MID-STATE BANCSHARES
Form 10-K
March 16, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20529

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2004

or

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

For the transition period N/A to N/A

Commission file number 000-23925

MID-STATE BANCSHARES

(Exact name of registrant as specified in its charter)

California	**77-0442667**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1026 Grand Ave. Arroyo Grande, CA	**93420**
(Address of principal executive offices)	(Zip Code)

(805) 473-6829

Registrant s telephone number, including area code :

None

Securities registered pursuant to Section 12(b) of the Act:

Securities registered pursuant to Section 12(g) of the Act:

Common Stock

(no par value)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or shorter period that the Registrant was required to file such reports) Yes x No o, and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes x No o

The aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2004 was $523,007,621.

The number of shares of common stock of the registrant outstanding as of March 2, 2005 was 22,993,521.

The following documents are incorporated by reference herein: Part III, Items 10 through 14 are incorporated from Registrant s definitive proxy statement for the 2005 Annual Meeting of Shareholders.

This annual report on Form 10K is 91 pages long.

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PART I

Certain statements contained in this Annual Report on Form 10-K (Annual Report), including, without limitation, statements containing the words estimates , believes , anticipates , intends , may , expects , could and words of similar import, constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934. These forward- looking statements relate to, among other things, our current expectations regarding future operating results, net interest margin, strength of the local economy, allowance for credit losses and the integration of our acquisition of Ojai Valley Bank. They involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: general economic and business conditions in those areas in which the Company operates, demographic changes, competition, natural disasters, growth in loans and deposits, fluctuations in interest rates, changes in business strategy or development plans, changes in governmental regulation, credit quality, the availability of capital to fund the expansion of the Company s business, economic, political and global changes arising from the war on terrorism and the conflict in Iraq, and other factors referenced in this report, including in Item 1. Business Factors that May Affect Future Results of Operations. When relying on forward-looking statements to make decisions with respect to our Company, investors and others are cautioned to consider these and other risks and uncertainties. The Company disclaims any obligation to update any such factors or to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

This discussion should be read in conjunction with our financial statements, including the notes thereto, appearing elsewhere in this report.

ITEM 1. BUSINESS

Mid-State Bancshares and Mid-State Bank & Trust

Mid-State Bancshares (the Company) is the parent company to Mid-State Bank & Trust (the Bank), its 100% owned principal subsidiary. The Company is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended (BHC Act) and is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (Federal Reserve Board).

The Company, through the Bank, derives its income primarily from interest received on loans, and to a lesser extent, from interest on investment securities, fees received in connection with loans and other services offered, including loan servicing and deposit services. The Company s major operating expenses are the interest it pays on deposits and borrowings and general operating expenses. The Company s operations, like those of other financial institutions operating in California, are significantly influenced by economic conditions in California, including the strength of the real estate market, the fiscal and regulatory policies of the federal government and of the regulatory authorities that govern financial institutions. See Supervision and Regulation.

Mid-State Bank & Trust was incorporated under the laws of the State of California and commenced operations on June 12, 1961 as a California state chartered bank. The Bank s accounts are insured by the Federal Deposit Insurance Corporation (FDIC), but it is not a member of the Federal Reserve System. At December 31, 2004 the Company had total assets of approximately $2.3 billion, total deposits of $2.0 billion and total shareholders equity of $275 million.

The Bank operates 41 full service retail-banking offices along the central coast of California in Santa Barbara, San Luis Obispo and Ventura counties. The Bank s headquarters is located in Arroyo Grande and it also serves the communities of Paso Robles, Cambria, Templeton, Atascadero, Cayucos, Morro Bay, Los Osos, San Luis Obispo, Pismo Beach, Grover Beach, Guadalupe, Nipomo, Santa Maria, Orcutt,

Lompoc, Vandenberg Village, Buellton, Santa Ynez, Solvang, Goleta, Oxnard, Camarillo, Ojai, Oak View, Ventura and Santa Barbara. The headquarters street address is 1026 Grand Ave., Arroyo Grande, CA 93420. Its mailing address is P.O. Box 6002, Arroyo Grande, CA 93421-6002. The telephone number is: (805) 473-6829. The Bank can also be reached through its internet address at *www.midstatebank.com*.

The Bank is a full-service community bank offering a broad range of banking products and services, including accepting time and demand deposits, originating loans and leases, providing trust services, and making other investments. The Bank originates several types of loans, including secured and unsecured commercial and consumer loans, residential real estate mortgage loans, and residential construction loans. The Bank s loans are both short-term and intermediate term in length and consist of both fixed and adjustable rate contracts. Special services and requests beyond the lending limits of the Bank are arranged through correspondent banks.

Bank Subsidiaries

The Bank operates two wholly owned subsidiaries Mid Coast Land Company and MSB Properties. Mid Coast Land Company was founded in 1984 pursuant to section 751.3 of the Financial Code of the State of California. Section 751.3 provided that state-chartered banks were authorized to invest in a corporation that engaged in real estate activities. Under the Federal Deposit Insurance Corporation Improvement Act (FDICIA) which became law in December 1991, the Bank, through Mid Coast Land Company, was required to divest itself of its real estate development activities. That process was completed in January 2003. The holdings and results of operations of Mid Coast Land Company are included within the consolidated financial statements of the Company. On a stand-alone basis, Mid Coast Land Company had after-tax earnings of $379 thousand in 2004, $322 thousand in 2003, and a loss of $72 thousand in 2002. For further information concerning Mid Coast Land Company, see the Subsidiary Activity section of the Management s Discussion and Analysis section included in Item 7 of this Report.

MSB Properties was incorporated under the laws of the State of California in May of 1968, allowing for the ownership of property which may be reasonably necessary for the expansion of the Bank s business, or which is otherwise reasonably related to the conduct of the Bank s business, pursuant to Section 752 of the Financial Code of the State of California.

The holdings and results of operations of MSB Properties are included within the consolidated financial statements of the Company. On a stand-alone basis, MSB Properties had earnings of $1.2 million, $1.4 million, and $1.3 million in 2004, 2003, and 2002, respectively. For further information concerning MSB Properties, see the Subsidiary Activity portions of the Management s Discussion and Analysis section included in Item 7. of this Report.

Acquisition of Ojai Valley Bank

On October 31, 2003, Mid-State Bancshares and its wholly owned subsidiary Mid-State Bank & Trust acquired 100 percent of the outstanding common stock of Ojai Valley Bank. The results of Ojai Valley Bank s operations have been included in the consolidated financial statements since that date. Ojai Valley Bank was a community bank serving the communities of Ojai and Oak View in Ventura County. The merger gives Mid-State Bank & Trust two new offices in Ventura County.

The aggregate purchase price was $25.0 million, including $11.8 million in cash paid to Ojai Valley Bank shareholders, $11.8 million in Mid-State Bancshares common stock issued and $1.3 million for other merger related expenses. The value of the 498,153 shares issued was determined based on the average closing market price of Mid-State Bancshares common stock over the twenty consecutive trading days that Mid-State Bancshares stock traded ending October 24, 2003. The average price of Mid-State Bancshares stock over that period was $23.78. The merger was accounted for utilizing the purchase method of accounting.

Services

The Bank offers a full range of commercial banking services including checking accounts, NOW accounts, savings accounts, money market accounts, and various types of time certificates of deposit (including various maturities and individual retirement accounts). The Bank makes a variety of construction and land development loans, real estate related loans, home equity credit lines, installment loans, agricultural and commercial loans, business equipment leases and SBA loans. Other services offered by the Bank include, but are not limited to, trust services, safe deposit boxes, travelers cheques, notary public, merchant depository services for VISA and Mastercard, cash management, home banking, telephone voice response system and ATM s. The Bank s organization and structure is designed to serve the banking needs of individuals and small to medium sized businesses in Santa Barbara, Ventura and San Luis Obispo counties.

Deposit and Liability Management

Deposits represent the Bank s primary source of funds. As of December 31, 2004 the Bank had approximately 36,713 non interest bearing demand deposit accounts representing $517.1 million, or an average of $14,085 per account. The Bank also had approximately 121,526 NOW, Money Market and Savings accounts amounting to $1,083 million, or about $8,912 average per account. There were 16,054 time certificates of deposit outstanding at December 31, 2004, representing $394.3 million with an average deposit balance of approximately $24,559. Of the total time certificates of deposit, $166.3 million represented holders who carried an amount on deposit of $100,000 or more, approximately 42% of the total.

The Bank is not dependent on a single or a few customers for its deposits. Most deposits are obtained from individuals and small-to-medium sized businesses. This results in the relatively small average balances noted above and allows the Bank to be less subject to the adverse effects of the loss of a large depositor. As of December 31, 2004, no individual, corporate, or public depositor accounted for more than 2% of the Bank s total deposits.

Liquidity is the Bank s ability to meet fluctuations in deposit levels and to provide for the credit needs of its customers. The objective in liquidity management is to maintain a balance between the sources and uses of funds. Principal sources of liquidity include interest and principal payments on loans and investments, proceeds from the maturity of investments and growth in deposits. The Bank holds overnight Fed Funds Sold as a cushion for temporary liquidity needs. For 2004, Fed Funds Sold averaged $37.4 million representing 1.6% of average assets. In addition, the Bank maintains Federal Funds lines of credit totaling $70 million with major correspondents, subject to customary terms for such arrangements.

The Bank s internally calculated liquidity ratio, which measures the percentage of total liabilities (excluding equity) which are used to fund cash, cash equivalents and non-pledged marketable securities, was 34.2% in excess of the Bank s policy minimum of 15%.

Liquidity demands at the Holding Company have been limited historically to dividend payments it makes to its stockholders, the repurchase of its common stock, and certain payments to vendors. Management does not anticipate any further demands requiring liquidity in the near term. Currently, the liquidity needs of the Holding Company are funded by dividends it receives from the Bank.

Loans

The Bank s loan-to-deposit ratio stood at approximately 71.3% at year-end 2004. It is the Bank s goal to maintain its loan-to-deposit ratio in the 65% to 75% range while maintaining credit quality.

