and with the December 31, 2007 audited consolidated financial statements and its accompanying notes included in our recent Annual Report on Form 10-K. In the following discussion, unless otherwise noted, references to increases or decreases in average balances in items of income and expense for a particular period and balances at a particular date refer to the comparison with corresponding amounts for the period or date one year earlier.

#### NOTE REGARDING FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q may be deemed to include forward looking statements, which management believes to be a benefit to shareholders. These forward looking statements describe management's expectations regarding future events and developments such as future operating results, growth in loans and deposits, continued success of our style of banking and the strength of the local economy. The words "will," "believe," "expect," "should," and "anticipate" and words of similar construction are intended in part to help identify forward looking statements. Future events are difficult to predict, and the expectations described above are necessarily subject to risk and uncertainty that may cause actual results to differ materially and adversely. In addition to discussions about risks and uncertainties set forth from time to time in our filings with the SEC, factors that may cause actual results to differ materially from those contemplated by such forward looking statements include, among others, the following possibilities: (1) local and national economic conditions are less favorable than expected or have a more direct and pronounced effect on us than expected and adversely affect our ability to continue internal growth at historical rates and maintain the quality of our earning assets; (2) a continued decline in the housing/real estate market; (3) changes in interest rates significantly reduce interest margins and negatively affect funding sources; (4) deterioration of credit quality that could, among other things, increase defaults and delinquency risks in the Company's loan portfolios (5) projected business increases following strategic expansion activities are lower than expected; (6) competitive pressure among financial institutions increases significantly; (7) legislation or regulatory requirements or changes adversely affect the businesses in which we are engaged; and (8) our ability to realize the efficiencies we expect to receive from our investments in personnel, acquisitions and infrastructure.

#### CRITICAL ACCOUNTING POLICIES

Management has identified the accounting policies related to the allowance for loan and lease losses as critical to an understanding of our financial statements. These policies and related estimates are discussed in "Item 7. Management Discussion and Analysis of Financial Condition and Results of Operation" under the heading "Allowance for Loan and Lease Losses and Unfunded Loan Commitments and Letters of Credit" in our 2007 Annual Report on Form 10-K. There have not been any material changes in our critical accounting policies relating to the allowance for loan and lease losses as compared to those disclosed in our 2007 Annual Report on Form 10-K.

#### OVERVIEW

Note: The second quarter and first six months of 2007 financial information does not include the results of Mountain Bank Holding Company and Town Center Bancorp, which were both acquired on July 23, 2007.

#### Earnings Summary

The Company reported net income for the second quarter of \$1.9 million or \$.11 per diluted share, compared to \$8.5 million or \$.53 per diluted share for the second quarter of 2007. Return on average assets and return on average equity were 0.24% and 2.19%, respectively, for the second quarter of 2008, compared with returns of 1.29% and 13.04%, respectively for the same period of 2007. The Company's results for the second quarter of 2008 declined from the same period in 2007, as a result of a provision for loan and lease losses of \$15.4 million as discussed below. The results of the second quarter of 2008 reflect the financial consolidation of Mountain Bank Holding Company and Town Center Bancorp, which were both acquired on July 23, 2007; accordingly, the financial information for the second quarter of 2007 does not include the results of the two organizations.

The Company reported net income of \$12.9 million for the first six months of 2008 or \$.72 per diluted share, compared with \$15.8 million or \$.97 per diluted share for the first six months of 2007. Return on average assets and return on average equity were .82% and 7.37%, respectively, for the first six months of 2008, compared with returns of 1.22% and 12.29%, respectively for the first six months of 2007. As stated above, the Company's results for the first six months of 2008 declined from the same period in 2007, as a result of a provision for loan and lease losses of \$17.4 million as discussed

## Table of Contents

below. The results of the first six months reflect the financial consolidation of Mountain Bank Holding Company and Town Center Bancorp, which were both acquired on July 23, 2007; accordingly, the financial information for the first six months of 2007 does not include the results of the two organizations.

Revenue (net interest income plus noninterest income) for the three months ended June 30, 2008 was \$39.6 million, or 22%, higher than the same period in 2007. The increase reflected a 38% increase in noninterest income driven primarily by proceeds from the redemption of MasterCard International shares totaling \$1.1 million, increased service charges and other fees, and the receipt of life insurance proceeds received in connection with the death of a former officer covered by a bank owned life insurance policy. Net interest income increased 18% from the prior year driven primarily by growth in earning assets. Excluding the \$1.1 million gain arising from the redemption of the MasterCard shares, revenue was \$38.5 million, or 19%, higher than the same period last year.

Revenue (net interest income plus noninterest income) for the first six months of 2008 was \$80.1 million, or 26%, higher than the first six months of 2007, reflecting a 51% increase in noninterest income driven primarily by gains on the sale of investment securities, proceeds from the redemption of Visa and MasterCard shares and increased service charges and other fees. Net interest income increased 20% from the prior year driven primarily by growth in earning assets. Excluding the \$882,000 gain arising from the sale of investment securities and the \$3.0 million gain from the Visa and MasterCard's IPO, revenue was \$76.2 million, or 20%, higher than the same period last year.

Total noninterest expense in the quarter ended June 30, 2008 was \$23.4 million, or 15%, higher than in the second quarter of 2007, principally due to higher compensation costs and other expenses. The higher compensation costs and other expenses were driven in part by the 2007 acquisitions and the expansion of the retail branch and professional lending team.

Total noninterest expense in the first six months of 2008 was \$46.9 million, or 15%, higher than in the first six months of 2007, principally due to higher operating costs from investments in personnel, branches and data processing. These increases were mitigated by a partial reversal, totaling \$889,000, of legal expenses related to certain Visa litigation previously accrued in the fourth quarter of 2007.

The provision for loan and lease losses for the second quarter of 2008 was \$15.4 million compared with \$329,000 for the second quarter of 2007. The additional provision is due to the weakness in the for-sale housing industry resulting from the slowing economic environment and non-accrual loans increasing to \$71.7 million at June 30, 2008 compared to \$14.0 million at December 31, 2007 and \$14.4 million at March 31, 2008. The provision increased the Company's total allowance for loan and lease losses to 1.83% of net loans at June 30, 2008. Net charge-offs for the current quarter were \$1.5 million compared to net recoveries of \$191,000 for the second quarter of 2007.

The provision for loan and lease losses for the first six months of 2008 was \$17.4 million compared with \$967,000 for the first six months of 2007. Net charge-offs for the first six months of 2008 were \$2.3 million as compared with net recoveries of \$190,000 for the first six months of 2007.

## RESULTS OF OPERATIONS

Our results of operations are dependent to a large degree on our net interest income. We also generate noninterest income through service charges and fees, merchant services fees, and bank owned life insurance. Our operating expenses consist primarily of compensation and employee benefits, occupancy, merchant card processing, data processing and legal and professional fees. Like most financial institutions, our interest income and cost of funds are affected significantly by general economic conditions, particularly changes in market interest rates, and by government policies and actions of regulatory authorities.

Note: The first six months of 2007 financial information does not include the results of Mountain Bank Holding Company and Town Center Bancorp, which were both acquired on July 23, 2007.

