FORM 10QSB

Optional form for quarterly and transition reports of small business issuers under section 13 or 15(d)

Filing Date: **1999-07-27** | Period of Report: **1999-06-30**
SEC Accession No. 0001047469-99-028717

FILER

HERITAGE OAKS BANCORP

CIK:**921547**| IRS No.: **953763629** | State of Incorp.:**CA** | Fiscal Year End: **1231**
Type: **10QSB** | Act: **34** | File No.: **000-25020** | Film No.: **99670975**
SIC: **6022** State commercial banks

Mailing Address
545 12TH ST
PASO ROBLES CA 93446

Business Address
545 12TH ST
PASO ROBLES CA 93446
8052395200

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 1999

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

FOR THE TRANSITION PERIOD FROM --------- TO -------

COMMISSION FILE NO. 0-25020

HERITAGE OAKS BANCORP

(EXACT NAME OF REGISTRANT AS SPECIFIED IN CHARTER)

STATE OF CALIFORNIA

(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)

77-0388249

(I.R.S. EMPLOYER IDENTIFICATION CODE)

545 12TH STREET, PASO ROBLES, CA 93446

(ADDRESS OF PRINCIPAL OFFICE)

(805) 239-5200

(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

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 TWELVE (12) MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST NINETY (90) DAYS.

YES X NO

AGGREGATE MARKET VALUE OF COMMON STOCK OF HERITAGE OAKS BANCORP AT JULY 9, 1999: $18,134,188.

INDICATE THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE ISSUER'S CLASSES OF COMMON STOCK, AS OF THE LATEST PRACTICABLE DATE:

NO PAR VALUE COMMON STOCK - 1,115,950 SHARES OUTSTANDING AT JULY 9, 1999.

HERITAGE OAKS BANCORP
CONSOLIDATED BALANCE SHEETS

<TABLE>
<CAPTION>

ASSETS	06/30/99 (UNAUDITED)	12/31/98 (1)
<S>	<C>	<C>
Cash and due from banks	$16,997,472	$17,239,179
Federal funds sold	2,500,000	7,700,000
Total cash and cash equivalents	19,497,472	24,939,179
Interest bearing deposits other banks	670,124	666,975
Securities Available for sale	7,594,929	12,863,106
Securities held to maturity (see note 2)	13,265,772	15,758,151
Loans Held For Sale	328,389	1,654,765
Loans, net (see note 3)	84,454,494	69,803,041

Property, premises and equipment, net	3,122,263	2,447,385
Other real estate owned	0	0
Cash surrender value life insurance	1,273,984	1,020,576
Other assets	2,054,075	2,015,320
TOTAL ASSETS	$132,261,502	$131,168,498
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Demand, non-interest bearing	$39,886,715	$38,672,576
Savings, NOW, and money market deposits	54,291,228	51,604,881
Time deposits of $100,000 or more	4,298,339	4,673,298
Time deposits under $100,000	22,294,511	24,456,951
Total deposits	120,770,793	119,407,706
Other borrowed money	350,000	750,000
Other liabilities	1,292,815	1,574,122
Total liabilities	122,413,608	121,731,828
Stockholders' equity		
Common stock, no par value; 20,000,000 shares authorized; issued and outstanding 1,115,950 and 1,112,390 for June 30, 1999, and December 31, 1998, respectively.	4,506,694	4,470,170
Accumulated other comprehensive income	(331,510)	(188,166)
Retained earnings	5,672,710	5,154,666
Total stockholders' equity	9,847,894	9,436,670
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY	$132,261,502	$131,168,498

</TABLE>

(1) These numbers have been derived from the audited financial statements. See notes to condensed financial statements

HERITAGE OAKS BANCORP
CONSOLIDATED STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED JUNE 30,

<TABLE>
<CAPTION>

<S>	1999 (UNAUDITED) <C>	1998 (UNAUDITED) <C>
Interest Income:		
Interest and fees on loans	$1,966,207	$1,554,310
Investment securities	341,944	283,531
Federal funds sold and commercial paper	55,016	42,173
Time certificates of deposit	7,120	3,407
Total interest income	2,370,287	1,883,421
Interest Expense:		
Now accounts	165,764	203,460
MMDA accounts	53,972	25,365
Savings accounts	65,760	65,896
Time deposits of $100,000 or more	52,550	65,628
Other time deposits	239,910	240,237
Other borrowed funds	26,050	27,744
Total interest expense	604,006	628,330
Net Interest Income Before Prov. for Possible Loan Losses	1,766,281	1,255,091
Provision for loan losses	39,500	25,000
Net interest income after provision for loan losses	1,726,781	1,230,091
Non-interest Income:		
Service charges on deposit accounts	181,143	181,729
Investment securities gains (losses), net	0	10,429
Other income	1,258,876	1,451,640
Total Non-interest Income	1,440,019	1,643,798

Non-interest Expense:		
Salaries and employee benefits	884,259	719,019
Occupancy and equipment	404,845	259,959
Other expenses	1,408,239	1,381,777
	---------	---------
Total Noninterest Expenses	2,697,343	2,360,755
Income before provision for income taxes	469,457	513,134
Provision for applicable income taxes	137,839	180,176
	---------	---------
Net Income	$ 331,618	$ 332,958
	=========	=========
Earnings per share: (See note #4)		
Basic	$0.30	$0.32
Fully Diluted	$0.27	$0.30

</TABLE>

See notes to condensed financial statements

HERITAGE OAKS BANCORP
CONSOLIDATED STATEMENTS OF INCOME
FOR THE SIX MONTHS ENDED JUNE 30,

<TABLE>
<CAPTION>

	1999 (UNAUDITED)	1998 (UNAUDITED)
<S>	<C>	<C>
Interest Income:		
Interest and fees on loans	$3,734,411	$3,014,814
Investment securities	699,017	565,324
Federal funds sold and commercial paper	128,389	60,407
Time certificates of deposit	13,729	10,021
	----------	----------
Total interest income	4,575,546	3,650,566
Interest Expense:		
Now accounts	320,493	373,815
MMDA accounts	97,710	78,921
Savings accounts	128,244	130,084
Time deposits of $100,000 or more	98,669	89,730
Other time deposits	522,101	451,603
Other borrowed funds	46,352	51,048
	----------	----------
Total interest expense	1,213,569	1,175,201
Net Interest Income Before Prov. for Possible Loan Losses	3,361,977	2,475,365
Provision for loan losses	81,500	46,000
	----------	----------
Net interest income after provision for loan losses	3,280,477	2,429,365
Non-interest Income:		
Service charges on deposit accounts	354,591	328,633
Investment securities gains (losses), net	0	8,588
Other income	2,286,316	2,887,944
	----------	----------
Total Non-interest Income	2,640,907	3,225,165
Non-interest Expense:		
Salaries and employee benefits	1,754,977	1,402,702
Occupancy and equipment	747,255	530,027
Other expenses	2,637,811	2,689,209
	----------	----------
Total Noninterest Expenses	5,140,043	4,621,938
Income before provision for income taxes	781,341	1,032,592
Provision for applicable income taxes	260,415	371,226
	----------	----------
Net Income	$ 520,926	$ 661,366
	==========	==========
Earnings per share: (See note #4)		
Basic	$0.47	$0.63
Fully Diluted	$0.42	$0.60

</TABLE>

See notes to condensed financial statements

HERITAGE OAKS BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS
PERIODS ENDED JUNE 30, 1999 AND 1998