The Bank maintains an allowance for loan losses which is netted against loans on the balance sheet. Additions to the allowance are made by charges to expense. All loans deemed to be uncollectible are

charged to the allowance; subsequent recoveries are credited to the allowance. The amount in the loan loss allowance is an estimate of the losses inherent in the loan portfolio as determined by a variety of factors considered by Management. Factors include, but are not limited to, the current economic climate, type and quality of loans in the portfolio, trends in delinquencies, historical loss rates, non-accrual totals, diversification of the portfolio, value of available collateral and the cost of collateral liquidation.

As of December 31, 2004, the Bank s allowance for loan losses stood at $13.8 million. Additionally, the Bank has an allowance for losses on unfunded commitments totaling $1.8 million. Collectively, these allowances for losses represent 145.6% of non-performing loans (non-accrual loans plus loans 90 days or more past due). Outside factors, not within the Bank s control, such as adverse changes in the economy, can affect the adequacy of the allowances and there can be no assurance that in any given period, the Bank might not suffer losses which are substantial in relation to the size of the allowances. During 2004, the Bank experienced net recoveries after charge-offs, of $0.4 million, or 0.03% of average loans.

Underwriting and Credit Administration

The lending activities of Mid-State Bank & Trust are guided by the lending policies approved by the Bank s Board of Directors. The credit policy is managed through periodic reviews and approved annually by the Board.

Each loan is evaluated using underwriting criteria established in the Bank s lending policy. Lending authority is granted to officers of the Bank on a limited basis, dependent upon individual knowledge and experience. Loan requests exceeding individual limits are submitted to the Board Loan Committee, which consists of the President, Chief Credit Officer and three non-management directors. The Board Loan Committee meets on a regular basis in order to provide timely responses to the Bank s clients.

Mid-State Bank & Trust s credit administration function includes an internal review and the regular use of an outside loan review firm.

Loan Portfolio

At December 31, 2004 and 2003, Mid-State Bank & Trust s gross loan portfolio totaled $1.4 billion and $1.1 billion, respectively. The portfolio was distributed as follows:

	December 31,	
	2004	2003
Construction and Land Development	16.1 %	20.8 %
Real Estate Farmland	2.3 %	2.1 %
Real Estate Residential	13.7 %	7.4 %
Real Estate Non Farm, Non Residential	37.5 %	39.6 %
Home Equity Credit Lines	11.2 %	7.8 %
Cash Reserve	0.3 %	0.6 %
Installment	1.3 %	2.2 %
Agricultural Production	2.8 %	2.9 %
Commercial, Other	14.8 %	16.6 %
	100.0 %	100.0 %

The interest rates charged for the loans made by the Bank vary with the degree of risk, size and maturity of the loans. Rates are generally affected by competition, the client s deposit relationship with the Bank, and the Bank s cost of funds.

Commercial Loans. The Bank provides financial services to diverse commercial and professional businesses in the marketplace. Commercial loans consist primarily of short term loans (normally with a

maturity of one year or less) for working capital and business expansion. Commercial loans typically include revolving lines of credit, either uncollateralized, or collateralized by inventory, loans secured by accounts receivable and equipment loans. Emphasis is placed on the borrower s earnings history, capitalization, secondary sources of repayment, and in some instances, third-party guarantees or highly liquid collateral (such as time deposits and investment securities). Commercial loan pricing is generally at a rate tied to the prime rate (as quoted in the *Wall Street Journal*) or the Bank s reference rates. Certain equipment loans may be made at fixed rates for short to medium terms.

The Bank participates in a Small Business Administration (SBA) loan guarantee program. Those programs used include both the 504 program, which is focused toward longer-term financing of buildings and other long-term assets, and the 7A program, which is primarily used for financing of equipment, inventory and working capital needs of eligible businesses, generally over a three to twenty-five year term. The Bank s collateral position in the SBA loans is enhanced by the SBA guarantee in the case of 7A loans, and by lower loan-to-value ratios under the 504 program. The Bank is designated as a preferred lender by the SBA, allowing it to process these loans more quickly. Under the SBA s Preferred Lending Program, the SBA delegates a substantial degree of lending authority to participating lenders, such as the Bank. The Bank also participates in other government sponsored loan programs offered by various government agencies, such as through the California Coastal Rural Development Corporation, Central Coast Development Companies and others.

Agricultural Loans. The Bank provides production loans to help finance the seasonal needs of farming operations, including crop and livestock financing, inventory purchases, and receivable financing. The Bank has very limited vineyard lending exposure (less than $10 million at December 31, 2004). Equipment loans are also financed on everything from field equipment to office automation systems. Emphasis is placed on the borrower s earnings history, capitalization, secondary sources of repayment, and in some instances, third-party guarantees or highly liquid collateral (such as time deposits and investment securities). Agricultural loan pricing, like Commercial loan pricing, is generally at a rate tied to the prime rate (as quoted in the *Wall Street Journal*) or the Bank s reference rates. Certain equipment loans may be made at fixed rates for short to medium terms.

Real Estate Construction and Development Loans. The Bank s real estate construction loan activity has focused on providing short-term (maturity of two years or less) loans to individuals and developers with whom the Bank has established relationships, for the construction primarily of single family residences in the Bank s market area.

Residential real estate construction loans are typically secured by first deeds of trust. The economic viability of the project and the borrower s credit-worthiness are primary considerations in the loan underwriting decision. The Bank utilizes approved independent local appraisers as well as in-house staff, and loan-to-value ratios that generally do not exceed 80% of the appraised value of the property. The Bank monitors projects during the construction phase through regular construction inspections and a disbursement program tied to the percentage of completion of each project.

The Bank also occasionally makes land loans to individuals and developers who intend to construct a single-family residence(s) on the lot, generally within 24 months. In addition, the Bank makes commercial real estate construction loans for construction of office and warehouse properties, generally to high-net-worth clients with adequate liquidity. The economic viability of the project and the borrower s credit-worthiness are primary considerations in the loan underwriting decision. Such loans are typically secured by first deeds of trust.

Commercial Real Estate Term Loans and Loans Secured by Farmland. The Bank provides medium-term commercial real estate loans secured by commercial or industrial buildings or farmland where the properties are either used by the owner for business purposes (owner-user properties) or have income derived from tenants (investment properties). As a general rule, the Bank s loan policies require the

principal balance of the loan to be no more than 70% of the stabilized appraised value of the underlying real estate collateral. The loans, which are typically secured by first deeds of trust only, generally have terms of no more than ten years and are amortized over 25 to 30 years. Some of these loans have rates tied to Wall Street Journal prime rate that adjust whenever the prime rate changes. The remaining loans adjust every three, five or seven years depending upon the index to which the loan is tied.

Residential Real Estate Loans. The Bank provides a variety of real estate loans secured by residential real estate. These loans are generally secured by first or second trust deeds on individual residential properties. Most of these loans are sold, servicing retained, in the secondary market. Certain shorter term mortgages, especially jumbo adjustable rate mortgages, may be kept in portfolio and not sold in the secondary market depending on the Bank s appetite for these earning assets. These consist of adjustable rate loans with a short fixed rate period of 3, 5 or 7 years, then adjusted annually using an index of the 1 year treasury constant maturity or 1 year LIBOR. These loans are originated using FNMA/FHMLC underwriting guidelines. Although the loans are held for investment, they are eligible for sale in the secondary market.

Home Equity Credit Lines. The Bank provides lines of credit secured by a first or second deed of trust on the borrower s residential real property. The loans have a 15 year draw period followed by a 15 year amortization of the outstanding principal balance. The loans have an interest rate that adjusts monthly with the Wall Street Journal published prime rate. The total combined percentage of the of the Home Equity Credit Line and first mortgage is dependent on several factors such as credit score, income ratios, stability of employment etc, and can go as high as 100%.

Consumer and Other Loans. The Bank s consumer and other loan portfolio is divided between installment loans secured by automobiles, other consumer purposes and revolving, unsecured consumer debt such as reserve lines of credit. Installment loans tend to be fixed rate and longer-term (one-to-five-year maturity). The Bank s portfolio of revolving credit plans, issued as an additional service to its clients, is minimal at just 0.3% of total loans.

Investment Securities

The Bank maintains a portfolio of investment securities to provide income and to serve as a secondary source of liquidity for its operations in conjunction with Federal Funds Sold (see Deposit and Liability Management above). The Bank s investment policy provides for the purchase of United States Treasury Securities, United States Government Agency Securities, Mortgage Backed Securities, Obligations of State and Political Subdivisions, and Other Securities as permitted by Federal and State regulation. As of December 31, 2004, the aggregate carrying value of the Investment Portfolio was $644.8 million. Of this total, $25.5 million was invested in U.S. Treasury Securities, $216.7 million in U.S. Government Agencies, $9.4 million in Mortgage Backed Securities, $377.0 million in Obligations of State and Political Subdivisions and $16.2 million in Other Securities. The types of securities held are influenced by several factors, which include: rate of return, maturity, and risk. Generally, the Bank endeavors to stagger the maturities of its securities so that it has regular maturities for liquidity purposes. The Bank does not participate in any swap or hedge activity on the investment portfolio (or any other part of the balance sheet) and has no plans to begin such activity.

Acceptable securities may be pledged to secure public deposits from State and Public Agencies. As of December 31, 2004, the Bank had public funds totaling approximately $55.6 million. The Bank has made available $106.4 million of securities to securitize these funds. Excess collateral can be released as needed.

Economic Climate

The economy in the Bank s trade area is based upon agriculture, oil, tourism, light industry, government services, aerospace industries and retail trade. Services supporting those involved in these

industries have also developed in the areas of medical, financial and educational services. Population in the Tri-county area, according to the California Department of Finance, is estimated at January 2004 to be 1,475,400. Ventura County represents about 54% of this total with Santa Barbara and San Luis Obispo Counties accounting for 28% and 18% respectively. Certain economic activities are unique to the area such as the space launching facilities at Vandenberg Air Force Base and the production of seeds for various flowers grown worldwide. While major oil companies have elected to do business elsewhere (due to very stringent county business regulations), smaller production companies have moved in to continue the oil industry in the area. The moderate climate allows a year round growing season for numerous vegetables and fruits. Vineyards and cattle ranches make large contributions to the local economy. There are large numbers of retail businesses and light manufacturers with only limited numbers of high tech firms throughout the service area. Access to numerous recreational activities, including both mountains and beaches, provide a fairly stable tourist industry from larger metropolitan areas such as the Los Angeles/Orange County basin and the San Francisco Bay area. Real estate values throughout the Tri-counties have steadily increased in recent years. With the diversity of the various types of industries in the Bank s service area, the Central Coast, while not immune from economic fluctuations, has historically tended to enjoy a more stable level of economic activity than many other areas of California.