#### Net Interest Income

For the three months ended June 30, 2008 we experienced a slight increase in our net interest margin when compared to the same period in 2007. This increase resulted primarily from decreased funding costs. For the second quarter of 2008 interest income increased 2% while interest expense decreased 20%, when compared to the same period in 2007. The increase in interest income for the period is primarily due to increased loan volume whereas the decrease in interest expense

Table of Contents

is primarily due to rate decreases on interest bearing deposits and borrowed funds. For the six months ended June 30, 2008 interest income increased 10% over the same period in 2007 whereas interest expense decreased 5%. Similar to the quarterly results, the increase in interest income in the first half of the year was driven primarily by loan growth and the decrease in interest expense driven by rate decreases on interest bearing deposits and borrowed funds.

The following tables set forth the average balances of all major categories of interest-earning assets and interest-bearing liabilities, the total dollar amounts of interest income on interest-earning assets and interest expense on interest-bearing liabilities, the average yield earned on interest-earning assets and average rate paid on interest-bearing liabilities by category and in total, net interest income and net interest margin.

|                                                             | Three months ending June 30,<br>2008 |                              |                 | Three months ending June 30,<br>2007 |                              |                 |
|-------------------------------------------------------------|--------------------------------------|------------------------------|-----------------|--------------------------------------|------------------------------|-----------------|
| (in thousands)                                              | Average<br>Balances (1)              | Interest<br>Earned /<br>Paid | Average<br>Rate | Average<br>Balances (1)              | Interest<br>Earned /<br>Paid | Average<br>Rate |
| <b>ASSETS</b>                                               |                                      |                              |                 |                                      |                              |                 |
| Loans, net (2)                                              | \$ 2,297,661                         | \$ 37,437                    | 6.55%           | \$ 1,846,163                         | \$ 36,224                    | 7.87%           |
| Securities (2)                                              | 584,780                              | 8,172                        | 5.62%           | 582,378                              | 7,692                        | 5.30%           |
| Interest-earning deposits with banks and federal funds sold | 20,008                               | 95                           | 1.91%           | 32,062                               | 414                          | 5.18%           |
| Total interest-earning assets                               | 2,902,449                            | \$ 45,704                    | 6.33%           | 2,460,603                            | \$ 44,330                    | 7.23%           |
| Other earning assets                                        | 47,780                               |                              |                 | 39,196                               |                              |                 |
| Noninterest-earning assets                                  | 232,648                              |                              |                 | 155,064                              |                              |                 |
| Total assets                                                | \$ 3,182,877                         |                              |                 | \$ 2,654,863                         |                              |                 |
| <b>LIABILITIES AND<br/>SHAREHOLDERS' EQUITY</b>             |                                      |                              |                 |                                      |                              |                 |
| Certificates of deposit                                     | \$ 798,844                           | \$ 7,369                     | 3.71%           | \$ 604,307                           | \$ 6,613                     | 4.39%           |
| Savings accounts                                            | 115,889                              | 103                          | 0.36%           | 105,089                              | 109                          | 0.42%           |
| Interest-bearing demand and money market accounts           | 1,035,391                            | 3,989                        | 1.55%           | 960,729                              | 6,894                        | 2.88%           |
| Total interest-bearing deposits                             | 1,950,124                            | 11,461                       | 2.36%           | 1,670,125                            | 13,616                       | 3.27%           |
| Federal Home Loan Bank advances                             | 313,763                              | 1,995                        | 2.56%           | 180,952                              | 2,485                        | 5.51%           |
| Securities sold under agreements to repurchase              | 25,000                               | 118                          | 1.89%           | 70,000                               | 945                          | 5.41%           |
| Other borrowings and interest-bearing liabilities           | 5,122                                | 46                           | 3.64%           | 263                                  | 2                            | 2.60%           |
| Long-term subordinated debt                                 | 25,547                               | 429                          | 6.76%           | 22,401                               | 512                          | 9.17%           |
| Total interest-bearing liabilities                          | 2,319,556                            | \$ 14,049                    | 2.44%           | 1,943,741                            | \$ 17,560                    | 3.62%           |
| Noninterest-bearing deposits                                | 463,101                              |                              |                 | 420,148                              |                              |                 |
| Other noninterest-bearing liabilities                       | 45,361                               |                              |                 | 28,069                               |                              |                 |
| Shareholders' equity                                        | 354,859                              |                              |                 | 262,905                              |                              |                 |
| Total liabilities & shareholders' equity                    | \$ 3,182,877                         |                              |                 | \$ 2,654,863                         |                              |                 |
| Net interest income (2)                                     |                                      | \$ 31,655                    |                 |                                      | \$ 26,770                    |                 |

|                     |       |       |
|---------------------|-------|-------|
| Net interest margin | 4.39% | 4.36% |
|---------------------|-------|-------|

(1) Nonaccrual loans have been included in the tables as loans carrying a zero yield. Interest reversals for the second quarter ended June 30, 2008 related to nonaccrual loans totaled \$335,000. Excluding the impact of interest reversals, net interest margin for the quarter would have been 4.43%. Amortized net deferred loan fees were included in the interest income calculations. The amortization of net deferred loan fees was \$984,000 and \$706,000 for the three months ended June 30, 2008 and 2007, respectively.

(2) Tax-exempt income is calculated on a tax equivalent basis, based on a marginal tax rate of 35%.

Table of Contents

| (in thousands)                                                 | Six months ending June 30,<br>2008 |                             |                 | Six months ending June 30,<br>2007 |                             |                 |
|----------------------------------------------------------------|------------------------------------|-----------------------------|-----------------|------------------------------------|-----------------------------|-----------------|
|                                                                | Average<br>Balances (1)            | Interest<br>Earned/<br>Paid | Average<br>Rate | Average<br>Balances (1)            | Interest<br>Earned/<br>Paid | Average<br>Rate |
| <b>ASSETS</b>                                                  |                                    |                             |                 |                                    |                             |                 |
| Loans, net (2)                                                 | \$ 2,301,125                       | \$ 78,825                   | 6.89%           | \$ 1,806,150                       | \$ 70,254                   | 7.84%           |
| Securities (2)                                                 | 583,418                            | 16,472                      | 5.68%           | 590,122                            | 15,512                      | 5.30%           |
| Interest-earning deposits with banks and<br>federal funds sold | 19,767                             | 244                         | 2.48%           | 30,404                             | 785                         | 5.20%           |
| Total interest-earning assets                                  | 2,904,310                          | \$ 95,541                   | 6.62%           | 2,426,676                          | \$ 86,551                   | 7.19%           |
| Other earning assets                                           | 47,470                             |                             |                 | 38,987                             |                             |                 |
| Noninterest-earning assets                                     | 232,665                            |                             |                 | 154,971                            |                             |                 |
| Total assets                                                   | \$ 3,184,445                       |                             |                 | \$ 2,620,634                       |                             |                 |
| <b>LIABILITIES AND<br/>SHAREHOLDERS' EQUITY</b>                |                                    |                             |                 |                                    |                             |                 |
| Certificates of deposit                                        | \$ 821,845                         | \$ 16,457                   | 4.03%           | \$ 580,748                         | \$ 12,454                   | 4.32%           |
| Savings accounts                                               | 115,378                            | 217                         | 0.38%           | 107,139                            | 218                         | 0.41%           |
| Interest-bearing demand and money<br>market accounts           | 1,039,886                          | 9,622                       | 1.86%           | 941,178                            | 13,103                      | 2.81%           |
| Total interest-bearing deposits                                | 1,977,109                          | 26,296                      | 2.67%           | 1,629,065                          | 25,775                      | 3.19%           |
| Federal Home Loan Bank advances                                | 298,908                            | 4,577                       | 3.08%           | 206,953                            | 5,664                       | 5.52%           |
| Securities sold under agreements to<br>repurchase              | 22,115                             | 260                         | 2.36%           | 57,293                             | 1,540                       | 5.42%           |
| Other borrowings and interest-bearing<br>liabilities           | 5,188                              | 106                         | 4.11%           | 308                                | 4                           | 2.62%           |
| Long-term subordinated debt                                    | 25,537                             | 916                         | 7.21%           | 22,392                             | 1,020                       | 9.18%           |
| Total interest-bearing liabilities                             | 2,328,857                          | \$ 32,155                   | 2.78%           | 1,916,011                          | \$ 34,003                   | 3.58%           |
| Noninterest-bearing deposits                                   | 457,099                            |                             |                 | 416,886                            |                             |                 |
| Other noninterest-bearing liabilities                          | 45,906                             |                             |                 | 28,120                             |                             |                 |
| Shareholders' equity                                           | 352,583                            |                             |                 | 259,617                            |                             |                 |
| Total liabilities & shareholders' equity                       | \$ 3,184,445                       |                             |                 | \$ 2,620,634                       |                             |                 |
| Net interest income (2)                                        |                                    | \$ 63,386                   |                 |                                    | \$ 52,548                   |                 |
| Net interest margin                                            |                                    |                             | 4.39%           |                                    |                             | 4.37%           |