<TABLE>
<CAPTION>

<S>	1999 (UNAUDITED) <C>	1998 (UNAUDITED) <C>
Cash flows from operating activities:		
(dollars in thousands)		
Net Income	$520,926	$661,366
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	298,528	196,596
Provision for possible loan loss	81,500	46,000
Increase (decrease) in deferred loan fees	(48,024)	136,870
Net loss on sales of investment securities	-	(8,588)
Amortization of premiums (Discount accretion) on investment securities, net	(166,920)	(53,893)
Loss on sale of other real estate owned	-	-
Gain on sale of property, premises, and equipment	-	(8,093)
Decrease (increase) in other assets	(38,755)	(37,113)
Increase (decrease) in other liabilities	(291,207)	(190,315)
Net cash used in operating activities	356,048	742,830
Cash flows from investing activities:		
Purchase of investment securities	(16,472,098)	(9,414,447)
Proceeds from sales, price reductions and maturities from investment securities	24,229,505	8,265,688
Increase in time deposits with other banks	-	343,443
Net additions to real estate acquired in settlement of loans	-	-
Purchase of insurance policies	(253,408)	(24,458)
Increase in loans, net	(13,325,077)	(9,022,969)
Purchase of property, premises and equipment, net	(973,406)	(178,758)
Net cash used in investing activities	(6,794,484)	(10,031,501)
Cash flows from financing activities:		
Increase (decrease) in deposits, net	1,363,087	12,771,510
Net (decrease) increase in other borrowings	(400,000)	-
Proceeds from exercise of stock options	36,524	18,644
Cash paid in lieu of fractional shares	(2,882)	(519,717)
Net cash provided by (used in) financing activities	996,729	12,270,437
Net increase (decrease) in cash and cash equivalents	(5,441,707)	2,981,766
Cash and cash equivalents at beginning of year	24,939,179	12,991,388
Cash and cash equivalents at end of period	$19,497,472	$15,973,154

</TABLE>

See notes to condensed financial statements

HERITAGE OAKS BANCORP
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
JUNE 30, 1999 AND JUNE 30, 1998
(UNAUDITED)

<TABLE>
<CAPTION>

<S>	SHARES OUTSTANDING <C>	COMMON STOCK <C>	RETAINED EARNINGS <C>	ACCUMULATED OTHER COMPREHENSIVE INCOME <C>	TOTAL STOCKHOLDERS' EQUITY <C>
Balance January 1, 1999	1,069,791	$4,470,170	5,154,666	(188,166)	9,436,670
Exercise of Stock Options	3,500	36,524	0		36,524
Cash dividends paid	0	0	0		0
Stock dividend- 4%	42,659				0
Cash paid to Shareholders' in Lieu of fractional shares on 4% Stock Dividend			(2,882)		(2,882)
Comprehensive Income					
Net Income			520,926		520,926
Unrealized Security Holding Gains (net of $38,021 tax)				(54,121)	(54,121)
Less Reclassification Adjustment for Losses (net of $59,510 tax)				(89,223)	(89,223)
Total Other Comprehensive Income					
Total comprehensive Income					377,582

BALANCE JUNE 30, 1999	1,115,950	$4,506,694	$5,672,710	(331,510)	9,847,894

</TABLE>

<TABLE>
<CAPTION>

	SHARES OUTSTANDING	COMMON STOCK	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME	TOTAL STOCKHOLDERS' EQUITY
	-----------	----------	---------	--------	---------
<S>	<C>	<C>	<C>	<C>	<C>
JANUARY 1, 1998	1,036,626	$4,180,486	$4,327,921	($381,329)	$8,127,078
Exercise of Stock Options	4,868	18,644	0		$18,644
Cash dividends paid - $.50 per share	0	0	(519,716)		($519,716)
Comprehensive Income					
Net Income			661,366		$661,366
Unrealized Security Holding Gains				49,551	
					49,551
Total Other Comprehensive Income					
Total comprehensive Income					$710,917
BALANCE JUNE 30, 1998	1,041,494	$4,199,130	$4,469,571	($331,778)	$8,336,923

</TABLE>

NOTES TO CONSOLIDATED CONDENSED FINANACIAL STATEMENTS

Note 1: CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of Management, the unaudited consolidated condensed financial statements contain all (consisting of only normal recurring adjustments) adjustments necessary to present fairly the Company's consolidated financial position at June 30, 1999 and December 31, 1998 and the results of cash flows for the six months ended June 30, 1999 and 1998 and the results of operations for the three and six months ended June 30, 1999 and 1998.

Certain information and footnote disclosures normally presented in financial statements prepared in accordance with generally accepted accounting principles have been omitted. These interim consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 1998 Annual Report to shareholders. The results for the three and six months ended June 30, 1999 and 1998 may not necessarily be indicative of the operating results for the full year.

Note 2: INVESTMENT SECURITIES

The Company adopted SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" on January 1, 1994, which addresses the accounting for investments in equity securities that have readily determinable fair values and for investments in all debt securities. Securities are classified in three categories and accounted for as follows: debit and equity securities that the company has the positive intent and ability to hold to maturity are classified as held-to-maturity and are measured at amortized cost; debt and equity securities bought and held principally for the purpose of selling in the near term are classified as trading securities and are measured at fair value, with unrealized gains and losses included in earnings;, debt and equity securities not classified as either held-to-maturity or trading securities are deemed as available-for-sale and are measured at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of stockholders' equity. Any gains and losses on sales of investments are computed on a specific identification basis.

The amortized cost and fair values of investment securities available for sale at June 30, 1999 and December 31, 1998 were:
<TABLE>
<CAPTION>

JUNE 30, 1999	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
	-----	------	------	-----
<S>	<C>	<C>	<C>	<C>
Obligations of U.S. government agencies and corporations	$4,171,247	$1,779	$281,068	$3,891,958
Mortgage-backed securities	3,356,754	8,152	131,243	3,233,663
Commercial Paper	0	0	0	0
Obligations of State and Political Subdivisions	497,554	0	28,246	469,308
TOTAL	$8,025,555	$9,931	$440,557	$7,594,929
	----------	------	--------	----------

</TABLE>
<TABLE>

<CAPTION>

DECEMBER 31, 1998	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
<S>	<C>	<C>	<C>	<C>
U.S. Treasury securities	$ 0	$ 0	$ 0	$ 0
Obligations of U.S. government agencies and corporations	1,650,875	163,545	0	1,814,420
Mortgage-backed securities	3,286,605	2,903	214,455	3,075,053
Commercial Paper	7,969,833	0	0	7,969,833
Obligations of State and Political Subdivisions	0	0	0	0
Other Securities	3,800	0	0	3,800
TOTAL	$12,911,113	$166,448	$214,455	$12,863,106

</TABLE>

Note 2: INVESTMENT SECURITIES (continued)

The amortized cost and fair values of investment securities held to maturity at June 30, 1999 and December 31, 1998 were:

<TABLE>
<CAPTION>

JUNE 30, 1999	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
<S>	<C>	<C>	<C>	<C>
U.S. Treasury securities	$ 0	$ 0	$ 0	
Obligations of U.S. government agencies and corporations	6,010,447	10,543	226,139	$ 5,794,851
Mortgage-backed securities	668,719	3,553	16,191	656,081
Obligations of State and political subdivisions	6,191,406	16,537	125,726	6,082,217
Other securities	395,200	0	0	395,200
TOTAL	$13,265,772	$30,633	$368,056	$12,928,349

</TABLE>
<TABLE>
<CAPTION>

DECEMBER 31, 1998	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
<S>	<C>	<C>	<C>	<C>
U.S. Treasury securities	$98,777	$ 0	$ 777	$ 98,000
Obligations of U.S. government agencies and corporations	1,235,905	25,798	132	1,261,571
Mortgage-backed securities	8,168,695	283,004	12,759	8,438,940
Obligations of state and political subdivisions	6,254,774	14,059	8,337	6,260,496
TOTAL	$15,758,151	$322,861	$22,005	$16,059,007

</TABLE>

Note 3: Loans and Reserve for Possible Loan Losses

<TABLE>
<CAPTION>

Major classifications of loans were:

	June 30, 1999	December 31, 1998
<S>	<C>	<C>
Commercial, financial, and agricultural	$40,623,886	$38,220,932
Real estate-construction	11,463,689	8,357,701
Real estate-mortgage	31,011,432	21,672,158
Installment loans to individuals	2,192,743	2,611,325
All other loans (including overdrafts)	678,833	323,493
	85,970,583	71,185,609
Less - deferred loan fees	(361,057)	(313,033)
Less - reserve for possible loan losses	(1,155,032)	(1,069,535)
Total loans	$84,454,494	$69,803,041
Loans Held For Sale	$328,389	$1,654,765

</TABLE>

Concentration of Credit Risk

At June 30, 1999, approximately $42,475,121 of the Bank's loan portfolio was collateralized by various forms of real estate. Such loans are generally made to borrowers located in San Luis Obispo County. The Bank attempts to reduce its concentration of credit risk by making loans which are diversified by project type. While management believes that the collateral presently securing this portfolio is adequate, there can be no assurances that significant deterioration in the California real estate market would not expose the Bank to significantly greater credit risk.