Competition

The banking business in California generally, and in the Bank s primary service areas specifically, is highly competitive with respect to both loans and deposits and is dominated by a relatively small number of major banks with many offices and operations over a wide geographic area. Among the advantages such major banks have over the Bank are their ability to finance wide-ranging advertising campaigns and to allocate their investment assets to regions of higher yield and demand. Such banks offer certain services such as international banking which is not offered directly by the Bank, but which can be offered indirectly by the Bank through correspondent institutions. In addition, by virtue of their greater total capitalization, such banks have substantially higher lending limits than the Bank. (Legal lending limits to an individual customer are based upon a percentage of a bank s total capital accounts.) The Bank s secured and unsecured lending limits at December 31, 2004, were approximately $56.5 million and $33.9 million, respectively. These levels compare to $54.3 million and $32.6 million, respectively, at December 31, 2003.

Other entities, both governmental and in private industry, seeking to raise capital through the issuance and sale of debt or equity securities, also provide competition for the Bank in the acquisition of deposits. Banks also compete with money market funds and other providers of money market instruments.

Commercial banks compete with savings and loan associations, credit unions, other financial institutions, securities brokerage firms and other entities for funds. For instance, yields on corporate and government debt securities and other commercial paper affect the ability of commercial banks to attract and hold deposits. Commercial banks also compete for loans with savings and loan associations, credit unions, consumer finance companies, mortgage companies and other lending institutions.

The financial services industry is undergoing rapid technological changes involving frequent introductions of new technology-driven products and services that have further increased competition. There can also be no assurance that these technological improvements, if made, will increase the Bank s operational efficiency or that the Bank will be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

The trend toward consolidation of banking assets exhibited over the past few years in California continued in 2004. Statewide, through November 2004, 21 banks are merging out of existence based on announced merger transactions. According to the California State Department of Financial Institutions however, 14 new banks have filed in 2004 to start a new bank in California, as of November 2004.

Employees

At December 31, 2004, the Bank had a total of 860 employees. A number of these employees are part-time however. On a full-time equivalent basis, employees represent 794 positions. The Bank believes that its employee relations are positive.

Effect of Governmental Policies and Legislation

Banking is a business that depends on rate differentials. In general, the difference between the interest rate paid by the Bank on its deposits and its other borrowings and the interest rate received by the Bank on loans extended to its customers and securities held in the Bank s portfolio comprise the major portion of the Bank s earnings. These rates are highly sensitive to many factors that are beyond the control of the Bank. Accordingly, the earnings and growth of the Bank are subject to the influence of local, domestic and foreign economic conditions, including recession, unemployment and inflation.

The commercial banking business is not only affected by general economic conditions but is also influenced by the monetary and fiscal policies of the federal government and the policies of regulatory agencies, particularly the Federal Reserve Board. The Federal Reserve Board implements national monetary policies (with objectives such as curbing inflation and combating recession) by its open-market operations in United States Government securities which effect short term rates such as the Fed Funds rate, by adjusting the required level of reserves for financial institutions subject to its reserve requirements and by varying the discount rates applicable to borrowings by depository institutions. The actions of the Federal Reserve Board in these areas influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. The nature and impact on the Bank of any future changes in monetary policies cannot be predicted.

From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial intermediaries. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial intermediaries are frequently made in Congress, the California legislature and before various bank regulatory and other professional agencies. See Financial Services Modernization Legislation, and Sarbanes-Oxley Act of 2002.

Supervision and Regulation

The Bank is extensively regulated under both federal and state law. Set forth below, is a summary description of certain laws which relate to the regulation of the Company and the Bank. The description does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations.

Mid-State Bancshares

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the Bank Holding Company Act), and is registered as such with, and subject to the supervision of, the Federal Reserve Board. It is required to file with the Federal Reserve Board quarterly and annual reports and such additional information as the Federal Reserve Board may require pursuant to the Bank Holding Company Act. The Federal Reserve Board may conduct examinations of bank holding companies and their subsidiaries.

The Company is required to obtain the approval of the Federal Reserve Board before it may acquire all or substantially all of the assets of any bank, or ownership or control of the voting shares of any bank if, after giving effect to such acquisition of shares, the Company would own or control more than 5% of the

voting shares of such bank. Prior approval of the Federal Reserve Board is also required for the merger or consolidation of the Company and another bank holding company.

The Company is prohibited by the Bank Holding Company Act, except in certain statutorily prescribed instances, from acquiring direct or indirect ownership or control of more than 5% of the outstanding voting shares of any company that is not a bank or bank holding company and from engaging, directly or indirectly, in activities other than those of banking, managing or controlling banks or furnishing services to its subsidiaries. However, the Company may, subject to the prior approval of the Federal Reserve Board, engage in any, or acquire shares of companies engaged in, activities that are deemed by the Federal Reserve Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

The Federal Reserve Board may require that the Company terminate an activity or terminate control of or liquidate or divest subsidiaries or affiliates when the Federal Reserve Board determines that the activity or the control or the subsidiary or affiliates constitutes a significant risk to the financial safety, soundness or stability of any of its banking subsidiaries. The Federal Reserve Board also has the authority to regulate provisions of certain bank holding company debt, including authority to impose interest ceilings and reserve requirements on such debt. Under certain circumstances, the Company must file written notice and obtain approval from the Federal Reserve Board prior to purchasing or redeeming its equity securities.

Under the Federal Reserve Board s regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe and unsound manner. In addition, it is the Federal Reserve Board s policy that in serving as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company s failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve Board to be an unsafe and unsound banking practice or a violation of the Federal Reserve Board s regulations or both.

The Company and the Bank are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, neither the Company nor the Bank may condition an extension of credit to a customer on either (1) a requirement that the customer obtain additional services provided by the Company and the Bank or (2) an agreement by the customer to refrain from obtaining other services from a competitor.

The Company s common stock is registered with the Securities and Exchange Commission (the SEC) under the Securities Exchange Act of 1934, as amended. As such, we are subject to the information, proxy solicitation, insider trading, corporate governance, and other requirements and restrictions of such Act.

The Bank

The Bank is chartered under the laws of the State of California and its deposits are insured by the FDIC to the extent provided by law. The Bank is subject to the supervision of, and is regularly examined by, the California Department of Financial Institutions (DFI) and the FDIC. Such supervision and regulation include comprehensive reviews of all major aspects of the Bank s business and condition.

Various requirements and restrictions under the laws of the United States and the State of California affect the operations of the Bank. Federal and California statutes relate to many aspects of the Bank s operations, including reserves against deposits, interest rates payable on deposits, loans, investments, mergers and acquisitions, borrowings, dividends and locations of branch offices. Further, the Bank is required to maintain certain levels of capital.

If, as a result of an examination of a bank, the FDIC or the DFI should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of the Bank s operations are unsatisfactory or that the Bank or its management is violating or has violated any law or regulation, various remedies are available to these regulatory agencies. Such remedies include the power to enjoin unsafe or unsound practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict the growth of the Bank, to assess civil monetary penalties, to remove officers and directors, and ultimately to terminate the Bank s deposit insurance, which for a California chartered bank would result in a revocation of the bank s charter.

Capital Standards

The Federal Reserve Board and the FDIC have adopted risk-based minimum capital guidelines intended to provide a measure of capital that reflects the degree of risk associated with a banking organization s operations for both transactions reported on the balance sheet as assets and transactions, such as letters of credit and recourse arrangements, which are recorded as off balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. Treasury securities, to 100% for assets with relatively high credit risk, such as certain business loans.

A banking organization s risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets. The regulators measure risk-adjusted assets, which includes off balance sheet items, against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1 capital consists primarily of common stock, retained earnings, non-cumulative perpetual preferred stock (cumulative perpetual preferred stock for bank holding companies) and minority interests in certain subsidiaries, less most intangible assets. Tier 2 capital may consist of a limited amount of the allowance for loan and lease losses, cumulative preferred stock, long term preferred stock, eligible term subordinated debt and certain other instruments with some characteristics of equity. The inclusion of elements of Tier 2 capital is subject to certain other requirements and limitations of the federal banking agencies. The federal banking agencies require a minimum ratio of qualifying total capital to risk-adjusted assets of 8% and a minimum ratio of Tier 1 capital to risk-adjusted assets of 4%.

In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets is 3%. For all banking organizations not rated in the highest category, the minimum leverage ratio must be at least 100 to 200 basis points above the 3% minimum, or 4% to 5%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the regulators have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

Future changes in regulations or practices could further reduce the amount of capital recognized for purposes of capital adequacy. Such a change could affect the ability of the Bank to grow and could restrict the amount of profits, if any, available for the payment of dividends to the Company.

On January 1, 1998 legislation became effective which, among other things, gave the DFI power to take possession of the business and properties of a bank in the event that the tangible shareholders equity of the bank is less than the greater of (i) 3% of the bank s total assets or (ii) $1.0 million.

For information concerning the capital ratios of the Company and the Bank, see, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations.

Under applicable regulatory guidelines, the Bank was considered Well Capitalized as of December 31, 2004.