(1) Nonaccrual loans have been included in the tables as loans carrying a zero yield. Interest reversals for the six months ended June 30, 2008 related to nonaccrual loans totaled \$418,000. Excluding the impact of interest reversals, net interest margin for the six month period would have been 4.42%. Amortized net deferred loan fees were included in the interest income calculations. The amortization of net deferred loan fees was \$2.1 million and \$1.3 million for the six months ended June 30, 2008 and 2007, respectively.

(2) Tax-exempt income is calculated on a tax equivalent basis, based on a marginal tax rate of 35%.

Provision for Loan and Lease Losses

During the second quarter of 2008, the Company allocated \$15.4 million to its provision for loan and lease losses, compared to \$329,000 for the same period in 2007. For the six months ended June 30, 2008, the Company allocated \$17.4 million to its provision for loan and lease losses, compared to \$967,000 for the first half of 2007. The additional provision is due to the weakness in the for-sale housing industry resulting from the slowing economic environment and an increase in non-accrual loans. The increased provision will increase the Company's total allowance for loan losses to 1.83% of net loans at June 30, 2008. See the discussion under "Nonperforming Assets" for details related to the non-accrual loans.

Table of Contents

Noninterest Income

Noninterest income increased \$2.6 million, or 38%, to \$9.3 million for the second quarter of 2008 from \$6.7 million for the second quarter of 2007. The increase in noninterest income is primarily due to pre-tax income of \$1.1 million from the redemption of shares of MasterCard International shares obtained in connection with its 2006 initial public offering and \$612,364 of pre-tax income from the receipt of insurance proceeds from the death of a former officer covered by BOLI. In addition, service charges and other fees increased \$445,000, or 14%, during the second quarter of 2008 as compared to the same period in 2007. This increase is the result of a change in the Company's deposit account fee structure in conjunction with an increase in the number of deposit accounts, primarily due to the third quarter 2007 acquisitions.

For the six months ended June 30, 2008, noninterest income increased \$6.5 million, or 51%, compared to the same period in 2007. The increase in noninterest income is primarily due to the gain on the redemption of Visa and MasterCard shares of \$3.0 million and a gain on the sale of investment securities of \$882,000. In addition, service charges and other fees increased \$1.1 million, or 17% during the first six months of 2008 as compared to the same period in 2007 reflecting a change in our deposit account fee structure in conjunction with an increase in the number of deposit accounts.

Noninterest Expense

Total noninterest expense increased \$3.1 million, or 15%, for the second quarter of 2008 from \$20.3 million for the second quarter of 2007. This increase is primarily a result of increased salary expense as a result of the third quarter 2007 acquisitions and the expansion of the retail branch and professional lending teams. Regulatory premiums in the current quarter increased \$328,000 from the same period one year ago. This increase is due to the fact that, in the prior year period, we benefited from a federal deposit insurance premium credit which offset the majority of federal deposit insurance premiums due. Based upon recent events and the state of the economy, it is likely that the Federal Deposit Insurance Corporation may increase federal deposit insurance premiums in the near future. Depending on circumstances, this increase may be relatively significant and will add to our cost of operations. Finally, data processing expenses and core deposit intangible expense increased \$230,000 and \$200,000 compared to the same period in 2007 primarily as a result of the 2007 third quarter acquisitions.

Total noninterest expense for the first six months of 2008 increased \$6.3 million, or 15%, as compared to the same period in 2007. This increase is due primarily to increased compensation and employee benefits and other expense increases as discussed above. Regulatory premiums were \$728,000 higher for the first six months of 2008 than in the same period last year. As noted above, this increase relates to a credit we received in 2007 which offset the majority of FDIC premiums due. Finally, occupancy expenses increased \$676,000 from the first half of 2007, primarily due to the third quarter acquisitions and two new branch locations opened during the fourth quarter 2007.

Table of Contents

The following table presents selected items included in other noninterest expense and the associated change from period to period:

| (in thousands)                               | Three months ended |                  | Increase<br>(Decrease)<br>Amount | Six months ended |                  | Increase<br>(Decrease)<br>Amount |
|----------------------------------------------|--------------------|------------------|----------------------------------|------------------|------------------|----------------------------------|
|                                              | June 30,<br>2008   | June 30,<br>2007 |                                  | June 30,<br>2008 | June 30,<br>2007 |                                  |
| Core deposit intangible amortization ("CDI") | \$ 296             | \$ 96            | \$ 200                           | \$ 592           | \$ 192           | \$ 400                           |
| Software support & maintenance               | 168                | 209              | (41)                             | 377              | 389              | (12)                             |
| Telephone & network communications           | 410                | 277              | 133                              | 809              | 550              | 259                              |
| Federal Reserve Bank processing fees         | 116                | 127              | (11)                             | 227              | 240              | (13)                             |
| Supplies                                     | 366                | 289              | 77                               | 629              | 577              | 52                               |
| Postage                                      | 390                | 280              | 110                              | 751              | 571              | 180                              |
| Investor relations                           | 90                 | 83               | 7                                | 141              | 158              | (17)                             |
| Travel                                       | 140                | 120              | 20                               | 234              | 199              | 35                               |
| ATM Network                                  | 144                | 153              | (9)                              | 343              | 290              | 53                               |
| Sponsorships and charitable contributions    | 145                | 169              | (24)                             | 303              | 256              | 47                               |
| Regulatory premiums                          | 394                | 66               | 328                              | 836              | 108              | 728                              |
| Directors fees                               | 95                 | 105              | (10)                             | 230              | 215              | 15                               |
| Employee expenses                            | 141                | 149              | (8)                              | 322              | 320              | 2                                |
| Insurance                                    | 124                | 109              | 15                               | 244              | 219              | 25                               |
| Losses on CRA investments (1)                | 218                | 107              | 111                              | 346              | 288              | 58                               |
| Miscellaneous                                | 698                | 650              | 48                               | 1,511            | 1,251            | 260                              |
| Total other noninterest expense              | \$ 3,935           | \$ 2,989         | \$ 946                           | \$ 7,895         | \$ 5,823         | \$ 2,072                         |

(1) A substantial portion, \$256,000 for the six months ended June 30, 2008, of these losses is offset by credits taken as a reduction in our current period income tax expense.