Loans on nonaccrual status totaled $931,000 and $934,389 at June 30, 1999 and December 31, 1998, respectively. Interest income that would have been recognized on non-accrual loans if they had performed in accordance with the terms of the loans was approximately $54,898 and $103,164 for the period ended June 30, 1999 and December 31, 1998, respectively.

Note 3: Loans and Reserve for Possible Loan Losses (continued)

An analysis of the changes in the reserve for possible loan losses is as follows:

<TABLE>
<CAPTION>

	June 30, 1999	December 31, 1998
<S>	<C>	<C>
Balance at beginning of year	$1,069,535	$930,284
Additions charged to operating expense	81,500	164,000
Loans charged off	(6,018)	(45,277)
Recoveries of loans previously charged off	10,015	20,528
Balance at end of year	$1,155,032	$1,069,535

</TABLE>

At June 30, 1999, the Bank was contingently liable for letters of credit accommodations made to its customers totaling $935,904 and undisbursed loan commitments in the amount of $30,613,742. The Bank makes commitments to extend credit in the normal course of business to meet the financing needs of its customers. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total outstanding commitment amount does not necessarily represent future cash requirements. Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank anticipates no losses as a result of such transactions.

In accordance with Financial Accounting Standards Board (FASB) Statement No. 114, Accounting by Creditors for Impairment of a Loan. Allowance for credit losses related to loans that are identified for evaluation in accordance with Statement 114 is based on discounted cash flows using the loan's initial effect interest rate or the fair value of the collateral for certain collateral dependent loans.

Management believes that the allowance for credit losses at June 30, 1999 is prudent and warranted, based on information currently available. However, no prediction of the ultimate level of loans charged-off in future years can be made any certainty.

Note 4: Earnings Per Share:

Basic earnings per share are based on the weighted average number of shares outstanding before any dilution from common stock equivalents. Diluted earnings per share includes common stock equivalents from the effect of the exercise of stock options. The total number of share used for calculating basic and diluted for June 30, 1999 was 1,116,143 and 1,243,082, respectively. The total number of shares used for calculating basic and diluted for June 30, 1998 was 1,082,473 and 1,151,650, respectively.

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

HERITAGE OAKS BANCORP (THE "COMPANY") COMMENCED OPERATIONS ON NOVEMBER 15, 1994 WITH THE ACQUISITION OF HERITAGE OAKS BANK (THE "BANK"). EACH SHAREHOLDER OF THE BANK RECEIVED ONE SHARE OF STOCK IN THE COMPANY IN EXCHANGE FOR EACH SHARE OF HERITAGE OAKS BANK STOCK OWNED. THE BANK BECAME A WHOLLY OWNED SUBSIDIARY OF THE COMPANY. THE BANK IS THE ONLY ACTIVE SUBSIDIARY OWNED BY THE COMPANY.

SUMMARY OF FINANCIAL RESULTS

AS OF JUNE 30, 1999, TOTAL CONSOLIDATED ASSETS OF HERITAGE OAKS BANCORP WERE $132,261,502 COMPARED TO $131,168,498 AT DECEMBER 31, 1998. THIS REFLECTS AN INCREASE OF ONLY 0.83%, HOWEVER, TOTAL ASSETS AT DECEMBER 31, 1998 INCLUDED A DEPOSIT OF APPROXIMATELY $5 MILLION FROM ONE PARTICULAR CUSTOMER ON DECEMBER 31, 1998 THAT REMAINED ON DEPOSIT FOR ONLY ONE WEEK. TAKING THAT ADJUSTMENT INTO CONSIDERATION, TOTAL ASSETS HAVE GROWN BY 4.8% FROM YEAREND. THIS GROWTH IS ATTRIBUTABLE TO TWO DE NOVO BRANCH OFFICES IN SANTA MARIA AND ATASCADERO THAT OPENED ON FEBRUARY 1, 1999 AND MARCH 15, 1999, RESPECTIVELY.

TOTAL CASH AT JUNE 30, 1999 WAS $16,997,472. THE LARGE CASH BALANCE REFLECTS THE INCREASED NUMBER OF BRANCH OFFICES AND CASH NEEDED TO FUND THE BANK'S AUTOMATIC TELLER MACHINE ("ATM") NETWORK. AS OF JUNE 30, 1999, THE BANK WAS OPERATING APPROXIMATELY 80 ATMS.

TOTAL NET LOANS AT JUNE 30, 1999 WERE $84,454,494 COMPARED TO $69,803,041 AT DECEMBER 31, 1998. THIS INCREASE FROM YEAREND IS THE RESULT OF EXPANSION IN THE NUMBER OF BRANCHES AND THE REPUTATION OUR BANK HAS ESTABLISHED IN OUR NEW AND EXISTING MARKET AREA. MANAGEMENT INTENDS TO CONTINUE ITS AGGRESSIVE INCREASE IN THE LEVEL OF LOANS OUTSTANDING WHILE NOT COMPROMISING UNDERWRITING STANDARDS.

SECURITIES AVAILABLE FOR SALE, WHICH ARE CARRIED AT MARKET VALUE, WERE $7,594,929 AT JUNE 30, 1999 COMPARED TO $12,863,106 AT DECEMBER 31, 1998. SECURITIES HELD TO MATURITY, WHICH ARE CARRIED AT THEIR AMORTIZED COST, WERE $13,265,772 AT JUNE 30, 1999 COMPARED TO $15,758,151 AT DECEMBER 31, 1998. BOTH CATEGORIES HAVE DECREASED THROUGH SECURITY MATURITY AND PRINCIPAL CASH FLOW PAY DOWN TO SUPPLY FUNDS FOR LOAN DEMAND.

FEDERAL FUNDS SOLD WERE $2,500,000 AT JUNE 30, 1999 AND $7,700,000 AT DECEMBER 31, 1998.

TOTAL DEPOSITS WERE $120,770,793 AT JUNE 30, 1999 COMPARED TO $119,407,706 AT DECEMBER 31, 1998, WHICH REPRESENTS AN INCREASE OF ONLY 1.14%. HOWEVER, THE IMPACT OF THE DEPOSIT TRANSACTION ON DECEMBER 31, 1998 THAT IS NOTED ABOVE, DISTORTS THE REAL GROWTH OF APPROXIMATELY 5.3%. THE INCREASE IN TOTAL DEPOSITS IS PRIMARILY ATTRIBUTABLE TO THE TWO NEW BRANCH OFFICES AND DEPOSITS OBTAINED IN RELATIONSHIPS AS THE RESULT OF NEW LOANS.

CORE DEPOSITS (TIME DEPOSITS LESS THAN $100,000, DEMAND, AND SAVINGS) GATHERED IN THE LOCAL COMMUNITIES SERVED BY THE BANK CONTINUE TO BE THE BANK'S PRIMARY SOURCE OF FUNDS FOR LOANS AND INVESTMENTS. CORE DEPOSITS OF $116,472,454 REPRESENTED 96.4% OF TOTAL DEPOSITS AT JUNE 30, 1999. THE COMPANY DOES NOT PURCHASE FUNDS THROUGH DEPOSIT BROKERS.

THE COMPANY HAS A $2 MILLION REVOLVING LINE OF CREDIT AVAILABLE WITH PACIFIC COAST BANKERS BANK. AT JUNE 30, 1999, THE BALANCE OF BORROWED FUNDS ON THIS LINE WAS $350,000 COMPARED TO $750,000 AT DECEMBER 31, 1998.

RESULTS OF OPERATIONS

THE COMPANY REPORTED NET INCOME FOR THE SIX MONTHS ENDED JUNE 30, 1999 OF $520,926 COMPARED TO $661,366 FOR THE SAME PERIOD IN 1998. PER SHARE EARNINGS ON A DILUTED BASIS FOR JUNE 30, 1999 AND JUNE 30, 1998 WERE $0.42 AND $0.60, RESPECTIVELY. BASIC PER SHARE EARNINGS FOR JUNE 30, 1999 AND JUNE 30, 1998 WERE $0.47 AND $0.63, RESPECTIVELY.

NET INCOME FOR THE THREE MONTHS ENDED JUNE 30, 1999 WAS $331,618, COMPARED TO $332,958 FOR THE SAME PERIOD IN 1998.