Prompt Corrective Action and Other Enforcement Mechanisms

Federal banking agencies possess broad powers to take corrective and other supervisory action to resolve the problems of insured depository institutions, including but not limited to those institutions that fall below one or more prescribed minimum capital ratios described above. An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions. The federal banking agencies, however, may not treat a significantly undercapitalized institution as critically undercapitalized unless its capital ratio actually warrants such treatment.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include:

- the imposition of a conservator or the issuance of a cease-and-desist order that can be judicially enforced;
- the termination of insurance of deposits (in the case of a depository institution);
- the imposition of civil money penalties;
- the issuance of directives to increase capital;
- the issuance of formal and informal agreements;
- the issuance of removal and prohibition orders against institution-affiliated parties; and
- the enforcement of such actions through injunctions or restraining orders based upon a judicial determination that the agency would be harmed if such equitable relief was not granted.

Additionally, a holding company s inability to serve as a source of strength to its subsidiary banking organizations could serve as an additional basis for a regulatory action against the holding company.

Banks are also subject to certain Federal Reserve Board restrictions on extensions of credit to executive officers, directors, principal shareholders or any related interests of such persons (i.e., insiders). Extensions of credit (1) must be made on substantially the same terms and pursuant to the same credit underwriting procedures as those for comparable transactions with persons who are neither insiders nor employees, and (2) must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to insiders. A violation of these restrictions may result in regulatory sanctions on the bank or its insiders.

Premiums for Deposit Insurance

The Bank s deposits are currently insured to a maximum of $100,000 per depositor through the Bank Insurance Fund administered by the FDIC. The Bank is required to pay deposit insurance premiums, which are assessed semiannually and paid quarterly. The premium amount is based upon a risk classification system established by the FDIC. Banks with higher levels of capital and a low degree of supervisory concern are assessed lower premiums than banks with lower levels of capital or a higher degree of supervisory concern.

The FDIC is also empowered to make special assessments on insured depository institutions in amounts determined by the FDIC to be necessary to give it adequate assessment income to repay amounts borrowed from the U.S. Treasury and other sources or for any other purpose the FDIC deems necessary.

The FDIC is authorized to terminate a depository institution s deposit insurance upon a finding by the FDIC that the institution s financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution s regulatory agency.

Sarbanes-Oxley Act of 2002

On July 30, 2002, the Sarbanes-Oxley Act of 2002 (SOX), was signed into law to address corporate and accounting fraud. SOX establishes a new accounting oversight board that will enforce auditing standards and restricts the scope of services that accounting firms may provide to their public company audit clients. Among other things, SOX also (i) requires chief executive officers and chief financial officers to certify to the accuracy of periodic reports filed with the SEC; (ii) imposes new disclosure requirements regarding internal controls, off-balance-sheet transactions, and pro forma (non-GAAP) disclosures; (iii) accelerates the time frame for reporting of insider transactions and periodic disclosures by public companies; and (iv) requires companies to disclose whether or not they have adopted a code of ethics for senior financial officers and whether the audit committee includes at least one audit committee financial expert.

Under SOX, the SEC is required to regularly and systematically review corporate filings, based on certain enumerated factors. To deter wrongdoing, SOX: (i) subjects bonuses issued to top executives to disgorgement if a restatement of a company s financial statements was due to corporate misconduct; (ii) prohibits an officer or director from misleading or coercing an auditor; (iii) prohibits insider trades during pension fund blackout periods ; (iv) imposes new criminal penalties for fraud and other wrongful acts; and (v) extends the period during which certain securities fraud lawsuits can be brought against a company or its officers.

As a public reporting company, the Company is subject to the requirements of SOX and related rules and regulations issued by the SEC and Nasdaq. The Company has incurred additional expense as a result of the requirements of the Act, but does not expect that such compliance will have a material impact on its business overall.

Financial Services Modernization Legislation

On November 12, 1999, the Gramm-Leach-Bliley Act of 1999 (the Financial Services Modernization Act) was signed into law. The Financial Services Modernization Act is intended to modernize the banking industry by removing barriers to affiliation among banks, insurance companies, the securities industry and other financial service providers. It provides financial organizations with the flexibility of structuring such affiliations through a holding company structure or through a financial subsidiary of a bank, subject to certain limitations. The Financial Services Modernization Act establishes a new type of bank holding company, known as a financial holding company, which may engage in an expanded list of activities that

are financial in nature, which include securities and insurance brokerage, securities underwriting, insurance underwriting and merchant banking. The Company has not chosen to seek financial holding company status.

The Financial Services Modernization Act also sets forth a system of functional regulation that makes the Federal Reserve Board the umbrella supervisor for holding companies, while providing for the supervision of the holding company s subsidiaries by other federal and state agencies. In addition, the Bank is subject to other provisions of the Financial Services Modernization Act, including those relating to CRA, privacy and safe-guarding confidential customer information, regardless of whether the Company elects to become a financial holding company or to conduct activities through a financial subsidiary of the Bank. The Company does not, however, currently intend to file notice with the Federal Reserve Board to become a financial holding company or to engage in expanded financial activities through a financial subsidiary of the Bank.

The Company and the Bank do not believe that the Financial Services Modernization Act will have a material adverse effect on their operations in the near-term. However, to the extent that it permits banks, securities firms, and insurance companies to affiliate, the financial services industry may experience further consolidation. The Financial Services Modernization Act is intended to grant to community banks certain powers as a matter of right that larger institutions have accumulated on an ad hoc basis. Nevertheless, this act may have the result of increasing the amount of competition that the Company and the Bank face from larger institutions and other types of companies offering financial products, many of which may have substantially more financial resources than the Company and the Bank.

USA Patriot Act of 2001

On October 26, 2001, President Bush signed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism, or the Patriot Act, of 2001. Among other things, the Patriot Act (i) prohibits banks from providing correspondent accounts directly to foreign shell banks; (ii) imposes due diligence requirements on banks opening or holding accounts for foreign financial institutions or wealthy foreign individuals (iii) requires financial institutions to establish an anti-money-laundering compliance program, and (iv) eliminates civil liability for persons who file suspicious activity reports. The Patriot Act also increases governmental powers to investigate terrorism, including expanded government access to account records. The Department of the Treasury is empowered to administer and make rules to implement the Patriot Act. While the Company and the Bank believes the Patriot Act may, to some degree, affect their recordkeeping and reporting expenses, they do not believe that it will have a material adverse effect on their business and operations.

Transactions between Affiliates

Transactions between a bank and its affiliates are quantitatively and qualitatively restricted under the Federal Reserve Act. The Federal Reserve Board issued Regulation W on October 31, 2002, which comprehensively implements Sections 23A and 23B of the Federal Reserve Act. Sections 23A and 23B and Regulation W restrict loans by a depository institution to its affiliates, asset purchases by a depository institution from its affiliates, and other transactions between a depository institution and its affiliates. Regulation W unifies in one public document the Federal Reserve Board s interpretations of Section 23A and 23B. Regulation W had an effective date of April 1, 2003.

Community Reinvestment Act

The Bank is subject to certain fair lending requirements and reporting obligations involving home mortgage lending operations and CRA activities. The CRA generally requires the federal banking agencies to evaluate the record of a financial institution in meeting the credit needs of their local communities,

including low and moderate income neighborhoods. In addition to substantial penalties and corrective measures that may be required for a violation of certain fair lending laws, the federal banking agencies may take compliance with such laws and CRA into account when regulating and supervising other activities.

When a bank holding company applies for approval to acquire a bank or other bank holding company, the Federal Reserve will review the assessment of each subsidiary bank of the applicant bank holding company, and such records may be the basis for denying the application. A bank s compliance with its CRA obligations is based on a performance-based evaluation system which bases CRA ratings on an institution s lending service and investment performance, resulting in a rating by the appropriate bank regulatory agency of outstanding , satisfactory , needs to improve or substantial noncompliance. At its last examination by the FDIC, the Bank received a CRA rating of Satisfactory.

Safety and Soundness Standards

The Federal Deposit Insurance Corporation Improvement Act (FDICIA) imposes certain specific restrictions on transactions and requires federal banking regulators to adopt overall safety and soundness standards for depository institutions related to internal control, loan underwriting and documentation and asset growth. Among other things, FDICIA limits the interest rates paid on deposits by undercapitalized institutions, restricts the use of brokered deposits, limits the aggregate extensions of credit by a depository institution to an executive officer, director, principal shareholder or related interest, and reduces deposit insurance coverage for deposits offered by undercapitalized institutions for deposits by certain employee benefits accounts. The federal banking agencies may require an institution to submit to an acceptable compliance plan as well as have the flexibility to pursue other more appropriate or effective courses of action given the specific circumstances and severity of an institution s noncompliance with one or more standards.

Privacy

Federal banking rules limit the ability of banks and other financial institutions to disclose non-public information about consumers to non-affiliated third parties. Pursuant to these rules, financial institutions must provide:

- initial notices to customers about their privacy policies, describing the conditions under which they may disclose non-public information to non-affiliated third parties and affiliates;
- annual notices of their privacy policies to current customers; and
- a reasonable method for customers to opt out of disclosures to non-affiliated third parties.

These privacy provisions affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. We have implemented our privacy policies in accordance with the law.

In recent years, a number of states have implemented their own versions of privacy laws. For example, in 2003, California adopted standards that are more restrictive than federal law, allowing bank customers the opportunity to bar financial companies from sharing information with their affiliates.

Federal Home Loan Bank System

The Bank is a member of the Federal Home Loan Bank (FHLB) of San Francisco. Among other benefits, each FHLB serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB.

A new capital plan of the FHLB of San Francisco was approved by the Federal Housing Finance Board and was implemented on April 1, 2004. The new capital plan incorporates a single class of stock with a par value of $100 share, and may be issued, exchanged, redeemed, and repurchased only at par value. Each member must own stock in an amount equal to the greater of:

- a membership stock requirement with an initial cap of $25 million (1.00% of membership asset value as defined), or
- an activity based stock requirement (based on percentage of outstanding advances).

The new capital stock is redeemable with five years written notice, subject to certain conditions. The effect of this plan was that the Bank had to purchase $5.9 million of additional FHLB stock.