In managing our business, we review the efficiency ratio, on a fully taxable-equivalent basis (see definition in table below), which is not defined in accounting principles generally accepted in the United States. Our efficiency ratio [noninterest expense divided by the sum of net interest income and noninterest income on a tax equivalent basis, excluding any gains and losses arising from nonrecurring transactions] was 59.31% for the second quarter 2008 and was 60.77% for the first six months of 2008, compared to 60.04% and 61.68% for the second quarter and first six months of 2007, respectively. The second quarter change in the efficiency ratio is due to the increase in net interest income driven primarily by the drop in interest expense.

The following table presents a reconciliation of the financial data utilized to calculate the efficiency ratio (a non-GAAP financial measure) to the same measures calculated and presented in accordance with GAAP:

Table of Contents

## Reconciliation of Financial Data to GAAP Financial Measures

| (in thousands)                                                                               | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|----------------------------------------------------------------------------------------------|--------------------------------|-----------|------------------------------|-----------|
|                                                                                              | 2008                           | 2007      | 2008                         | 2007      |
| Net interest income (1)                                                                      | \$ 30,274                      | \$ 25,695 | \$ 60,601                    | \$ 50,398 |
| Tax equivalent adjustment for non-taxable loan and investment securities interest income (2) | 1,381                          | 1,075     | 2,785                        | 2,150     |
| Adjusted net interest income                                                                 | \$ 31,655                      | \$ 26,770 | \$ 63,386                    | \$ 52,548 |
| Noninterest income                                                                           | \$ 9,305                       | \$ 6,741  | \$ 19,462                    | \$ 12,918 |
| Gain on sale of investment securities, net                                                   | -                              | -         | (882)                        | -         |
| Redemption of Visa and Mastercard shares                                                     | (1,066)                        | -         | (3,028)                      | -         |
| Death benefit proceeds on former officer covered by BOLI                                     | (612)                          | -         | (612)                        | -         |
| Tax equivalent adjustment for BOLI income (2)                                                | 295                            | 243       | 567                          | 472       |
| Adjusted noninterest income                                                                  | \$ 7,922                       | \$ 6,984  | \$ 15,507                    | \$ 13,390 |
| Noninterest expense                                                                          | \$ 23,367                      | \$ 20,266 | \$ 46,921                    | \$ 40,668 |
| Net gain on sale of OREO                                                                     | -                              | -         | 23                           | -         |
| BOLI policy swap net income                                                                  | 107                            | -         | 107                          | -         |
| Reversal of previously accrued Visa litigation expense                                       | -                              | -         | 889                          | -         |
| Adjusted noninterest expense                                                                 | \$ 23,474                      | \$ 20,266 | \$ 47,940                    | \$ 40,668 |
| Efficiency ratio                                                                             | 61.94%                         | 62.48%    | 63.46%                       | 64.23%    |
| Efficiency ratio (fully taxable-equivalent)                                                  | 59.31%                         | 60.04%    | 60.77%                       | 61.68%    |
| Tax Rate                                                                                     | 35.00%                         | 35.00%    | 35.00%                       | 35.00%    |

(1) Amount represents net interest income before provision for loan and lease losses.

(2) Fully taxable-equivalent basis: Non taxable revenue is increased by the statutory tax rate to recognize the income tax benefit of the income realized.

## Income Taxes

We recorded an income tax benefit of \$1.1 million for the second quarter and an income tax provision of \$2.8 million for the first six months of 2008, compared with a provision of \$3.3 million and \$5.9 million for the same periods in 2007. The effective tax rate for the second quarter of 2008 and 2007 was (125%) and 28%, respectively, as well as 18% and 27% for the six months ended June 30, 2008 and 2007. Our effective tax rate remains lower than the statutory tax rate due to our nontaxable income generated from tax-exempt municipal bonds, investments in bank owned life insurance, and low income housing credits. Effective tax rates for the quarter and six months ended June 30, 2008 are significantly lower than same periods last year as a result of our nontaxable income being a larger percentage of income before income taxes. For additional information, refer to the Company's annual report on Form 10-K for the year ended December 31, 2007.

## Credit Risk Management

The extension of credit in the form of loans or other credit products to individuals and businesses is one of our principal business activities. Our policies and applicable laws and regulations require risk analysis as well as ongoing portfolio and credit management. We manage our credit risk through lending limit constraints, credit review, approval policies, and extensive, ongoing internal monitoring. We also manage credit risk through diversification of the loan portfolio by type of loan, type of industry, type of borrower and by limiting the aggregation of debt limits to a single borrower. In analyzing our existing portfolio, we review our consumer and residential loan portfolios by their performance as a pool of loans since no single loan is individually significant or judged by its risk rating, size, or potential risk of loss. In contrast, the monitoring process for the commercial business, private banking, real estate construction, and commercial real estate portfolios includes periodic reviews of individual loans with risk ratings assigned to each loan and performance judged on a loan by loan basis. We review these loans to assess the ability of the borrower to service all of its interest and principal obligations and, as a result, the risk rating may be adjusted accordingly. In the event that full collection of principal and interest is not reasonably assured, the loan is appropriately downgraded and, if warranted, placed on nonaccrual status even though the loan may be current as to principal and interest payments. Additionally, we review these types of loans for impairment in accordance with SFAS No. 114, "Accounting by Creditors for the Impairment of a Loan". Impaired loans are

Table of Contents

considered for nonaccrual status and will typically remain as such until all principal and interest payments are brought current and the prospects for future payments in accordance with the loan agreement appear relatively certain.

Loan policies, credit quality criteria, portfolio guidelines and other controls are established under the guidance of our Chief Credit Officer and approved, as appropriate, by the Board. Credit Administration, together with the loan committee, has the responsibility for administering the credit approval process. As another part of its control process, we use an independent internal credit review and examination function to provide assurance that loans and commitments are made and maintained as prescribed by our credit policies. This includes a review of documentation when the loan is initially extended and subsequent monitoring to assess continued performance and proper risk assessment.

We have diversification of loan types within our portfolio. However, we are not immune to the current instability in the residential real estate markets and mortgage-related industries. Accordingly, we will continue to be diligent in our risk management practices and maintain, what we believe, are adequate reserves for probable loan losses.

### Loan Portfolio Analysis

We are a full service commercial bank, originating a wide variety of loans, but concentrating our lending efforts on originating commercial business and commercial real estate loans.

The following table sets forth the Company's loan portfolio by type of loan for the dates indicated:

| (in thousands)                                            | June 30,<br>2008 | % of<br>Total | December 31,<br>2007 | % of<br>Total |
|-----------------------------------------------------------|------------------|---------------|----------------------|---------------|
| Commercial business                                       | \$ 760,282       | 33.4%         | \$ 762,365           | 33.4%         |
| Real estate:                                              |                  |               |                      |               |
| One-to-four family residential                            | 55,504           | 2.4%          | 60,991               | 2.7%          |
| Commercial and five or more family residential properties | 829,048          | 36.4%         | 852,139              | 37.3%         |
| Total real estate                                         | 884,552          | 38.8%         | 913,130              | 40.0%         |
| Real estate construction:                                 |                  |               |                      |               |
| One-to-four family residential                            | 281,848          | 12.4%         | 269,115              | 11.8%         |
| Commercial and five or more family residential properties | 156,990          | 6.9%          | 165,490              | 7.2%          |
| Total real estate construction                            | 438,838          | 19.3%         | 434,605              | 19.0%         |
| Consumer                                                  | 195,914          | 8.7%          | 176,559              | 7.8%          |
| Subtotal                                                  | 2,279,586        | 100.2%        | 2,286,659            | 100.2%        |
| Less: Deferred loan fees                                  | (3,867)          | -0.2%         | (3,931)              | -0.2%         |
| Total loans                                               | \$ 2,275,719     | 100.0%        | \$ 2,282,728         | 100.0%        |
| Loans Held for Sale                                       | \$ 3,323         |               | \$ 4,482             |               |

Loan growth for the first half of 2008 was primarily from consumer loans, which rose \$19.4 million, or 11% from year-end 2007. Home equity lines of credit were the primary driver of consumer loan growth. One-to-four family real estate construction loans contributed an increase of \$12.7 million. Commercial business loans declined by \$2.1 million and real estate declined by \$28.6 million.