REDUCED EARNINGS ARE THE DIRECT RESULT OF THE BANK'S EXPANSION INTO SANTA MARIA AND ATASCADERO. MANAGEMENT'S 1999 BUDGET REFLECTED THIS DECREASE IN EARNINGS FROM THE SAME PERIOD IN 1998.

THE FOLLOWING DISCUSSION HIGHLIGHTS CHANGES IN CERTAIN ITEMS IN THE CONSOLIDATED STATEMENTS OF INCOME.

NET INTEREST INCOME

NET INTEREST INCOME, THE PRIMARY COMPONENT OF THE NET EARNINGS OF A FINANCIAL INSTITUTION, REFERS TO THE DIFFERENCE BETWEEN THE INTEREST PAID ON DEPOSITS AND BORROWINGS, AND THE INTEREST EARNED ON LOANS AND INVESTMENTS. THE NET INTEREST MARGIN IS THE AMOUNT OF NET INTEREST INCOME EXPRESSED AS A PERCENTAGE OF AVERAGE EARNING ASSETS. FACTORS CONSIDERED IN THE ANALYSIS OF NET INTEREST INCOME ARE THE COMPOSITION AND VOLUME OF EARNING ASSETS AND INTEREST-BEARING LIABILITIES, THE AMOUNT OF NON-INTEREST BEARING LIABILITIES AND NON-ACCRUAL LOANS, AND CHANGES IN MARKET INTEREST RATES.

NET INTEREST INCOME FOR THE SIX MONTHS ENDED JUNE 30, 1999 WAS $3,361,977 AS COMPARED TO $2,475,365 FOR THE SAME PERIOD IN 1998. THIS REPRESENTS AN IMPROVEMENT OF $886,612 OR 35.8%. AS A PERCENTAGE OF AVERAGE EARNING ASSETS, THE NET INTEREST MARGIN FOR THE FIRST SIX MONTHS OF 1999 INCREASED TO 6.20% FROM 6.03% FROM THE SAME PERIOD ONE YEAR EARLIER. THE INCREASE IN NET INTEREST MARGIN IS PRIMARILY DUE TO AN $26,390,000 INCREASE IN AVERAGE INTEREST EARNING ASSETS AND AN INCREASE OF ONLY $11,897,000 IN INTEREST BEARING LIABILITIES. THIS IMPROVEMENT WAS THE RESULT OF THE BANK'S MARKETING EFFORTS TO ATTRACT NON-INTEREST BEARING DEMAND DEPOSIT ACCOUNTS. THE AVERAGE BALANCE OF DEMAND DEPOSITS AT JUNE 30, 1999 WAS $34,850,000 COMPARED TO $18,485,000 AT JUNE 30, 1998.

NET INTEREST INCOME FOR THE THREE MONTHS ENDED JUNE 30, 1999 WAS $1,766,281 COMPARED TO $1,265,091 FOR THE SAME PERIOD IN 1998. THIS REPRESENTS AN INCREASE OF 40.7%. INTEREST EXPENSE FOR THIS THREE MONTH PERIOD WAS $604,006 AT JUNE 30, 1999 COMPARED TO $628,330 AT JUNE 30, 1999.

AVERAGE INTEREST EARNING ASSETS WERE $108,518 AT JUNE 30, 1999 COMPARED TO $82,128,000 AT JUNE 30, 1998. AVERAGE INTEREST-BEARING LIABILITIES INCREASED TO $81,727,000 AT JUNE 30, 1999 FROM $69,830,000 AT JUNE 30, 1998. AVERAGE INTEREST RATES ON INTEREST-BEARING LIABILITIES DROPPED FROM 3.39% FOR THE FIRST SIX MONTHS OF 1998 TO 2.97% FOR THE FIRST SIX MONTHS OF 1999.

AVERAGE BALANCE SHEET INFORMATION FOR JUNE 30,

(DOLLARS IN THOUSANDS)

<TABLE>
<CAPTION>

	1999			1998		
	AVERAGE BALANCE	AVERAGE YIELD RATE PAID	AMOUNT INTEREST	AVERAGE BALANCE	AVERAGE YIELD RATE PAID	AMOUNT INTEREST
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Interest Earning Assets:						
Time deposits with other banks	$495	5.66%	$14	$224	6.30%	$7
Investment securities taxable	18,252	5.98%	546	15,150	6.10%	458
Investment securities non-taxable	6,478	4.72%	153	4,313	5.00%	107
Federal funds sold	5,237	4.89%	128	2,261	5.35%	60
Loans (1) (2)	78,056	9.57%	3,734	60,180	10.11%	3,018
Total interest earning assets	108,518	8.43%	4,575	82,128	8.96%	3,650
Allowance for possible loan losses	-1,106			(937)		
Non-earning assets:						
Cash and due from banks	14,091			10,806		
Property, premises and equipment	2,839			2,058		
Other assets	3,443			4,238		
TOTAL ASSETS	$127,785			$98,293		
Interest -bearing liabilities:						
Savings/NOW/money market	53,444	2.04%	546	46,618	2.52%	583
Time deposits	26,926	4.61%	621	21,470	5.08%	541
Other borrowings	1,357	6.63%	45	1,742	5.90%	51
Total interest-bearing liabilities	81,727	2.97%	1,212	69,830	3.39%	1,175
Non-interest bearing liabilities:						
Demand deposits	34,850			18,485		

Other liabilities	1,324		1,770	
Total liabilities	117,901		90,085	
Stockholders' equity				
Common stock	4,500		4,190	
Retained earnings	5,608		4,399	
Valuation Allowance Investments	(224)		(381)	
Total stockholders' equity	9,884		8,208	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$127,785		$98,293	
Net Interest Income		$3,363		$2,475
Net Interest Margin (3)	6.20%		6.03%	

</TABLE>

(1) NONACCRUAL LOANS HAVE BEEN INCLUDED IN TOTAL LOANS.
(2) LOAN FEES OF $213,454 AND $131,600 FOR 1999 AND 1998, RESPECTIVELY, HAVE BEEN INCLUDED IN THE INTEREST INCOME COMPUTATION.
(3) NET INTEREST INCOME HAS BEEN CALCULATED BY DIVIDING THE NET INTEREST INCOME BY TOTAL EARNING ASSETS.

THE PRECEDING TABLE SETS FORTH AVERAGE BALANCE SHEET INFORMATION, INTEREST INCOME AND EXPENSE, AVERAGE YIELDS AND RATES AND NET INTEREST INCOME AND MARGIN FOR THE THREE MONTHS ENDED JUNE 30, 1999 AND 1998.

NON-INTEREST INCOME

NON-INTEREST INCOME CONSISTS OF BANKCARD MERCHANT FEES, AUTOMATIC TELLER MACHINE ("ATM") TRANSACTIONS, AND OTHER FEES, SERVICE CHARGES, AND GAINS ON OTHER REAL ESTATE OWNED. NON-INTEREST INCOME FOR THE SIX MONTHS ENDED JUNE 30, 1999 WAS $2,640,907 COMPARED TO $3,225,165 FOR THE SAME PERIOD IN 1998. THAT REPRESENTS A DECREASE OF $584,258 OR 18.1%. SERVICE CHARGE INCOME INCREASED FROM $328,633 DURING THE FIRST SIX MONTHS OF 1998 TO $354,591 FOR THE SIX MONTHS ENDED JUNE 30, 1999. THIS MODEST INCREASE IN SERVICE CHARGES IS A RESULT OF THE BANK'S GROWTH IN DEPOSIT ACCOUNTS. ATM TRANSACTION FEES AND INTERCHANGE INCOME WERE $1,580,843 DURING THE SIX MONTHS ENDED JUNE 30, 1999 COMPARED TO $2,166,921 DURING THE SAME PERIOD FOR 1998. THE BANK RECEIVES INCOME FOR EACH TRANSACTION. APPROXIMATELY 18% OF THE ATMS ARE LOCATED AT GAMING SITES ON NATIVE AMERICAN LANDS. THE COMPETITION RELATED TO THE INSTALLATION OF ATM MACHINES HAS BEEN INCREASING AND HAS REDUCED CURRENT INCOME FROM THESE MACHINES. IN ORDER FOR NON-FINANCIAL INSTITUTIONS TO UTILIZE THE VARIOUS REGIONAL, NATIONAL AND INTERNATIONAL NETWORKS, THEY NEED A FINANCIAL INSTITUTION TO SPONSOR THEM ON THESE NETWORKS. THE BANK HAS ENTERED AN AGREEMENT WITH A FEW NON-FINANCIAL INSTITUTIONS TO SPONSOR THEM ON THESE NETWORKS. THE BANK RECEIVES A NOMINAL SPONSORSHIP FEE FOR EACH TRANSACTION RUN THROUGH THE NETWORKS. THE SPONSORSHIP REVENUE FOR THE SIX MONTHS ENDED JUNE 30, 1999 WAS $44,117 COMPARED TO $67,243 FOR THE SAME PERIOD DURING 1998. INCOME FROM BANKCARD MERCHANT FEES DECREASED TO $370,812 FOR THE SIX MONTHS ENDED JUNE 30, 1999 COMPARED TO $410,386 FOR THE SAME PERIOD DURING 1998. TO DEFRAY LIABILITY, THE BANK HAS TAKEN A MORE CONSERVATIVE STANCE ON THIS PRODUCT LINE AND HAS ELIMINATED HIGHER RISK MERCHANTS THAT GENERATED SIGNIFICANT REVENUES IN THE PAST. THE BANK IS CURRENTLY FINALIZING AN OFFER TO ELIMINATE LIABILITY AND CHANGE THE REVENUE FLOW TO REFLECT "NET" EARNINGS ON A MONTHLY BASIS. THE PROPOSED TRANSACTION WILL PROVIDE A PROFITABLE PRODUCT WITH CONTINUED REVENUE BASED ON THE NET VOLUME OF SALES. IT IS THE BANK'S INTENTION TO ACTIVELY MARKET THIS PRODUCT TO PROVIDE GREATER ONGOING REVENUE, WITHOUT THE RISK.