Predatory Lending

The term predatory lending, much like the terms safety and soundness and unfair and deceptive practices, is far-reaching and covers a potentially broad range of behavior. As such, it does not lend itself to a concise or a comprehensive definition. But typically predatory lending involves at least one, and perhaps all three, of the following elements:

- making unaffordable loans based on the assets of the borrower rather than on the borrower s ability to repay an obligation, or asset-based lending;
- inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced, or loan flipping; and
- engaging in fraud or deception to conceal the true nature of the loan obligation from an unsuspecting or unsophisticated borrower.

Federal Reserve Board regulations aimed at curbing such lending significantly widened the pool of high-cost home-secured loans covered by the Home Ownership and Equity Protection Act of 1994, a federal law that requires extra disclosures and consumer protections to borrowers. The following triggers coverage under the Home Ownership and Equity Protection Act of 1994:

- interest rates for first lien mortgage loans in excess of 8 percentage points above comparable Treasury securities,
- subordinate-lien loans of 10 percentage points above Treasury securities, and
- fees such as optional insurance and similar debt protection costs paid in connection with the credit transaction, when combined with points and fees if deemed excessive.

In addition, the regulation bars loan flipping by the same lender or loan servicer within a year. Lenders also will be presumed to have violated the law which says loans shouldn t be made to people unable to repay them unless they document that the borrower has the ability to repay. Lenders that violate the rules face cancellation of loans and penalties equal to the finance charges paid. The Company does not expect these rules and potential state action in this area to have a material impact on our financial condition or results of operation.

Accounting Changes

From time to time the Financial Accounting Standards Board (FASB) issues pronouncements which govern the accounting treatment for the Company s financial statements. For a description of the recent pronouncements applicable to the Company see the Notes to the Financial Statements included in Item 8 of this Report.

Off Balance Sheet and Other Related Party Transactions

As noted in Footnote 12 to the financial statements, the Company is contingently liable for letter of credit accommodations made to its customers in the ordinary course of business totaling $30.2 million at December 31, 2004 compared to $31.0 million one year earlier. Additionally, the Company has undisbursed loan commitments, also made in the ordinary course of business, totaling $656.1 million, which compares to $523.4 million outstanding one year earlier.

There are no Special Purpose Entity (SPE) trusts, corporations, or other legal entities established by the Company which reside off-balance sheet. There are no other off-balance sheet items other than the aforementioned items related to letter of credit accommodations and undisbursed loan commitments.

As noted in Footnote 5 to the financial statements, the Company does make loans to related parties (directors and officers) in the ordinary course of business at prevailing rates and terms. These loans totaled $8.7 million at the end of 2004, compared to the $1.2 million outstanding one year earlier. While loans to insiders and related parties are generally prohibited under SOA, as a bank, Mid-State is exempt from this rule.

Factors That May Affect Future Results of Operations

Dependence on Real Estate. A significant portion of the loan portfolio of the Company is dependent on real estate. At December 31, 2004, real estate served as the principal source of collateral with respect to approximately 80.8% percent of the Company s loan portfolio. A decline in current economic conditions or rising interest rates could have an adverse effect on the demand for new loans, the ability of borrowers to repay outstanding loans, the value of real estate and other collateral securing loans and the value of real estate owned by the Bank, as well as the Company s financial condition and results of operations in general and the market value of the Company s common stock. Acts of nature, including earthquakes and floods, which may cause uninsured damage and other loss of value to real estate that secures these loans, may also negatively impact the Company s financial condition. The impact of the San Simeon earthquake in 2003 did not have a significant adverse impact on the Bank s premises or on the value of the collateral supporting the Company s real estate loan portfolio.

Management continuously monitors residential real estate reports and markets, and is aware of press articles that have discussed a possible slow down in and/or drop in value of residential real estate in the Bank s service area. While long term interest rates remain historically low and the Bank s service area is marked by limited supply and strong demand, residential projects financed by the Bank are underwritten with a requirement of a percentage of cash equity to the total cost of the project in addition to prudent exposures to current appraised values. To further mitigate this risk, individual projects financed are analyzed using direct, current and historical project trends with limitations to production unit starts ahead of sales using the projected absorption analysis contained in the appraisal of each project. The Bank believes, based upon past experience, that this process helps mitigate against the production of a supply of units that would exceed the current market demand.

Additionally, due to the popularity of our market area to urban retirees and others wanting to enjoy the environment and life style it provides, we have seen and continue to see a migration of wealthier individuals and families absorb the residential housing production with greater cash equities than is typical of other areas throughout the country. This assumption is supported by the fact that the Bank s portfolio of residential mortgages have an average loan to value ratio of less than 60% along with average credit scores substantially exceeding industry standards with low delinquency ratios.

Operating Strategies. From time to time, the Company develops long-term financial performance goals to guide and measure the success of our operating strategies. The Company can make no assurance that we will be successful in achieving these long-term goals or that our operating strategies will be successful. Achieving success in these areas is dependent on a number of factors, many of which are

beyond the Company s direct control. Factors that may adversely affect the Company s ability to attain its long-term financial performance goals include:

- Deterioration of asset quality;
- Inability to control non-interest expense, including, but not limited to, rising employee and healthcare costs;
- Inability to increase non-interest income;
- Ability to increase loan growth;
- Ability to find acquisition targets at valuation levels we find attractive;
- Ability to effectively integrate acquired institutions into the Company;
- Regulatory and other impediments associated with making acquisitions;
- Deterioration in general economic conditions, especially in the Company s core markets;
- Decreases in the Company s net interest margin;
- Increases in competition;
- Adverse regulatory or legislative developments;
- Unexpected increase in costs related to regulatory compliance; and
- Unexpected increase in costs related to acquisitions.

Expensing of Stock Options. The Company expects to adopt a new accounting pronouncement in the third quarter of 2005. The new accounting will require the Company to recognize additional expense for employee services received in exchange for an award of equity instruments, such as stock options, based on the grant date fair value of the award and the estimated number of awards that are expected to vest. Pro forma disclosures of net income and earnings per share for the years 2004, 2003 and 2002 are disclosed in Note 15 of the Notes to the Consolidated Financial Statements in Part II, item 8 of this Annual Report on Form 10K. Management expects that the adoption of the new accounting pronouncement will have a material effect on its Consolidated Statements of Income, Comprehensive Income and Changes in Capital Accounts.

Interest Rate Changes. The earnings of the Company and the Bank are substantially affected by changes in prevailing interest rates. Changes in interest rates affect the demand for new loans, the credit profile of existing loans, the rates received on loans and securities and the rates the Bank must pay on deposits and borrowings. The difference between the rates the Bank receives on loans and securities and the rates it must pay on deposits and borrowings is known as the interest rate spread. Given the Bank s current volume and mix of interest-bearing liabilities and interest-earning assets, the Bank s interest rate spread can be expected to increase when market interest rates are rising, and to decline when market interest rates are declining. The Federal Reserve Board s decrease in rates during 2001, 2002 and 2003 substantially impacted the Bank s interest rate spread, as its spread for 2004 declined to 5.36% (taxable equivalent) from 5.54% (taxable equivalent) in 2003 and from 5.74% (taxable equivalent) in 2002. Increases in short term rates by the Federal Reserve Board in the latter half of 2004 are having the effect of beginning to reverse this trend with the Bank s interest spread rising to 5.42% (taxable equivalent) in the fourth quarter of 2004. Although the Bank believes

its current level of interest rate sensitivity is reasonable, significant fluctuations in interest rates may have an adverse impact on its business, financial condition and results of operations.

Competition. Competition may adversely affect the Bank s performance. The financial services business in the Bank s market area is highly competitive, and becoming more so due to changes in regulation, technological advances and the accelerating pace of consolidation among financial service

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providers. Mid-State faces competition both in attracting deposits and making loans. Mid-State competes for loans principally through competitive interest rates and the efficiency and quality of the services provided. Increasing levels of competition in the banking and financial services businesses may reduce market share or cause the prices charged for services to fall. Results may differ in future periods depending on the nature or level of competition.

Regulation. Both the Company and the Bank are subject to government regulation that could limit or restrict their activities, adversely affecting operations. The financial services industry is heavily regulated. Federal and state regulation is designed to protect the deposits of consumers, not to benefit shareholders. The regulations impose significant limitations on operations, and may be changed at any time, possibly causing results to vary significantly from past results. Government policy and regulation, particularly as implemented through the Federal Reserve System, significantly affects credit conditions.

In response to several well-publicized corporate and auditing scandals, the President signed the Sarbanes-Oxley Act into law. This act calls for increased federal regulation of the accounting profession and imposes new requirements upon boards of directors, audit committees and executive officers of public companies. These requirements increased the accounting and legal costs to the Company. As a public company whose securities are listed on the Nasdaq national market, the Company was subject to all of these provisions of the Act and implementing regulations as well as additional corporate governance standards which Nasdaq adopted. The company expended significant amounts of internal staff time and $913 thousand in outside hard dollar costs to comply with the various provisions of these requirements in 2004. Management does not expect the amount of staff time and hard dollar costs to be as significant in future years, however, the effect of the legislation has created a permanent annual increase in the cost structure to the Bank of at least $400 to $500 thousand.

Borrowers Failure to Perform. A significant number of the Bank s borrowers and guarantors may fail to perform their obligations as required by the terms of their loans, which could result in larger than expected losses. This risk increases when the economy is weak, as it has been recently. The Bank has adopted underwriting and credit policies, and loan monitoring procedures, including the establishment and monitoring of allowances for credit losses. Management believes these provisions are reasonable and adequate, and should keep credit losses within expected limits by assessing the likelihood of nonperformance, tracking loan performance and diversifying the credit portfolio. However, these policies and procedures may not be adequate to prevent unexpected losses that could materially and adversely affect the results of operations.

Operations Risks. The Bank is subject to certain operations risks, including, but not limited to, data processing system failures and errors, customer or employee fraud and catastrophic failures resulting from terrorist acts or natural disasters. The Bank maintains a system of internal controls to mitigate against such occurrences and maintains insurance coverage for such risks, but should such an event occur that is not prevented or detected by the Bank s internal controls, uninsured or in excess of applicable insurance limits, it could have a significant adverse impact on the Company s business, financial condition or results of operations.