Commercial Loans: We are committed to providing competitive commercial lending in our primary market areas. We believe that decreases in commercial lending during the first half of 2008 were due to the slowing of our local economy. Management expects to see modest growth in its commercial lending products and to emphasize, in

particular, relationship banking with businesses, and business owners.

## Table of Contents

**Real Estate Loans:** These loans are used to collateralize outstanding advances from the FHLB. Generally, our policy is to originate residential loans for sale to third parties. Those residential loans are secured by properties located within our primary market areas, and typically have loan-to-value ratios of 80% or lower.

Generally, commercial and five-or-more family residential real estate loans are made to borrowers who have existing banking relationships with us. Our underwriting standards generally require that the loan-to-value ratio for these loans not exceed 75% of appraised value, cost, or discounted cash flow value, as appropriate, and that commercial properties maintain debt coverage ratios (net operating income divided by annual debt servicing) of 1.2 or better. However, underwriting standards can be influenced by competition and other factors. We endeavor to maintain the highest practical underwriting standards while balancing the need to remain competitive in our lending practices.

**Real Estate Construction Loans:** We originate a variety of real estate construction loans. One-to-four family residential construction loans are originated for the construction of custom homes (where the home buyer is the borrower) and to provide financing to builders for the construction of pre-sold homes and speculative residential construction. Underwriting guidelines for these loans vary by loan type but include loan-to-value limits, term limits and loan advance limits, as applicable.

Our underwriting guidelines for commercial and five-or-more family residential real estate construction loans generally require that the loan-to-value ratio not exceed 75% and stabilized debt coverage ratios (net operating income divided by annual debt servicing) of 1.2 or better. As noted above, underwriting standards can be influenced by competition and other factors. However, we endeavor to maintain the highest practical underwriting standards while balancing the need to remain competitive in our lending practices.

**Consumer Loans:** Consumer loans include automobile loans, boat and recreational vehicle financing, home equity and home improvement loans and miscellaneous personal loans.

**Foreign Loans:** Our banking subsidiaries are not involved with loans to foreign companies or foreign countries.

## Nonperforming Assets

Nonperforming assets consist of: (i) nonaccrual loans; (ii) in most cases restructured loans, for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower or the deferral of interest or principal, have been granted due to the borrower's weakened financial condition (interest on restructured loans is accrued at the restructured rates when it is anticipated that no loss of original principal will occur); (iii) other real estate owned; and (iv) other personal property owned. Collectively, nonaccrual and restructured loans are considered nonperforming loans.

**Nonaccrual loans:** The consolidated financial statements are prepared according to the accrual basis of accounting. This includes the recognition of interest income on the loan portfolio, unless a loan is placed on a nonaccrual basis, which occurs when there are serious doubts about the collectibility of principal or interest. Generally our policy is to discontinue the accrual of interest on all loans past due 90 days or more and place them on nonaccrual status. As discussed below, in the current quarter we also discontinued the accrual of interest on certain performing loans. The decision to discontinue interest on these performing loans was based upon our assessment that these borrowers will be experiencing significant financial challenges in the near future as a result of an economic downturn centered within their industry and in the markets they serve. When a loan is placed on nonaccrual status, any accrued but unpaid interest on that date is removed from interest income.

At June 30, 2008, total nonperforming assets were \$72.3 million, compared to \$14.6 million at December 31, 2007 and \$15.0 million at March 31, 2008. The percent of non-performing assets to period-end assets at June 30, 2008 was 2.28% compared to 0.46% for December 31, 2007 and 0.46% at March 31, 2008.

Table of Contents

The following tables set forth, at the dates indicated, information with respect to our nonaccrual loans, restructured loans, total nonperforming loans and total nonperforming assets:

| (in thousands)                                             | June 30,<br>2008 | December 31,<br>2007 |
|------------------------------------------------------------|------------------|----------------------|
| Nonaccrual:                                                |                  |                      |
| Commercial business                                        | \$ 2,066         | \$ 2,170             |
| Real estate:                                               |                  |                      |
| One-to-four family residential                             | 79               | 204                  |
| Commercial and five or more family residential real estate | 2,619            | 1,112                |
| Total real estate                                          | 2,698            | 1,316                |
| Real estate construction:                                  |                  |                      |
| One-to-four family residential                             | 47,360           | 6,005                |
| Commercial and five or more family residential real estate | 18,080           | 3,676                |
| Total real estate construction                             | 65,440           | 9,681                |
| Consumer                                                   | 1,526            | 838                  |
| Total nonaccrual loans                                     | 71,730           | 14,005               |
| Restructured:                                              |                  |                      |
| Commercial business                                        | 540              | 456                  |
| Total nonperforming loans                                  | 72,270           | 14,461               |
| Other real estate owned                                    | -                | 181                  |
| Other personal property owned                              | -                | -                    |
| Total nonperforming assets                                 | \$ 72,270        | \$ 14,642            |

The increase in non-accruals is centered in our real estate construction portfolios, both one-to-four family residential (“for-sale housing”) and commercial real estate. During the quarter, the for-sale housing portfolio, which currently totals \$282 million, had an increase in non-accrual loans of approximately \$42 million, bringing the total to about \$47 million. This increase primarily is due to seven builder banking customers whose activities are centered in the Pierce County area in Washington state and Clackamas County in Portland, Oregon. We have set aside \$7.0 million in specific reserves for these new non-accrual loans, based on lower anticipated value of some projects.

Market conditions in both of these counties have declined significantly in the past few months, and we have seen double-digit declines in year-over-year housing sales as well as double-digit declines in sales prices for land and lots. Given these market conditions, combined with the weak financial performance posted by some of these builders during the second quarter, we believe some of the builders to whom we have extended credit and who are focused in these markets will be experiencing significant challenges in the near future. Accordingly, we have placed \$29 million of performing loans on non-accrual; these loans are included in the \$42 million increase in non-accrual loans mentioned above.

In our commercial real estate construction portfolio, which is approximately \$157 million as of June 30, 2008, we experienced an increase of \$14.4 million in non-accrual loans. The increase in this segment is primarily centered in our condominium construction portfolio which accounts for approximately \$36 million of the total loans outstanding in this portfolio. This represents a little over \$9.0 million of the non-accruals as of June 30, 2008. We have set aside \$1.5 million in specific reserves for these newly-identified non-accrual loans.

We are continuing to work with our customers to resolve these issues as quickly as possible; however, given the nature of these types of projects, it is unlikely they will be resolved in the immediate future. Accordingly, the current

trend of a larger provision for loan losses as compared to prior periods may continue in the next few quarters dependent upon the economic climate and our customers' ability to repay.