NON-INTEREST INCOME FOR THE THREE MONTHS ENDED JUNE 30, 1999 WAS $1,440,019 COMPARED TO $1,643,798 FOR THE SAME PERIOD IN 1998. THAT REPRESENTS A DECREASE OF $203,779 OR 12.4%. SERVICE CHARGE INCOME REMAINED STATIC AT $181,143 DURING THE FIRST THREE MONTHS OF 1998 AND $181,729 FOR THE SAME PERIOD IN 1998. ATM TRANSACTION FEES AND INTERCHANGE INCOME WERE $885,300 DURING THE THREE MONTHS ENDED JUNE 30, 1999 COMPARED TO $1,018,752 DURING THE SAME PERIOD FOR 1998. THE SPONSORSHIP REVENUE FOR THE THREE MONTHS ENDED JUNE 30, 1999 WAS $29,275

COMPARED TO $33,469 FOR THE SAME PERIOD DURING 1998. INCOME FROM BANKCARD MERCHANT FEES DECREASED TO $192,724 FOR THE THREE MONTHS ENDED JUNE 30, 1999 COMPARED TO $216,260 FOR THE SAME PERIOD DURING 1998.

OTHER EXPENSE

THE BANK OPENED DE NOVO BRANCHES IN SANTA MARIA AND ATASCADERO ON FEBRUARY 1 AND MARCH 15, 1999, RESPECTIVELY. OTHER EXPENSES HAVE GROWN AS A RESULT OF THE ADDITIONAL BRANCHES AND OVERALL GROWTH OF THE BANK. NON-INTEREST EXPENSE WAS $5,140,043 AND $4,621,938 FOR THE SIX MONTHS ENDED JUNE 30, 1999 AND THE SAME PERIOD IN 1998, RESPECTIVELY. SALARIES AND EMPLOYEE BENEFITS EXPENSE WERE $1,754,977 AND $1,402,702 FOR THE SIX MONTHS ENDED JUNE 30, 1999 AND 1998, RESPECTIVELY. FULL TIME EQUIVALENT EMPLOYEES WERE 86 AT JUNE 30, 1999 COMPARED TO 66 AT JUNE 30, 1998. OCCUPANCY AND EQUIPMENT COSTS GREW TO $747,255 FOR THE SIX MONTHS ENDED JUNE 30, 1999 FROM $530,027 FOR THE SAME PERIOD OF 1998. THE BANK HAS FINALIZED PURCHASES IN CONJUNCTION WITH Y2K COMPLIANCE. (REFER TO THE YEAR 2000 SECTION OF THIS DOCUMENT) EXPENSE ASSOCIATED WITH THE ATM NETWORK WAS $1,122,862 AND $1,238,721 FOR THE SIX MONTHS ENDED JUNE 30, 1999 AND 1998, RESPECTIVELY. EXPENSE ASSOCIATED WITH THE MERCHANT BANCARD PROGRAM WAS $278,379 AND $431,708 FOR THE SIX MONTHS ENDED JUNE 30, 1999 AND 1998, RESPECTIVELY. EXPENSE ASSOCIATED WITH ALL OTHER NON-INTEREST EXPENSE CATEGORIES WAS $1,136,570 AND $1,018,780 FOR THE SIX MONTHS ENDED JUNE 30, 1999 AND 1998, RESPECTIVELY. THE INCREASE IN OTHER EXPENSE REFLECTS INCREASES ASSOCIATED WITH THE GROWTH AS A RESULT OF THE TWO NEW BRANCHES AND THE OVERALL GROWTH OF THE BANK.

NON-INTEREST EXPENSE WAS $2,697,343 AND $2,360,755 FOR THE THREE MONTHS ENDED JUNE 30, 1999 AND THE SAME PERIOD IN 1998, RESPECTIVELY. SALARIES AND EMPLOYEE BENEFITS EXPENSE WERE $884,259 AND $719,019 FOR THE THREE MONTHS ENDED JUNE 30, 1999 AND 1998, RESPECTIVELY. OCCUPANCY AND EQUIPMENT COSTS GREW TO $404,845 FOR THE THREE MONTHS ENDED JUNE 30, 1999 FROM $259,959

FOR THE SAME PERIOD OF 1998. EXPENSE ASSOCIATED WITH THE ATM NETWORK WAS $605,897 AND $743,075 FOR THE THREE MONTHS ENDED JUNE 30, 1999 AND 1998, RESPECTIVELY. EXPENSE ASSOCIATED WITH THE MERCHANT BANCARD PROGRAM WAS $199,095 AND $209,795 FOR THE THREE MONTHS ENDED JUNE 30, 1999 AND 1998, RESPECTIVELY. EXPENSE ASSOCIATED WITH ALL OTHER NON-INTEREST EXPENSE CATEGORIES WAS $603,247 AND $428,907 FOR THE THREE MONTHS ENDED JUNE 30, 1999 AND 1998, RESPECTIVELY. THE INCREASE IN OTHER EXPENSE REFLECTS INCREASES ASSOCIATED WITH THE GROWTH AS A RESULT OF THE TWO NEW BRANCHES AND THE OVERALL GROWTH OF THE BANK.

LOCAL ECONOMY

ACCORDING TO THE 1999 SAN LUIS OBISPO COUNTY ECONOMIC OUTLOOK, PREPARED BY THE UCSB ECONOMIC FORECAST PROJECT, THE APPARENT SLOWDOWN OF THE U.S. ECONOMY HAS NOT OBVIOUSLY INFLUENCED THE LOCAL SAN LUIS OBISPO COUNTY ECONOMY, YET. THE HEALTHY RATE OF U.S. ECONOMIC GROWTH DURING 1998 HAS BEEN INTERRUPTED, PREDOMINANTLY BY EVENTS AND FINANCIAL PROBLEMS ABROAD. CONSUMER CONFIDENCE AND SPENDING, INDUSTRIAL PRODUCTION, AND EMPLOYMENT GROWTH HAVE BEEN SLIDING RECENTLY.

THE PUBLICATION GOES ON TO SAY THAT TO DATE, HOWEVER, THE LOCAL ECONOMY HAS NOT EXPERIENCED ANY PRONOUNCED WEAKNESS IN ANY PARTICULAR SECTOR. GROWTH IN EMPLOYMENT, RESIDENT SPENDING, TOURISM SPENDING, AND INCOME HAVE REMAINED SOLID. RESIDENTIAL BUILDING ACTIVITY IS CURRENTLY HIGHER THAN ANY YEAR OF THE 1990S. THE HOME SALES MARKET IS ESPECIALLY STRONG. AT THIS POINT, THE SAN LUIS OBISPO COUNTY ECONOMY DOES NOT APPEAR AFFECTED BY THE SPREADING INTERNATIONAL WEAKNESS.