Loan Demand. The Company is significantly affected by the level of loan demand available to it in its markets. The inability to make sufficient loans directly affects the interest income it earns. Lower loan demand will generally result in lower interest income realized by the Company as it places funds in lower yielding investments.

Goodwill. Pursuant to GAAP, the Company is required to periodically asses its goodwill, intangibles and other long-lived assets to determine if they are impaired. Disruptions to our business, end market conditions and protracted economic weakness, unexpected significant declines in operating results of reporting units, divestitures and market capitalization declines may result in additional charges to goodwill and other asset impairments. Future impairment charges could substantially affect our reported earnings

in the period of such charge. In addition, such charges would reduce our consolidated net worth and our shareholders equity.

Geographic Concentration. The Company s operations are located almost entirely in the Central Coast region of California. As a result of this geographic concentration, our results depend largely upon economic and business conditions in this region. A deterioration in economic and business conditions in our market area could have a material adverse impact on the quality of our loan portfolio and the demand for our products and services, which in turn may have a material adverse effect on our results of operations.

War on Terrorism. The terrorist attacks of September 11, 2001, the ensuing worldwide war on terrorism and the actions in Afghanistan and Iraq, may lead to unexpected shifts in cash flows, deposit levels, and general economic activity. U.S. banking agencies have warned of the possible impact of such events on the capital ratios of banks.

Company Cash Flow. As a holding company, all of the Company s cash flow typically comes from dividends from the Bank. Various statutory provisions restrict the amount of dividends the Bank can pay to the Company without regulatory approval.

Small Business Administration (SBA) Lending. SBA lending is a federal government created and administered program. As such, legislative and regulatory developments can affect the availability and funding of the program. This dependence on legislative funding and regulatory restrictions from time to time causes limitations and uncertainties with regard to the continued funding of such loans, with a resulting potential adverse financial impact on the Company s business.

Environmental Liabilities. In the course of our business the Bank may foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. It may be held liable to a governmental entity or to third persons for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, the Bank may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If the Bank ever becomes subject to significant environmental liabilities, its business, financial condition, liquidity and results of operations could be materially and adversely affected.

Where You Can Find More Information.

Under the Securities Exchange Act of 1934 Sections 13 and 15(d), periodic and current reports must be filed with the SEC. The Company electronically files the following reports with the SEC: Form 10-K (Annual Report), Form 10-Q (Quarterly Report), Form 11-K (Annual Report for Employees Stock Purchase and Savings Plans), Form 8-K (Current Report of Unscheduled Material Events), Forms 3, 4, and 5 (Changes in Beneficial Ownership) and Form DEF 14A (Proxy Statement). The Company may file additional forms. The SEC maintains an Internet site, *www.sec.gov*, in which all forms filed electronically may be accessed. Additionally, all forms filed with the SEC and additional shareholder information, such as certain corporate governance documents including the Company s and Bank s audit committee charter, compensation committee charter, nominating/corporate governance committee charter, corporate governance guidelines, and corporate code of conduct (which includes the code of ethics required by the SEC and applicable to senior executive officers of the Company and Bank), is available free of charge on the Company s website: *www.midstatebank.com*. The Company posts these reports to its website as soon as reasonably practicable after filing them with the SEC. None of the information on or hyperlinked from the Company s website is incorporated into this Annual Report on Form 10-K.

ITEM 2. PROPERTIES

The Company s principal office is located at 1026 Grand Avenue, Arroyo Grande, California. As of December 31, 2004, the Bank owned 23 of its branch offices, 4 non-banking support offices and leased 18 other Bank locations (covered by 20 leases). The Company believes its present facilities are in good condition and are adequate for its present needs. The Company does not anticipate difficulty in renewing existing leases as they expire or in finding alternative facilities. See Note 6 to the Consolidated Financial Statements for a further description of the Company s lease obligations.

Owned by Bank or Subsidiary:	Location of Offices	Encumbrance
Arroyo Grande*	991 Bennett Avenue	NONE
Arroyo Grande	1026 Grand Avenue	NONE
Arroyo Grande*	550 Camino Mercado	NONE
Arroyo Grande*	398 Sunrise Terrace	NONE
Atascadero	6950 El Camino Real	NONE
Buellton	West Highway 246 & Central	NONE
Cambria	1070 Main Street	NONE
Goleta Valley	5956 Calle Real	NONE
Grover Beach	899 Grand Avenue	NONE
Grover Beach*	140 North Second Street	NONE
Guadalupe	905 Guadalupe Street	NONE
Lompoc	828 North H Street	NONE
Los Osos	1001 Los Osos Valley Road	NONE
Morro Bay	251 Harbor Street	NONE
Nipomo	615 West Tefft Street	NONE
Paso Robles	845 Spring Street	NONE
Pismo Beach	801 Price Street	NONE
San Luis Obispo	75 Santa Rosa	NONE
San Luis Obispo	2276 Broad Street	NONE
Santa Barbara	33 East Carrillo Street	NONE
Santa Barbara	2222 Bath Street	NONE
Santa Maria	720 North Broadway	NONE
Santa Maria	2739 Santa Maria Way	NONE
Santa Maria	1554 South Broadway	NONE
Santa Maria	519 E. Main Street	NONE
Templeton	1025 Las Tablas Road	NONE
Vandenberg Village	3745 Constellation Road	NONE

Leased by Bank or Subsidiary

Location	Address	Terms
Arroyo Grande West Branch In Store Office	1132 West Branch Street	$3,100.00 per month Expires February, 2005
Camarillo Camarillo Financial Center	470 Arneill Road	$6,808.76 per month Expires June, 2009
Cayucos	107 North Ocean Avenue	$1,694.00 per month Expires November, 2007
Goleta Valley Hollister Office	5340 Hollister Avenue	$4,824.00 per month Expires February, 2007
Ojai Oak View	410 Ventura Avenue	$2,124.27 per month Expires December, 2005
Ojai Ojai Valley	1207 Maricopa Highway	$7,622.00 per month Expires December, 2014
Orcutt	1110 East Clark Avenue	$11,292.00 per month Expires October, 2010
Oxnard Esplanade Financial Center	300 Esplanade Drive, Suite 101	$14,040.90 per month Expires September, 2012
Oxnard*	300 Esplanade Drive, Suite 110	$11,734.57 per month Expires August, 2012
Oxnard Downtown Oxnard Office	155 A Street	$6,030.42 per month Expires July, 2005
Oxnard Northside Plaza Office	121-125 Gonzales Boulevard	$6,666.76 per month Expires July, 2007
Paso Robles Creston Road Office	705 Golden Hill Road	$9,585.00 per month Expires October, 2012
Pismo Beach Oak Park Office	865 Oak Park Boulevard	$10,372.00 per month Expires March, 2008
Santa Barbara Milpas Office	914 Carpinteria Street	$10,117.53 per month Expires May, 2017
Santa Maria** North Broadway Office Land	720 North Broadway	$2,522.00 per month Expires Dec, 2008
Santa Ynez	3600 Sagunto Street	$2,632.00 per month Expires May, 2012
Solvang	1600 Copenhagen Drive	$9,688.69 per month Expires April, 2008
Ventura Mills Road Financial Center	300 S. Mills Road	$17,306.94 per month Expires August, 2012
Ventura Downtown Ventura Office	304 E. Main Street	$10,652.00 per month Expires November, 2012
Ventura County Center Office	6401 E. Telephone Road	$10,939.84 per month Expires September, 2012

Former Bank Offices Leased by Bank Which Are Sub-Leased

Nipomo Ground Lease	630 W. Tefft Street	$3,982.00 per month Expires February, 2015

* *The Bank s rental expense for 2004 was $1,985,000. See note 6 of the Company s financial statements included in Item 8 of this Report for certain additional information concerning the amount of the Bank s lease commitment. All offices listed are full service branch offices, except those with asterisks noted above. Asterisks represent non-banking support offices (e.g., Administration, Data Processing, Supplies Warehouse, Credit Services, et. al.)*

** *Ground lease on property adjacent to a fully owned facility.*

ITEM 3. LEGAL PROCEEDINGS

The Company is, from time to time, subject to various pending and threatened legal actions which arise out of the normal course of its business. The Company is not a party to any pending legal or administrative proceedings as of December 31, 2004 (other than ordinary routine litigation incidental to the Company s business) and no such proceedings are known to be contemplated.

There are no material proceedings adverse to the Company to which any director, officer, affiliate of the Company, 5% shareholder of the Company, or any associate of any such director, officer, affiliate or 5% shareholder of the Company is a party, and none of the above persons has a material interest adverse to the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of 2004.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

The Company s Common Stock trades on the Nasdaq National Market under the symbol MDST.

The following table summarizes those trades of the Company s Common Stock on NASDAQ, setting forth the approximate high and low closing sales prices for each quarterly period ended since January 1, 2003. The closing sales price on December 31, 2004 was $28.65 compared to the close one year earlier of $25.44.

	Sales Prices	
Quarter Ended 2003	**Low**	**High**
March 31	$ 16.20	$ 17.85
June 30	$ 16.62	$ 20.49
September 30	$ 19.15	$ 23.40
December 31	$ 22.45	$ 26.99

	Sales Prices	
Quarter Ended 2004	**Low**	**High**
March 31	$ 23.00	$ 26.99
June 30	$ 21.03	$ 24.50
September 30	$ 23.00	$ 26.13
December 31	$ 25.45	$ 30.61

Equity Plan Compensation Information

The following table summarizes information as of December 31, 2004 relating to equity compensation plans of the Company pursuant to which grants of options, restricted stock or other rights to acquire shares may be granted from time to time.

Plan Category	**Number of Securities To be issued upon Exercise of Options**	**Weighted Average Exercise Price of Outstanding Options**	**Number of Securities Remaining Available for Future Issuance**
Equity compensation Plans not approved by Stockholders	1,191,986	$ 15.36	207,743
Equity compensation Plans approved by Stockholders	-None-	N/A	N/A
Total	1,191,986	$ 15.36	207,743

Dividends

The following table sets forth the per share amount and month of payment for all cash dividends paid since January 1, 2003 by the Company to its shareholders.