#### Allowance for Loan and Lease Losses

At June 30, 2008, our allowance for loan and lease losses ("ALLL") was \$41.7 million, or 1.83% of total loans (excluding loans held for sale) and 58% of nonperforming loans and nonperforming assets. This compares with an allowance of \$26.6 million, or 1.17% of the total loan portfolio (excluding loans held for sale), 184% of nonperforming loans and 182% of nonperforming assets at December 31, 2007.

Table of Contents

There have been no significant changes during the first half of 2008 in estimation methods or assumptions that affected our methodology for assessing the appropriateness of the ALLL. Adjustments to the percentages of the allowance allocated to loan categories are made based on trends with respect to delinquencies and problem loans within each pool of loans. The Company maintains a conservative approach to credit quality and will continue to prudently add to its loan and lease loss allowance as necessary in order to maintain adequate reserves, factoring in changes and trends in the local and national economy. Management carefully monitors and evaluates the loan portfolio and continues to emphasize credit quality and strengthening of its loan monitoring systems and controls.

In addition to the ALLL, we maintain an allowance for unfunded loan commitments and letters of credit. We report this allowance as a component of other liabilities on our consolidated balance sheet. We determine this amount using estimates of the probability of the ultimate funding and losses related to those credit exposures. This methodology is similar to the methodology we use for determining the adequacy of our ALLL. At June 30, 2008 and December 31, 2007, our allowance for unfunded loan commitments and letters of credit was \$459,000 and \$349,000, respectively.

The following table provides an analysis of the Company's allowance for loan and lease losses at the dates and the periods indicated:

| (in thousands)                                     | Three Months Ended June 30, |              | Six Months Ended June 30, |              |
|----------------------------------------------------|-----------------------------|--------------|---------------------------|--------------|
|                                                    | 2008                        | 2007         | 2008                      | 2007         |
| Beginning balance                                  | \$ 27,914                   | \$ 20,819    | \$ 26,599                 | \$ 20,182    |
| Charge-offs:                                       |                             |              |                           |              |
| Residential, construction, land & acquisitions     | (580)                       | -            | (687)                     | -            |
| Commercial business                                | -                           | (98)         | (359)                     | (194)        |
| Commercial real estate                             | (505)                       | -            | (505)                     | -            |
| Private banking                                    | (24)                        | -            | (24)                      | -            |
| Consumer                                           | (579)                       | (77)         | (1,328)                   | (132)        |
| Total charge-offs                                  | (1,688)                     | (175)        | (2,903)                   | (326)        |
| Recoveries                                         |                             |              |                           |              |
| Residential, construction, land & acquisitions     | 16                          | -            | 16                        | -            |
| Commercial business                                | 72                          | 311          | 104                       | 408          |
| Commercial real estate:                            | 4                           | 3            | 304                       | 12           |
| Private banking                                    | 12                          | -            | 51                        | -            |
| Consumer                                           | 44                          | 52           | 127                       | 96           |
| Total recoveries                                   | 148                         | 366          | 602                       | 516          |
| Net charge-offs                                    | (1,540)                     | 191          | (2,301)                   | 190          |
| Provision charged to expense                       | 15,350                      | 329          | 17,426                    | 967          |
| Ending balance                                     | \$ 41,724                   | \$ 21,339    | \$ 41,724                 | \$ 21,339    |
| Total loans, net at end of period (1)              | \$ 2,275,719                | \$ 1,859,592 | \$ 2,275,719              | \$ 1,859,592 |
| Allowance for loan and lease losses to total loans | 1.83%                       | 1.15%        | 1.83%                     | 1.15%        |

(1) Excludes loans held for sale

During the second quarter of 2008, the Company had net loan charge-offs of \$1.5 million, compared to net loan recoveries of \$191,000 in the same period of 2007. For the first six months of 2008, the Company had net loan

charge-offs of \$2.3 million, compared to net loan recoveries of \$190,000 during the same period of 2007.

#### Securities

All of our securities are classified as available for sale and carried at fair value. These securities are used by management as part of our asset/liability management strategy and may be sold in response to changes in interest rates or significant prepayment risk. In accordance with our investment strategy, management monitors market conditions with a view to realize gains on its available for sale securities portfolio when prudent. During the first six months of 2008, we recorded a gain on sale of investment securities of \$882,000. The gain resulted from the execution of a strategy to extend the weighted average life of approximately \$50 million of the investment portfolio. At June 30, 2008, the market value of securities available for sale had an unrealized loss, net of tax, of \$3.1 million compared to an unrealized gain, net of tax, of

Table of Contents

\$1.7 million at December 31, 2007. The change in market value of securities available for sale is due primarily to fluctuations in interest rates and the effects of the slowing economic environment on certain government-sponsored enterprises. The Company does not consider these investment securities to be other than temporarily impaired. If in the future, however, the impairment is judged to be other than temporary, the cost basis of the individual impaired securities will be written down to fair value and the amount of the write-down will be included in earnings as a realized loss.

The following table sets forth our securities portfolio by type for the dates indicated:

| (in thousands)                                                                                                                | June 30,<br>2008  | December 31,<br>2007 |
|-------------------------------------------------------------------------------------------------------------------------------|-------------------|----------------------|
| <b>Securities Available for Sale</b>                                                                                          |                   |                      |
| U.S. government-sponsored enterprise preferred stock                                                                          | \$ 20,237         | \$ -                 |
| U.S. government-sponsored enterprise                                                                                          | -                 | 61,300               |
| U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations | 336,914           | 303,742              |
| State and municipal securities                                                                                                | 191,665           | 193,965              |
| Other securities                                                                                                              | 939               | 2,359                |
| <b>Total</b>                                                                                                                  | <b>\$ 549,755</b> | <b>\$ 561,366</b>    |

### Liquidity and Sources of Funds

Our primary sources of funds are customer deposits. Additionally, we utilize advances from the Federal Home Loan Bank of Seattle (the "FHLB") and wholesale repurchase agreements to supplement our funding needs. These funds, together with loan repayments, loan sales, retained earnings, equity and other borrowed funds are used to make loans, to acquire securities and other assets, and to fund continuing operations.

### Deposit Activities

Our deposit products include a wide variety of transaction accounts, savings accounts and time deposit accounts. Core deposits (demand deposit, savings, money market accounts and certificates of deposit less than \$100,000) decreased \$63.9 million since year-end 2007 while certificate of deposit greater than \$100,000 decreased \$28.9 million, or 7%, from year-end 2007.

We have established a branch system to serve our consumer and business depositors. In addition, management's strategy for funding asset growth is to make use of brokered and other wholesale deposits on an as-needed basis. At June 30, 2008 brokered and other wholesale deposits (excluding public deposits) totaled \$65.7 million, or 3% of total deposits, compared to \$72.0 million, or 3% of total deposits, at year-end 2007. The brokered deposits have varied maturities.