A FIVE YEAR EXPANSION OF THE CALIFORNIA ECONOMY, THE SEVEN YEAR EXPANSION OF THE U.S. ECONOMY, THE UNPRECEDENTED RETURNS FROM FINANCIAL AND EQUITY MARKETS, AND THE STEADY GROWTH OF VISITOR TRAVEL ALONG THE CENTRAL COAST OF CALIFORNIA, ARE THE PRINCIPAL REASONS FOR THE CURRENT PROSPERITY OF SAN LUIS OBISPO COUNTY. MORE JOB OPPORTUNITIES, AND AN INCREASE IN MIGRATION TO SAN LUIS OBISPO COUNTY, RESULTING IN HIGHER DEMAND FOR HOUSING ARE ALSO RESPONSIBLE FOR INCREASED ECONOMIC GROWTH THIS YEAR.

THE CONTINUING HEALTH OF THE SAN LUIS OBISPO COUNTY ECONOMY IS CONFIRMED BY A VARIETY OF INDICATORS. THE RECENT EVIDENCE IS BOTH CLEAR AND CONSISTENT. EMPLOYMENT GROWTH IS QUITE HEALTHY, VISITOR SPENDING CONTINUES TO RISE, AND RETAIL MARKETS ARE RECORDING SOLID GAINS. BECAUSE THERE IS LITTLE NEW COMMERCIAL BUILDING,

AVAILABLE OFFICE AND INDUSTRIAL SPACE IS EVAPORATING. THE FARM SECTOR SET ANOTHER RECORD FOR BOTH CROP SALES IN 1997 AND EMPLOYMENT IN 1998, AND PER CAPITA INCOME CONTINUED TO RISE TO HISTORICAL HIGHS. JUST SINCE 1995, THE

NUMBER OF JOBS IN AGRICULTURE HAS DOUBLED; TO OVER 6,300 IN THE COUNTY AND AVERAGE WAGES FOR FARM WORKERS JUMPED 11% IN 1998.

THE BANK'S BRANCH LOCATIONS HAVE BEEN LOCATED TO TAKE ADVANTAGE OF THIS GROWING ECONOMY, AS EVIDENCED BY THE TWO DE NOVO BRANCHES OPENED DURING THE FIRST QUARTER OF 1999. THE BANK IS CURRENTLY NEGOTIATING A LEASE TO ESTABLISH A FULL SERVICE BRANCH OFFICE IN ARROYO GRANDE WITH AN ANTICIPATED OPENING DATE SOMETIME DURING THE FOURTH QUARTER OF 1999.

CAPITAL

THE COMPANY'S TOTAL STOCKHOLDERS EQUITY WAS $9,847,894 AT JUNE 30, 1999 COMPARED TO $9,436,670 AS OF DECEMBER 31, 1998. THE INCREASE IN CAPITAL WAS FROM NET INCOME OF $520,926, $36,524 FROM STOCK OPTIONS EXERCISED, ($2,882) FOR FRACTIONAL SHARES FROM A 4% STOCK DIVIDEND DURING THE FIRST QUARTER AND ($146,226) NET CHANGE IN OTHER COMPREHENSIVE INCOME RELATED TO UNREALIZED SECURITY HOLDING LOSS, NET OF TAX.

CAPITAL RATIOS FOR COMMERCIAL BANKS IN THE UNITED STATES ARE GENERALLY CALCULATED USING NINE DIFFERENT FORMULAS. THESE CALCULATIONS ARE REFERRED TO AS THE "LEVERAGE RATIO" AND TWO "RISK BASED" CALCULATIONS KNOWN AS: "TIER ONE RISK BASED CAPITAL RATIO" AND THE "TOTAL RISK BASED CAPITAL RATIO." THESE STANDARDS WERE DEVELOPED THROUGH JOINT EFFORTS OF BANKING AUTHORITIES FROM 12 DIFFERENT COUNTRIES AROUND THE WORLD. THE STANDARDS ESSENTIALLY TAKE INTO ACCOUNT THE FACT THAT DIFFERENT TYPES OF ASSETS HAVE DIFFERENT LEVELS OF RISK ASSOCIATED WITH THEM. FURTHER, THEY TAKE INTO ACCOUNT THE OFF-BALANCE SHEET EXPOSURES OF BANKS WHEN ASSESSING CAPITAL ADEQUACY.

THE LEVERAGE RATIO CALCULATION SIMPLY DIVIDES COMMON STOCKHOLDERS' EQUITY (REDUCED BY ANY GOODWILL A BANK MAY HAVE) BY THE TOTAL AVERAGE ASSETS OF THE BANK. IN THE TIER ONE RISK BASED CAPITAL RATIO, THE NUMERATOR IS THE SAME AS THE LEVERAGE RATIO, BUT THE DENOMINATOR IS THE TOTAL "RISK-WEIGHTED ASSETS" OF THE BANK. RISK WEIGHTED ASSETS ARE DETERMINED BY SEGREGATING ALL THE ASSETS AND OFF BALANCE SHEET EXPOSURES INTO DIFFERENT RISK CATEGORIES AND WEIGHING THEM BY A PERCENTAGE RANGING FROM 0% (LOWEST RISK) TO 100% (HIGHEST RISK). THE TOTAL RISK BASED

CAPITAL RATIO AGAIN USES "RISK-WEIGHTED ASSETS" IN THE DENOMINATOR, BUT EXPANDS THE NUMERATOR TO INCLUDE OTHER CAPITAL ITEMS BESIDES EQUITY SUCH AS A LIMITED AMOUNT OF THE LOAN LOSS RESERVE, LONG-TERM CAPITAL DEBT, PREFERRED STOCK AND OTHER INSTRUMENTS.

SUMMARIZED BELOW ARE THE BANK'S CAPITAL RATIOS AT JUNE 30, 1999:

<TABLE>
<CAPTION>

<S>	ADEQUATELY-CAPITALIZED REGULATORY STANDARD <C>>	HERITAGE OAKS BANK <C>
LEVERAGE RATIO	4.00%	7.25%
TIER ONE RISK BASED CAPITAL RATIO	4.00%	9.88%
TOTAL RISK BASED CAPITAL RATIO	8.00%	11.09%

</TABLE>

IT IS THE INTENT OF MANAGEMENT TO CONTINUE TO MAINTAIN STRONG CAPITAL RATIOS.

LIQUIDITY

THE OBJECTIVE OF LIQUIDITY MANAGEMENT IS TO ENSURE THE CONTINUOUS AVAILABILITY OF FUNDS TO MEET THE DEMANDS OF DEPOSITORS, INVESTORS AND BORROWERS. ASSET LIQUIDITY IS PRIMARILY DERIVED FROM LOAN PAYMENTS AND THE MATURITY OF OTHER EARNING ASSETS. LIQUIDITY FROM LIABILITIES IS OBTAINED PRIMARILY FROM THE RECEIPT OF NEW DEPOSITS. THE BANK'S ASSET LIABILITY COMMITTEE (ALCO) IS RESPONSIBLE FOR MANAGING THE ON-AND OFF-BALANCE SHEET COMMITMENTS TO MEET THE NEEDS OF CUSTOMERS WHILE ACHIEVING THE BANK'S FINANCIAL OBJECTIVES. ALCO MEETS REGULARLY TO ASSESS THE PROJECTED FUNDING REQUIREMENTS BY REVIEWING HISTORICAL FUNDING PATTERNS, CURRENT AND FORECASTED ECONOMIC CONDITIONS, AND INDIVIDUAL CUSTOMER FUNDING NEEDS. DEPOSITS GENERATED FROM BANK CUSTOMERS SERVE AS THE PRIMARY SOURCE OF LIQUIDITY. THE BANK HAS CREDIT ARRANGEMENTS WITH CORRESPONDENT BANKS THAT SERVE AS A SECONDARY LIQUIDITY SOURCE IN THE AMOUNT OF $5,500,000 AND ADDITIONALLY CAN BORROW MONEY THROUGH REPURCHASE AGREEMENTS WITH TWO BROKERAGE FIRMS. THE BANK IS ALSO NEGOTIATING A BORROWING LINE WITH FEDERAL HOME LOAN BANK OF SAN FRANCISCO. DURING THE SECOND QUARTER OF 1999, THE BANK DID NOT BORROW ON ARRANGED FED FUND LINES; HOWEVER, A REVERSE REPURCHASE AGREEMENT FOR APPROXIMATELY $2.3 MILLION WAS IN PLACE FOR 60 DAYS, ENDING ON

JUNE 25, 1999.