Payable Date	**Dividend**
January 15, 2003	$ 0.11 per share
April 15, 2003	$ 0.11 per share
July 15, 2003	$ 0.13 per share
October 15, 2003	$ 0.13 per share
January 15, 2004	$ 0.13 per share
April 15, 2004	$ 0.14 per share
July 15, 2004	$ 0.14 per share
October 15, 2004	$ 0.14 per share
January 14, 2005	$ 0.16 per share

The Company is a legal entity separate and distinct from the Bank. The Company s shareholders are entitled to receive dividends when declared by its Board of Directors, out of funds legally available therefor, subject to the restrictions set forth in the California General Corporation Law (the Corporation Law). The Corporation Law provides that a corporation may make a distribution to its shareholders if the corporation s retained earnings equal at least the amount of the proposed distribution. The Corporation Law also provides that, in the event that sufficient retained earnings are not available for the proposed distribution, a corporation may, nevertheless, make a distribution to its shareholders if it meets two conditions, which generally stated are as follows: (i) the corporation s assets equal at least 1-1/4 times its liabilities, and (ii) the corporation s current assets equal at least its current liabilities or, if the average of the corporation s earnings before taxes on income and before interest expenses for the two preceding fiscal years was less than the average of the corporation s interest expenses for such fiscal years, then the corporation s current assets must equal at least 1-1/4 times its current liabilities.

The ability of the Company to pay a cash dividend depends largely on the Bank s ability to pay a cash dividend to the Company. The payment of cash dividends by the Bank is subject to restrictions set forth in the California Financial Code (the Financial Code). The Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lesser of (a) the bank s retained earnings; or (b) the bank s net income for its last three fiscal years, less the amount of any distributions made by the bank or by any majority-owned subsidiary of the bank to the shareholders of the bank during such period. However, a bank may, with the approval of the DFI, make a distribution to its shareholders in an amount not exceeding the greater of (x) its retained earnings; (y) its net income for its last fiscal year; or (z) its net income for its current fiscal year. In the event that the DFI determines that the shareholders equity of a bank is inadequate or that the making of a distribution by the bank would be unsafe or unsound, the DFI may order the bank to refrain from making a proposed distribution. The FDIC may also restrict the payment of dividends if such payment would be deemed unsafe or unsound or if after the payment of such dividends, the Bank would be included in one of the undercapitalized categories for capital adequacy purposes pursuant to federal law. (See, Item 1 Prompt Corrective Action and Other Enforcement Mechanisms.) Additionally, while the Federal Reserve Board has no general restriction with respect to the payment of cash dividends by an adequately capitalized bank to its parent holding company, the Federal Reserve Board might, under certain circumstances, place restrictions on the ability of a particular bank to pay dividends based upon peer group averages and the performance and maturity of the particular bank, or object to management fees to be paid by a subsidiary bank to its holding company on the basis that such fees cannot be supported by the value of the services rendered or are not the result of an arm s length transaction.

Whether or not dividends will be paid in the future will be determined by the Board of Directors after consideration of various factors. The Company s profitability and regulatory capital ratios in addition to other financial conditions will be key factors considered by the Board of Directors in making such determinations regarding the payment of dividends by the Company.

Transfer Agent

Mellon Investor Services, LLC serves as the Company s transfer agent. Shareholder inquiries regarding holdings of Mid-State Bancshares Common Stock can be directed to:

Mellon Investor Services, LLC
P. O. Box 3315
South Hackensack, NJ 07606-1915

Or

Mellon Investor Services, LLC
Overpeck Center
85 Challenger Road
Ridgefield Park, NJ 07660-2108

By Phone:
1-(888)-540-9878 (U.S. & Canada)
1-(201)-329-8660 (Outside U.S.)

Mellon Investor Services maintains the records for registered Mid-State Bancshares shareholders and can help with such services as change of name or address, consolidation of accounts, duplicate mailings, dividend reinvestment enrollment, lost stock certificates, transfer of stock to another person, and additional administrative services. For more information, they can be contacted via the Internet at *www.melloninvestor.com*.

Stock Repurchase Program

The Board of Directors at its regular meeting of January 21, 2004, authorized the purchase of up to 1,178,352 additional shares as its prior authorizations in March 2000 and May 2002 had been completed. The January 2004 authorization does not have an expiration date. The repurchase program seeks to reduce the number of outstanding shares resulting in an improvement to the Company s earnings per share and to its return on equity. These repurchases are being made from time to time by the Company in the open market or privately negotiated transactions in compliance with the SEC rules. The total number of shares repurchased was 658,867, 800,006, and 477,264 in 2004, 2003 and 2002, respectively. The average price paid per share in 2004, 2003, and 2002 was $25.26, $20.27, and $17.57, respectively. As of December 31, 2004, the Company could repurchase up to an additional 520,357 shares under the January 2004 authorization.

During the fourth quarter of 2004, share repurchase activity was as follows:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Remaining Shares That May be Purchased Under the Authorization	Dollar Value of Shares That May be Purchased Under the Authorization
October 2004	80,258	$ 26.34	725,147	$ 19,455,694
November 2004	116,168	$ 27.18	608,979	$ 18,171,933
December 2004	88,622	$ 28.86	520,357	$ 14,908,228
Fourth Quarter Totals	285,048	$ 27.47	520,357	$ 14,908,228

ITEM 6. SELECTED FINANCIAL DATA

Selected Consolidated Financial Data Mid-State Bancshares

(In thousands except per share data)	2004	2003	2002	2001	2000
Year Ended December 31:					
Interest Income (not taxable equivalent)	$ 109,936	$ 105,240	$ 109,332	$ 114,002	$ 109,967
Interest Expense	8,450	9,699	16,381	26,480	27,599
Net Interest Income	101,486	95,541	92,951	87,522	82,368
Provision for Loan Losses	(2,700)	(969)	600	4,100	700
Net Interest Income after provision for loan losses	104,186	96,510	92,351	83,422	81,668
Non-interest income	27,764	29,059	24,321	23,254	17,805
Non-interest expense	79,294	74,691	70,925	64,744	57,982
Income before income taxes	52,656	50,878	45,747	41,932	41,491
Provision for income taxes	17,547	17,714	15,892	14,530	14,142
Net Income	$ 35,109	$ 33,164	$ 29,855	$ 27,402	$ 27,349
Per share: *					
Net Income basic	$ 1.50	$ 1.41	$ 1.25	$ 1.22	$ 1.23
Net Income diluted	$ 1.47	$ 1.40	$ 1.20	$ 1.18	$ 1.20
Weighted avg. shares for Basic E.P.S. calculation	23,422	23,443	23,962	22,452	22,257
Weighted avg. shares for Diluted E.P.S. calculation	23,897	23,762	24,837	23,252	22,722
Cash dividends	$ 0.58	$ 0.50	$ 0.41	$ 0.37	$ 0.34
Book value at period-end	$ 11.89	$ 11.56	$ 10.72	$ 9.74	$ 8.05
Tangible book value at period-end	$ 9.48	$ 9.15	$ 8.94	$ 7.96	$ 7.96
Ending Shares	23,099	23,567	23,697	24,089	22,019
Period Averages:					
Total Assets	$ 2,269,873	$ 2,045,252	$ 1,892,137	$ 1,570,098	$ 1,389,625
Total Tangible Assets	2,213,639	2,000,406	1,850,671	1,558,507	1,388,210
Total Loans & Leases	1,310,842	1,131,932	1,109,245	999,501	847,797
Total Earning Assets	2,050,218	1,857,241	1,718,280	1,444,631	1,279,119
Total Deposits	1,970,248	1,763,215	1,623,510	1,351,256	1,205,826
Common Equity	277,054	261,103	244,295	195,955	166,402
Common Tangible Equity	220,820	217,982	202,829	184,364	164,987
At December 31,					
Cash and cash equivalents	$ 112,669	$ 123,763	$ 128,036	$ 102,970	$ 88,988
Investments and Fed Funds Sold	650,817	822,179	625,483	524,345	407,462
Loans held for sale	12,988	13,410	22,560	13,604	
Loans, net of deferred fees, before allowance	1,421,894	1,154,932	1,087,551	1,136,099	919,967
Allowance for Loan & Lease Losses	(13,799)	(16,063)	(17,370)	(19,073)	(10,920)
Goodwill and Core Deposit Intangibles	55,572	56,947	40,949	42,021	1,347
Other assets	88,946	53,664	47,531	53,698	51,394
Total Assets	$ 2,296,087	$ 2,208,832	$ 1,934,740	$ 1,853,664	$ 1,458,238
Non-interest bearing deposits	$ 517,139	$ 487,624	$ 390,212	$ 367,370	$ 275,624
Interest bearing deposits	1,477,406	1,424,807	1,262,735	1,216,796	955,538
Other borrowings	6,582	7,627	10,973	17,714	30,240
Allowance for losses unfunded commitments	1,783	1,941	1,771	1,586	2,360
Other liabilities	18,550	14,279	14,914	15,647	17,334
Shareholders equity	274,627	272,554	254,135	234,551	177,142
Total Liabilities and Shareholders equity	$ 2,296,087	$ 2,208,832	$ 1,934,740	$ 1,853,664	$ 1,458,238

* All historical share information has been adjusted to reflect the two for one stock split which took place in February 2001.