The following table sets forth the Company's deposit base by type of product for the dates indicated:

|                       | June 30, 2008 |               | December 31, 2007 |               | June 30, 2007 |               |
|-----------------------|---------------|---------------|-------------------|---------------|---------------|---------------|
| (in thousands)        | Balance       | % of<br>Total | Balance           | % of<br>Total | Balance       | % of<br>Total |
| <b>Core deposits:</b> |               |               |                   |               |               |               |

Edgar Filing: COLUMBIA BANKING SYSTEM INC - Form 10-Q

|                                                |              |        |              |        |              |        |
|------------------------------------------------|--------------|--------|--------------|--------|--------------|--------|
| Demand and other non-interest bearing          | \$ 480,612   | 20.0%  | \$ 468,237   | 18.7%  | \$ 419,695   | 19.8%  |
| Interest bearing demand                        | 445,798      | 18.6%  | 478,596      | 19.2%  | 440,051      | 20.8%  |
| Money market                                   | 580,535      | 24.2%  | 609,502      | 24.4%  | 509,463      | 24.0%  |
| Savings                                        | 118,145      | 4.9%   | 115,324      | 4.6%   | 102,997      | 4.9%   |
| Certificates of deposit less than \$100,000    | 308,166      | 12.9%  | 325,496      | 13.0%  | 253,669      | 12.0%  |
| Total core deposits                            | 1,933,256    | 80.6%  | 1,997,155    | 79.9%  | 1,725,875    | 81.5%  |
| Certificates of deposit greater than \$100,000 | 399,950      | 16.7%  | 428,885      | 17.2%  | 330,964      | 15.6%  |
| Wholesale certificates of deposit              | 65,718       | 2.7%   | 72,021       | 2.9%   | 60,486       | 2.9%   |
| Total deposits                                 | \$ 2,398,924 | 100.0% | \$ 2,498,061 | 100.0% | \$ 2,117,325 | 100.0% |

## Table of Contents

### Borrowings

We rely on FHLB advances as another source of both short and long-term borrowings. FHLB advances are secured by one-to-four family real estate mortgages and certain other assets. At June 30, 2008, we had FHLB advances of \$329.0 million, compared to advances of \$257.7 million at December 31, 2007.

We also utilize wholesale repurchase agreements as a supplement to our funding sources. Wholesale repurchase agreements are secured by mortgage-backed securities. At June 30, 2008, we had repurchase agreements of \$25.0 million compared to \$0 at December 31, 2007. Management anticipates that we will continue to rely on both FHLB advances and wholesale repurchase agreements in the future, and we will use those funds primarily to make loans and purchase securities.

During 2001, the Company, through a special purpose trust (“the Trust”) participated in a pooled trust preferred offering, whereby the Trust issued \$22.0 million of 30 year floating rate capital securities. The capital securities constitute guaranteed preferred beneficial interests in debentures issued by the Trust. The debentures had an initial rate of 7.29% and a rate of 6.48% at June 30, 2008. The floating rate is based on the 3-month LIBOR plus 3.58% and is adjusted quarterly. Through the Trust, we may call the debentures at any time for a premium and after ten years at par, allowing us to retire the debt early if market conditions are favorable. Through recent acquisition, the Company assumed an additional \$3.0 million in floating rate trust preferred obligations; these debentures had a rate of 6.46% at June 30, 2008. The floating rate is based on the 3-month LIBOR plus 3.75% and is adjusted quarterly.

The trust preferred obligations are classified as long-term subordinated debt and our related investment in the Trust is recorded in other assets on the consolidated balance sheets. The balance of the long-term subordinated debt was \$25.6 million at June 30, 2008 and \$25.5 million at December 31, 2007. The subordinated debt payable to the Trust is on the same interest and payment terms as the trust preferred obligations issued by the Trust.

Additionally, we have a \$20.0 million line of credit with a large commercial bank with an interest rate indexed to LIBOR. At both June 30, 2008 and December 31, 2007, \$5.0 million was outstanding on the line of credit. Subsequent to quarter-end, we borrowed the remaining \$15.0 million on the line of credit. The line matures on June 30, 2009 and, if not renewed, any principle balances outstanding are due at maturity.

### Contractual Obligations & Commitments

We are party to many contractual financial obligations, including repayment of borrowings, operating and equipment lease payments, commitments to extend credit and investments in affordable housing partnerships. At June 30, 2008, we had commitments to extend credit of \$788.8 million compared to \$857.6 million at December 31, 2007.

### Capital Resources

Shareholders’ equity at June 30, 2008 was \$344.3 million, up 0.7% from \$341.7 million at December 31, 2007. The increase is due primarily to net income of \$12.9 million for the first six months of 2008. Shareholders’ equity was 10.9% and 10.8% of total period-end assets at June 30, 2008, and December 31, 2007, respectively.

**Capital Ratios:** Banking regulations require bank holding companies to maintain a minimum “leverage” ratio of core capital to adjusted quarterly average total assets of at least 3%. In addition, banking regulators have adopted risk-based capital guidelines, under which risk percentages are assigned to various categories of assets and off-balance sheet items to calculate a risk-adjusted capital ratio. Tier I capital generally consists of common shareholders’ equity and trust preferred



Table of Contents

obligations, less goodwill and certain identifiable intangible assets, while Tier II capital includes the allowance for loan losses and subordinated debt, both subject to certain limitations. Regulatory minimum risk-based capital guidelines require Tier I capital of 4% of risk-adjusted assets and total capital (combined Tier I and Tier II) of 8% to be considered “adequately capitalized”.

Federal Deposit Insurance Corporation regulations set forth the qualifications necessary for a bank to be classified as “well capitalized”, primarily for assignment of FDIC insurance premium rates. To qualify as “well capitalized,” banks must have a Tier I risk-adjusted capital ratio of at least 6%, a total risk-adjusted capital ratio of at least 10%, and a leverage ratio of at least 5%. Failure to qualify as “well capitalized” can negatively impact a bank’s ability to expand and to engage in certain activities.

The Company and its subsidiaries qualify as “well-capitalized” at June 30, 2008 and December 31, 2007.

|                                 | Company   |            | Columbia Bank |            | Requirements           |                  |
|---------------------------------|-----------|------------|---------------|------------|------------------------|------------------|
|                                 | 6/30/2008 | 12/31/2007 | 6/30/2008     | 12/31/2007 | Adequately capitalized | Well-capitalized |
| Total risk-based capital ratio  | 11.43%    | 10.90%     | 11.19%        | 10.49%     | 8%                     | 10%              |
| Tier 1 risk-based capital ratio | 10.17%    | 9.87%      | 9.93%         | 9.47%      | 4%                     | 6%               |
| Leverage ratio                  | 8.64%     | 8.54%      | 8.47%         | 8.23%      | 4%                     | 5%               |

### Stock Repurchase Program

In March 2002 the Board of Directors approved a stock repurchase program whereby the Company may systematically repurchase up to 500,000 of its outstanding shares of Common Stock. The Company may repurchase shares from time to time in the open market or in private transactions, under conditions which allow such repurchases to be accretive to earnings while maintaining capital ratios that exceed the guidelines for a well-capitalized financial institution. As of June 30, 2008 we have repurchased 64,788 shares of common stock in this current stock repurchase program, none of which was repurchased in the periods covered by this report.

### Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

A number of measures are used to monitor and manage interest rate risk, including income simulations and interest sensitivity (gap) analyses. An income simulation model is the primary tool used to assess the direction and magnitude of changes in net interest income resulting from changes in interest rates. Basic assumptions in the model include prepayment speeds on mortgage-related assets, cash flows and maturities of other investment securities, loan and deposit volumes and pricing. These assumptions are inherently subjective and, as a result, the model cannot precisely estimate net interest income or precisely predict the impact of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes and changes in market conditions and management strategies, among other factors. At June 30, 2008, based on the measures used to monitor and manage interest rate risk, there has not been a material change in the Company’s interest rate risk since December 31, 2007. For additional information, refer to “Management’s Discussion and Analysis of Financial Condition and Results of Operation” referenced in the Company’s 2007 Annual Report on Form 10-K.