THE BANK MANAGES ITS LIQUIDITY BY MAINTAINING A MAJORITY OF ITS INVESTMENT PORTFOLIO IN FEDERAL FUNDS SOLD AND OTHER LIQUID INVESTMENTS. AT JUNE 30, 1999, THE RATIO OF LIQUID ASSETS TO DEPOSITS AND OTHER LIABILITIES WAS 27.39%. THE RATIO OF GROSS LOANS TO DEPOSITS, ANOTHER KEY LIQUIDITY RATIO, WAS 71.1% AT JUNE 30, 1999.

INFLATION

THE ASSETS AND LIABILITIES OF A FINANCIAL INSTITUTION ARE PRIMARILY MONETARY IN NATURE. AS SUCH, THEY REPRESENT OBLIGATIONS TO PAY OR RECEIVE FIXED AND DETERMINABLE AMOUNTS OF MONEY, WHICH ARE NOT AFFECTED BY FUTURE CHANGES IN PRICES. GENERALLY, THE IMPACT OF INFLATION ON A FINANCIAL INSTITUTION IS REFLECTED BY FLUCTUATIONS IN INTEREST RATES, THE ABILITY OF CUSTOMERS TO REPAY DEBT AND UPWARD PRESSURE ON OPERATING EXPENSES. IN ADDITION, INFLATION AFFECTS THE GROWTH OF TOTAL ASSETS BY INCREASING THE LEVEL OF LOAN DEMAND, AND MAY POTENTIALLY ADVERSELY AFFECT THE BANK'S CAPITAL ADEQUACY BECAUSE LOAN GROWTH IN INFLATIONARY PERIODS MAY INCREASE MORE RAPIDLY THAN CAPITAL. THE EFFECT ON INFLATION DURING THE PERIOD ENDED JUNE 30, 1999 HAS NOT BEEN SIGNIFICANT TO THE BANK'S FINANCIAL POSITION OR RESULT OF OPERATIONS.

YEAR 2000 RISKS AND PREPAREDNESS

MANY EXISTING COMPUTER PROGRAMS USE ONLY TWO DIGITS TO IDENTIFY A YEAR IN A DATA FIELD. THESE PROGRAMS WERE DESIGNED AND DEVELOPED WITHOUT CONSIDERING THE IMPACT OF THE UPCOMING CHANGE IN THE CENTURY. IF NOT CORRECTED, MANY COMPUTER APPLICATIONS COULD FAIL OR CREATE ERRONEOUS RESULTS BY OR AT THE YEAR 2000 OR POSSIBLY EARLIER. THE YEAR 2000 ISSUE AFFECTS THE COMPANY IN THAT THE FINANCIAL SERVICES BUSINESS IS HIGHLY DEPENDENT ON COMPUTER APPLICATIONS IN A VARIETY OF WAYS, INCLUDING THE FOLLOWING (i) THE COMPANY RELIES ON COMPUTER SYSTEMS IN ALMOST ALL ASPECTS OF ITS BUSINESS, INCLUDING THE PROCESSING OF DEPOSITS, LOANS AND OTHER SERVICES AND PRODUCTS OFFERED TO CUSTOMERS, THE FAILURE OF WHICH IN CONNECTION WITH THE YEAR 2000 COULD CAUSE SYSTEMIC DISRUPTIONS AND FAILURES IN THE PRODUCTS AND SERVICES OFFERED BY THE COMPANY, (ii) OTHER BANKS, CLEARING HOUSES AND VENDORS WHOSE PRODUCTS AND SERVICES THE COMPANY USES ARE AT RISK OF SYSTEMIC DISRUPTIONS AND POTENTIAL FAILURES IN THE EVENT THAT SUCH

ENTITIES HAVE NOT ADEQUATELY ADDRESSED THEIR YEAR 2000 ISSUE PRIOR TO THE YEAR 2000, (iii) THE CREDITWORTHINESS OF BORROWERS OF THE COMPANY MIGHT BE DIMINISHED BY SIGNIFICANT DISRUPTIONS OF THEIR BUSINESS AS A RESULT OF THEIR OWN OR OTHERS FAILURE TO ADDRESS ADEQUATELY THE YEAR 2000 ISSUES PRIOR TO THE YEAR 2000, AND (iv) FEDERAL BALANCING AGENCIES HAVE ISSUED INTERAGENCY GUIDANCE ON THE BUSINESS-WIDE RISK POSED TO FINANCIAL INSTITUTIONS BY THE YEAR 2000 PROBLEM PURSUANT TO WHICH THE FEDERAL BANKING AGENCIES MAY TAKE SUPERVISORY ACTION AGAINST FINANCIAL INSTITUTIONS THAT FAIL TO ADDRESS APPROPRIATELY YEAR 2000 ISSUES PRIOR TO THE YEAR 2000, INCLUDING FORMAL AND INFORMAL ENFORCEMENT ACTIONS, DENIAL OF APPLICATIONS TO THE FEDERAL BANKING AGENCIES, CIVIL MONEY PENALTIES AND A REDUCTION IN THE MANAGEMENT COMPONENT RATING OF THE INSTITUTIONS COMPOSITE RATING.

IN ORDER TO ADDRESS THE YEAR 2000 ISSUES FACING THE COMPANY, THE COMPANY'S MANAGEMENT HAS INITIATED A PROGRAM TO PREPARE THE COMPANY'S COMPUTER SYSTEMS AND APPLICATIONS FOR THE YEAR 2000 (THE "YEAR 2000 PLAN). THE PRIMARY FOCUS OF THE YEAR 2000 PLAN IS TO CONVERT TO THE TARGET SYSTEMS IDENTIFIED AND BELIEVED TO BE YEAR 2000 COMPLIANT. THE COMPANY EXPECTS TO INCUR INTERNAL STAFF COSTS AS WELL AS CONSULTING AND OTHER EXPENSES RELATED TO INFRASTRUCTURE AND FACILITIES ENHANCEMENTS NECESSARY TO PREPARE FOR CONVERSION AND YEAR 2000 SYSTEM PREPARATIONS, TESTING AND CONVERSION OF PRIMARY SYSTEM APPLICATIONS AND HARDWARE IS EXPECTED TO COST APPROXIMATELY $191,000 TO BE EXPENDED DURING FISCAL YEARS 1998 AND 1999.

AS A PART OF THE YEAR 2000 PLAN, THE COMPANY IS NOT ONLY UNDERTAKING THE INFRASTRUCTURE AND FACILITIES ENHANCEMENT AND TESTING NECESSARY TO ENSURE THAT THE COMPANY IS ADEQUATELY PREPARED FOR THE YEAR 2000, BUT THE COMPANY IS ALSO COMMUNICATING WITH ITS VENDORS UPON WHOSE SERVICES THE COMPANY RELIES TO ENSURE YEAR 2000 COMPLIANCE. PURSUANT TO THE YEAR 2000 PLAN, THE COMPANY HAS COMPLETED TESTING OF ITS MISSION-CRITICAL SYSTEMS AND THE COMPUTER-RELATED INTERACTIVE VENDOR SYSTEMS AS OF MARCH 31, 1999. IN ADDITION, AS PART OF THE CREDIT REVIEW PROCESS, THE COMPANY IS COMMUNICATING WITH ITS MAJOR BORROWERS IN AN EFFORT TO ENSURE THAT SUCH BORROWERS HAVE TAKEN APPROPRIATE STEPS TO ADDRESS THEIR YEAR 2000 ISSUES AND WILL NOT BE MATERIALLY AFFECTED BY ANY YEAR 2000 PROBLEMS. THE COMPANY IS COMMUNICATING WITH ITS DEPOSIT CUSTOMERS AS WELL. THE COMPANY HAS CONTINGENCY PLANS TO PROTECT THE COMPANY IN THE EVENT THAT THE COMPANY IS UNABLE TO ATTAIN YEAR 2000 COMPLIANCE IN CERTAIN APPLICATIONS ACCORDING TO THE YEAR 2000 PLAN.