### Item 4. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

An evaluation was carried out under the supervision and with the participation of the Company's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934). Based on that evaluation, the CEO and CFO have concluded that as of the end of the period covered by this report, our disclosure controls and procedures are effective in ensuring that the information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is (i) accumulated and communicated to our management (including the CEO and CFO) to allow timely decisions regarding required disclosure, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

#### Changes in Internal Controls Over Financial Reporting

There was no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

Table of Contents

PART II - OTHER INFORMATION

Item 1.

LEGAL PROCEEDINGS

The Company and its banking subsidiaries are parties to routine litigation arising in the ordinary course of business. Management believes that, based on the information currently known to them, any liabilities arising from such litigation will not have a material adverse impact on the Company's financial condition, results of operations or cash flows.

Item 1A.

RISK FACTORS

Our business exposes us to certain risks. The following is a discussion of what we currently believe are the most significant risks and uncertainties that may affect our business, financial condition and future results.

Further economic downturns in the market areas we serve or a rapidly increasing interest rate environment could increase the credit risk within the loan portfolio.

Lending activities are our largest source of credit risk, which is the risk that a borrower will fail to meet their obligations in accordance with agreed upon terms. We manage the credit risk inherent in our loan portfolio through the establishment of sound underwriting policies and procedures. We maintain an allowance for loan and lease losses as well as an allowance for unfunded loan commitments and letters of credit to absorb anticipated future losses. Although we consider our allowance for loan and lease losses and allowance for unfunded loan commitments and letters of credit to be adequate at June 30, 2008, a further downturn in the economy could result in higher delinquencies and defaults which would negatively impact our financial position. A substantial portion of the loans in our portfolio are variable rate. While recently we have been in a decreasing interest rate environment, a rapidly increasing interest rate environment or inability to access credit or other funding could impair our borrower's ability to service the interest portion of their obligations to us. This could result in decreased net income from increased provisions to the allowance for loan and lease losses as well as decreased interest income resulting from an increase in nonaccrual loans.

A rapid change in interest rates could negatively impact net interest income.

We are exposed to interest rate risk, which is the risk that changes in prevailing interest rates will adversely affect assets, liabilities, capital, income and expenses at different times or in different amounts. We utilize a number of measures to monitor and manage interest rate risk, such as income simulations and interest sensitivity (gap) analyses. A number of factors that impact interest rates are beyond our control such as general economic conditions as well as governmental and regulatory policies. We cannot assure you that we can minimize interest rate risk. The impact of rate changes to our net interest income is determined by the amount of change and the time horizon over which change occurs.

Competition.

We face significant competition from other financial institutions for loans and deposits. We believe the most significant competitive factor is customer service, in addition to interest rates offered on loans and paid on deposits, fee structures, branch locations, and the range of banking services and products offered. Failure to maintain our service culture could increase the susceptibility of our customer base to our competitors marketing campaigns and thwart our efforts to expand our existing customer base.

Failure to hire or retain management and staff could impede our ability to maintain or grow earnings.

Maintaining our current customer base is reliant upon the retention of key management and personnel across all our business lines. We rely on these talented professionals to manage lines of business which are critical in the generation of operating revenue. In addition, the failure to attract new employees critical to the execution of our expansion plan could result in diminished returns on our investment in these initiatives.

The tightening of available liquidity could limit our ability to meet loan demand, which could adversely affect our earnings.

A tightening of the credit market and the inability to obtain adequate money to fund continued loan growth may negatively affect asset growth and, therefore, earnings capability. In addition to any deposit growth, maturity of investment securities and loan payments, we rely on certain wholesale funding sources to fund loans. In the event of a downturn in the economy, these additional funding sources could be negatively affected which could limit the funds available to us.

Table of Contents

Concentration in real estate loans.

We have a high concentration of loans secured by real estate and a continued downturn in the real estate market, for any reason, could adversely impact our business and our prospects. Our business activities and credit exposure are concentrated in loans secured by real estate. A continued decline in the real estate market could adversely impact our business because the collateral securing those loans would decrease in value. A downturn in the local economy could have a material adverse effect both on a borrower's ability to repay these loans, as well as the value of the real property held as collateral. Our ability to recover on defaulted loans by foreclosing and selling the real estate collateral would then be diminished and we would be more likely to suffer losses on defaulted loans.

A significant decline in the Company's market value could result in an impairment of goodwill.

Recently, the Company's common stock has been trading at a price below its book value, including goodwill and other intangible assets. If impairment was deemed to exist, we would be required to write down our assets resulting in a charge to earnings. For additional discussion see Note 9, "Goodwill and Intangible Assets" in Part I, Item 1 above.

Allowance for loan and lease losses may not be adequate to cover actual loan losses, which could adversely affect earnings and capital.

We maintain an allowance for loan and lease losses in an amount that is believed adequate to provide for losses inherent in the portfolio. The size of the ALLL is determined through quarterly assessments of the probable estimated losses in the loan portfolio. The ALLL is increased by provisions for loan and lease losses charged to expense, and is reduced by loans charged off, net of recoveries. While we believe the best information available is used by us to determine the ALLL. However, unforeseen market conditions could result in adjustments to the ALLL, affecting net income and capital, if circumstances differ from the assumptions used in determining the ALLL. For additional discussion see "Allowance for Loan and Lease Losses" in "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" of this report.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Table of Contents

## Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company held its annual shareholders meeting on April 23, 2008. The following is a brief description and vote count of the proposals voted upon at the annual meeting.

## Proposal 1. ELECTION OF DIRECTORS

All nine persons nominated were elected to hold office for the ensuing year.

| Nominee                 | Votes "For" | Votes<br>"Withheld" |
|-------------------------|-------------|---------------------|
| Melanie J. Dressel      | 15,006,011  | 252,464             |
| John P. Folsom          | 15,008,750  | 249,725             |
| Frederick M. Goldberg   | 15,190,117  | 68,357              |
| Thomas M. Hulbert       | 15,190,678  | 67,797              |
| Thomas L. Matson, Sr.   | 15,182,326  | 76,148              |
| Daniel C. Regis         | 15,165,945  | 92,529              |
| Donald Rodman           | 15,000,628  | 257,846             |
| William T. Weyerhaeuser | 15,187,386  | 71,089              |
| James M. Will           | 14,294,201  | 964,274             |

## Proposal 2. RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTANTS

| Shares<br>Voted "For" | Shares<br>Voted<br>"Against" | Abstentions |
|-----------------------|------------------------------|-------------|
| 14,985,747            | 215,797                      | 56,930      |

## Item 5. OTHER INFORMATION

None.

Table of Contents

Item 6. EXHIBITS

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32 Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

29

---

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

COLUMBIA BANKING SYSTEM, INC.

Date: August 7, 2008

By /s/ MELANIE J. DRESSEL  
Melanie J. Dressel  
President and Chief Executive  
Officer  
(Principal Executive Officer)

Date: August 7, 2008

By /s/ GARY R. SCHMINKEY  
Gary R. Schminkey  
Executive Vice President and  
Chief Financial Officer  
(Principal Financial Officer)

Date: August 7, 2008

By /s/ CLINT E. STEIN  
Clint E. Stein  
Senior Vice President and  
Chief Accounting Officer  
(Principal Accounting Officer)