THE COMPANY HAS ESTABLISHED A WORKING COMMITTEE COMPRISED OF

SENIOR AND MIDDLE MANAGEMENT TO PLAN FOR AND MONITOR THE COMPANY'S COMPLIANCE WITH YEAR 2000 ISSUES. THIS COMMITTEE HAS DEVELOPED A COMPREHENSIVE POLICY SETTING FORTH PRIORITIES AND A TIMETABLE FOR THE BANK TO FOLLOW IN THIS PROCESS.

THE COMPANY HAS DEVELOPED A CONTINGENCY PLAN THAT IDENTIFIES THE MISSION CRITICAL PROCESSES AND SERVICE PROVIDERS. AN ALTERNATIVE PROVIDER OR PROCESS HAS BEEN IDENTIFIED FOR EACH MISSION CRITICAL VENDOR. IN ADDITION, ON THE ASSUMPTION THAT THE ORIGINAL OR ALTERNATIVE PROCESS FAILS AT THE POINT OF PROCESSING IN THE YEAR 2000, CONTINGENCY PLANS ARE BEING DESIGNED THAT WILL PROVIDE MINIMUM LEVELS OF SERVICE OR OUTPUTS UNTIL THE FAILED SYSTEM CAN BE REPAIRED OR REPLACED. MOST OF THESE CONTINGENCY PLANS ARE MANUAL EFFORT SYSTEMS. TEST RESULTS TO-DATE INDICATES THAT THE ORIGINAL SYSTEM FOR EACH MISSION CRITICAL SYSTEM SHOULD MEET THE DEMANDS OF PROCESSING IN THE YEAR 2000. AS A REASONABLE WORST CASE, THE MANUAL SYSTEMS DESIGNED SHOULD PROVIDE THE MINIMUM LEVELS OF SERVICE FOR THE TIME REQUIRED TO REPAIR OR REPLACE FAILED SYSTEMS. HOWEVER, IN THE CASE OF FAILURE, THE ULTIMATE IMPACT ON FINANCIAL OPERATIONS IS NOT KNOWN, NOR IS IT KNOWN WHAT IMPACT A REGIONAL OR NATIONWIDE POWER FAILURE OR COMMUNICATIONS BREAKDOWN WOULD HAVE ON THE FINANCIAL PERFORMANCE OF THE COMPANY.

THE COMPANY HAS CREATED A BUDGET SPECIFIC TO YEAR 2000 READINESS. THE BUDGET IS COMPRISED OF THE FOLLOWING COMPONENTS: (1) CONSULTING ASSISTANCE FOR TESTING, (2) AUDITING, AND (3) OPERATING SYSTEM AND NETWORK UPGRADES. THIS COMPONENT IS BUDGETED AT $191,000. AT JUNE 30, 1999, A TOTAL OF $164,768 OR 86% HAS BEEN SPENT, $93,664 IN 1999 AND $71,104 IN 1998. SENIOR MANAGEMENT REVIEWS THE BUDGET FROM TIME TO TIME AS THE YEAR 2000 PLAN IS IMPLEMENTED. THERE IS NO ASSURANCE THAT ADDITIONAL AMOUNTS WILL NOT BE ADDED TO THE AMOUNTS ALREADY BUDGETED FOR YEAR 2000 EXPENDITURES. WITH RESPECT COMPONENTS NUMBER (1) AND (2), IT SHOULD BE NOTED THAT HERITAGE OAKS BANK HAS THE RESOURCES IN-HOUSE TO AUDIT REVIEW THE EFFECTIVENESS OF THE YEAR 2000 PLAN AND THE TECHNOLOGICAL ASSISTANCE NECESSARY IN PREPARING FOR AND CONDUCTING THE COMPANY'S TESTING PLAN.

IN ADDITION, THE COMPANY HAS DEDICATED SIGNIFICANT HUMAN RESOURCES TO THE YEAR 2000 PLAN. THIS INCLUDES THE SALARIES AND BENEFITS OF PERSONNEL DEVOTING SIGNIFICANT TIME TO THE PLAN. AS OF JUNE 30, 1999, THE COMPANY HAD EXPENDED OVER $27,500 IN "MAN-HOURS" TO THE PROJECT. IN ADDITION, EXPENDITURES HAVE BEEN MADE IN THE AREAS OF ADVERTISING AND PUBLIC RELATIONS, CUSTOMER AND EMPLOYEE AWARENESS PROGRAMS AND MORE.

IN APRIL OF 1998, THE COMPANY INITIATED A CREDIT RISK ASSESSMENT PROGRAM, WITH LOAN OFFICERS COMPLETING A YEAR 2000 QUESTIONNAIRE FOR ALL NEW AND RENEWED CREDITS IN AMOUNTS OVER $150,000.00. THESE QUESTIONNAIRES WERE DESIGNED TO PROVIDE THE COMPANY'S MANAGEMENT WITH INFORMATION BY WHICH IT COULD EVALUATE THE BORROWER'S AWARENESS OF AND SENSITIVITY TO YEAR 2000 RISK. QUESTIONNAIRES ARE REVIEWED AND DISCUSSED AT WEEKLY OFFICER LOAN COMMITTEE MEETINGS AND ARE FURTHER REVIEWED BY CREDIT ADMINISTRATION AND SENIOR LENDER TO ASCERTAIN YEAR 2000 RISK ASSOCIATED WITH THE CREDIT. AS A RESULT OF THIS REVIEW, $105,057 HAS BEEN ALLOCATED TO THE COMPANY'S LOAN LOSS PROVISION. IN ADDITION, LEGAL YEAR 2000 ISSUES ARE INCLUDED IN SIGNIFICANT COMMITMENT LETTERS AND LOAN DOCUMENTATION FOR CERTAIN BORROWERS. FINALLY, ON LOAN PARTICIPATION'S PURCHASED, THE COMPANY REQUIRES ASSURANCES FROM THE LEAD LENDER THAT IT HAS OBTAINED A YEAR 2000 QUESTIONNAIRE FROM THE BORROWER AND ALSO THAT THE LEAD LENDER IS SATISFACTORILY PROGRESSING TOWARD YEAR 2000 COMPLIANCE.

ALTHOUGH THE COMPANY BELIEVES THAT ITS YEAR 2000 PLAN AND OTHER STEPS BEING TAKEN ARE ADEQUATE TO ENSURE THAT IT WILL NOT BE MATERIALLY AFFECTED BY THE YEAR 2000 PROBLEM, THERE CAN BE NO ASSURANCE THAT THE YEAR 2000 PLAN AND THE COMPANY'S OTHER YEAR 2000 REMEDIAL AND CONTINGENCY PLANS WILL FULLY PROTECT THE COMPANY FROM THE RISKS ASSOCIATED WITH THE YEAR 2000. THE ANALYSIS OF, AND PREPARATION FOR, THE YEAR 2000 AND RELATED PROBLEMS NECESSARILY RELY ON A VARIETY OF ASSUMPTIONS ABOUT FUTURE EVENTS AND THERE CAN BE NO ASSURANCE THAT THE COMPANY'S MANAGEMENT HAS ACCURATELY PREDICTED SUCH FUTURE EVENTS OR THAT THE REMEDIAL AND CONTINGENCY PLANS OF THE COMPANY WILL ADEQUATELY ADDRESS SUCH FUTURE EVENTS. IN THE EVENT THAT THE BUSINESS OF THE COMPANY, OF VENDORS OF THE COMPANY OR OF CUSTOMERS OF THE COMPANY IS DISRUPTED AS A RESULT OF THE YEAR 2000 PROBLEM, SUCH DISRUPTION COULD HAVE A MATERIAL ADVERSE EFFECT ON THE COMPANY.

PART 2. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

THE BANK IS NOT AWARE OF ANY LEGAL PROCEEDING AGAINST IT THAT WILL HAVE A

MATERIAL EFFECT ON THE COMPANY'S FINANCIAL STATEMENTS.

SIGNATURES

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934, THE REGISTRANT HAS DULY CAUSED THIS REPORT TO BE SIGNED ON ITS BEHALF BY THE UNDERSIGNED THEREUNTO DULY AUTHORIZED.

HERITAGE OAKS BANCORP

DATE: JULY 20, 1998

S/ LAWRENCE P. WARD

LAWRENCE P. WARD
PRESIDENT
CHIEF EXECUTIVE OFFICER

S/ MARGARET A. TORRES

MARGARET A. TORRES
CHIEF FINANCIAL OFFICER
EXECUTIVE VICE PRESIDENT

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