Selected Consolidated Financial Data Mid-State Bancshares (Continued)

(In thousands except per share data)	2004	2003	2002	2001	2000
Asset Quality					
Non-accrual loans	$ 10,700	$ 12,312	$ 16,748	$ 2,986	$ 4,510
Loans past due 90 days or more				690	222
Other real estate owned		3,428			
Total non performing assets	$ 10,700	$ 15,740	$ 16,748	$ 3,676	$ 4,732
Financial Ratios					
For the year:					
Return on assets	1.55 %	1.62 %	1.58 %	1.75 %	1.97 %
Return on tangible assets	1.59 %	1.66 %	1.61 %	1.76 %	1.97 %
Return on equity	12.67 %	12.70 %	12.22 %	13.98 %	16.44 %
Return on tangible equity	15.90 %	15.21 %	14.79 %	14.90 %	16.62 %
Net interest margin (not taxable equivalent)	4.95 %	5.14 %	5.41 %	6.06 %	6.44 %
Net interest margin (taxable equivalent)(2)	5.36 %	5.54 %	5.74 %	6.36 %	6.75 %
Net loan (recoveries) losses to avg. loans	(0.03)%	0.06 %	0.19 %	0.22 %	0.06 %
Dividend Payout Ratio	38.6 %	35.3 %	32.8 %	30.3 %	27.6 %
Efficiency ratio	61.3 %	59.9 %	60.5 %	58.4 %	57.9 %
At December 31:					
Equity to average assets (leverage ratio)	9.3 %	9.6 %	10.6 %	10.2 %	12.3 %
Tier One capital to risk-adjusted assets	12.1 %	13.8 %	14.7 %	13.8 %	15.5 %
Total capital to risk-adjusted assets	13.0 %	15.0 %	16.0 %	15.0 %	16.7 %
Loan loss allowance to loans, gross(1)	1.1 %	1.6 %	1.8 %	1.8 %	1.4 %
Non-accrual loans to total loans, gross	0.8 %	1.1 %	1.5 %	0.3 %	0.5 %
Non performing assets to total assets	0.5 %	0.7 %	0.9 %	0.2 %	0.3 %
Allowance for losses to non performing loans(1)	146 %	146 %	114 %	562 %	281 %

(1) Includes allowance for loan losses and allowance for losses unfunded commitments

(2) Taxable equivalent converts tax exempt income as if it were taxable

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction and Business of the Company

The Company has as its single, wholly owned subsidiary, Mid-State Bank & Trust (the Bank). The Bank has two wholly owned subsidiaries MSB Properties and Mid Coast Land Company (discussed above in Part I of this report and later in this Management s Discussion and Analysis). The Bank was founded in 1961 and operates a full service commercial banking business serving its customers on the Central Coast of California. Headquartered in Arroyo Grande, it operates 41 offices in communities throughout San Luis Obispo, Santa Barbara and Ventura Counties and serves over 101,000 households and businesses.

The following discussion and analysis will provide insight and supplementary information into the accompanying consolidated financial statements of the Company. It also provides Management s assessment of the operating trends over the past few years and certain of their expectations for 2005.

2004 RESULTS AND ACCOMPLISHMENTS

Financial Summary

The Company, on a consolidated basis, reported net income of $35.1 million in 2004 and $33.2 million in 2003 after generating $29.9 million in 2002. The diluted Earnings Per Share (EPS) was $1.47 for 2004 compared to $1.40 in 2003 and $1.20 in 2002. Consolidated total assets at December 31, 2004 were $2.296 billion compared to $2.209 billion at December 31, 2003, up 3.8%. Total deposits also increased from $1.912 billion as of December 31, 2003 to $1.995 billion as of December 31, 2004. Shareholders common equity stood at $274.6 million at year end up from its $272.6 million level one year earlier. Factors contributing to the increase in shareholders common equity included; 1) the $35.1 million of net income generated for the year and 2) the $2.6 million received for the exercise of stock options. Partially offsetting these increases were; 1) $13.6 million in dividends paid out during 2004, 2) $16.6 million paid for the repurchase of common stock outstanding, and 3) a $5.4 million reduction in accumulated other comprehensive income.

The table below illustrates net income by subsidiary unit.

Income (Loss) by subsidiary (000 s)	**2004**	**2003**	**2002**
Bank only, pre-tax	$ 50,711	$ 48,684	$ 44,292
MSB Properties, pre-tax	2,079	2,376	2,142
Mid Coast Land Co., pre-tax	654	556	(153)
Parent only, pre-tax	(788)	(738)	(563)
Tax (expense)	(17,547)	(17,714)	(15,892)
Net Income Mid-State Bancshares	$ 35,109	$ 33,164	$ 29,855

Executive Summary

Management considers the following to be the most significant items affecting net income during 2004 compared to 2003.

- The Company took a benefit to provision for loan losses of $2.7 million in 2004 compared to a benefit of $969 thousand in 2003 resulting in a positive pre-tax improvement in earnings of $1.7 million. The benefit taken to the provision for loan losses in 2004 reflected strong credit quality standards, consistent performance of the loan portfolio in recent years, improving trends in classified loans, improving trends in delinquencies and charge-offs, an improved outlook for the collection of the Company s non accrual loans, and an improved outlook for economic activity in general..

- Average earning assets increased by $193.0 million in 2004 compared to 2003 more than offsetting the decline in the net interest margin (from 5.54% in 2003 to 5.36% in 2004, taxable equivalent) thereby allowing the Company to show a $5.9 million increase in net interest income.

- The Company realized non-recurring gains in 2004 of $1.1 million on the sale of OREO and $475 thousand in securities gains. The Company had only minor securities gains of $40 thousand in 2003.

- Increases in non-interest expense amounted to $4.6 million in 2004 compared to 2003. Factors contributing to this increase included 1) increases in outside professional services of $913 thousand related to Section 404 Sarbanes-Oxley compliance efforts; 2) increases in advertising and promotional expenditures of approximately $1.0 million in 2004 compared to 2003; 3) increases in costs reflecting the merger with Ojai Valley Bank effective October 31, 2003 which resulted in two months of costs in the 2003 figures compared to a full 12 months in 2004 estimated to be an increase of $1.4 million; 4) increases in employee benefits primarily related to workers compensation and group insurance increases of $198 thousand (excluding the impact of the Ojai

employees) and 5) all other operating expenses increasing by $1.1 million, net of declines the primary impact being salary increases of $1.5 million (excluding the impact of Ojai employees).

- There was a decline in the net gains realized on mortgage loans sold of $2.8 million in 2004 compared to 2003 as a result of the dramatic slowdown in refinance activity during the year.

Management considers the following to be the most significant items affecting net income during 2003 compared to 2002.

- The gain on sale of loans held for sale increased by $2.4 million resulting from to the low interest rate environment and the surge in refinance activity on single family residential mortgage loans.

- The Company took a benefit to provision for loan losses of $969 thousand in 2003 compared to a provision expense of $600 thousand in 2002 creating a positive pre-tax improvement to earnings of $1.6 million between the two years. The benefit taken to the provision for loan losses in 2003 reflected strong credit quality standards, consistent performance of the loan portfolio in recent years, improving trends in classified loans, improving trends in delinquencies and charge-offs, an improved outlook for the collection of the Company s non accrual loans, and an improved outlook for economic activity in general.

- The impact of the lower interest rate environment in 2003 led to a decline in the Company s net interest margin to 5.54% (taxable equivalent) from 5.74% in 2002. This was offset by an increase in average earning assets of approximately $139 million, thereby allowing it to show a $2.6 million increase in net interest income from the prior year.

- Various other non interest income and expense items showed variances which collectively reduced pre-tax income by $1.5 million.

Management considers the following to be the most significant items affecting net income during 2002 compared to 2001.

- The impact of the lower interest rate environment in 2002 led to a decline in the Company s net interest margin to 5.74% (taxable equivalent) from 6.36% in 2001 which was offset by an increase in average earning assets of approximately $274 million, thereby allowing it to show a $5.4 million increase in net interest income from 2001 to 2002.

- Because of concerns of a pending economic slowdown in 2001, the Company added to its loan loss allowance through a charge to provision for loan loss expense of $4.1 million. This provision was reduced in 2002 to just $600 thousand, thus contributing a $3.5 million improvement to earnings in 2002.

- The Company recorded a non-recurring gain on sale of its credit card portfolio of $1.7 million in 2001.

- Salaries and benefits during 2002 were $3.1 million above the 2001 levels reflecting especially the Company s merger with Americorp in September 2001 resulting in additional staff expense for 2001 involving 3 months of activity compared to 12 months in 2002.

- Occupancy expense during 2002 was $1.6 million above the 2001 levels reflecting especially the Company s merger with Americorp in September 2001 resulting in additional occupancy expense for 2001 involving 3 months of activity compared to 12 months in 2002.

- Various other non interest income and expense items showed variances which collectively increased pre-tax income by $1.3 million. These are discussed in more detail in the Income Statement Analysis section below.

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Management believes that the primary challenges and risks to the Company in 2005 are as follows:

- The degree and speed with which the Board of Governors of the Federal Reserve System will continue to raise short term interest rates thereby allowing the Company to show improvements in its net interest margin.
- The ability of the economy to continue its recovery and enhance the Company s ability to grow its loan portfolio either through loan originations or purchases consistent with the Company s credit standards.
- The ability of the Company to generate new revenue to replace some of the non-recurring benefits to the income statement in 2004.
- The ability of the Company to contain salary and benefits costs which have risen rapidly in recent years.
- The ability of the Company to fully integrate its relatively new Ventura County offices and presence into the Company and take advantage of the expanded market opportunities it sees there.
- The ability of the Company to overcome the charge to expense that will result from a change in accounting for stock options which is scheduled to be implemented in the third quarter of 2005. See Note 1 and Note 15 of the Notes to the Consolidated Financial Statements which follows in item 8 of this report.
- The ability of the Company to make its internal support functions more efficient by exploring, and then implementing, a plan to consolidate their operations in one location in a cost effective manner.

Management believes that some of the significant opportunities it has are as follows:

- The ability the Company has to fund additional loans due to its strong liquidity at the present time.
- The Company s asset and liability, maturity and rate structure are such that its net interest margin should improve in a rising rate environment.
- The Company s expanded presence in Ventura County will allow it to take advantage of the large and growing economic base in that part of our market area.
- Because the Company is well capitalized and its stock price has performed well, it is well positioned to continue to make strategic acquisitions in selected markets as it has in recent years.
- The ability of the Company to make its internal support functions more efficient by exploring, and then implementing, a plan to consolidate their operations in one location in a cost effective manner.

Other Events and Items of Note in 2004

The Company celebrated the one year anniversary of the successful integration of its merger with the former Ojai Valley Bank on October 31, 2004. Core deposits (total deposits excluding certificates of deposit) at the two locations in Ojai and Oak View have increased from $57.8 million at the time of the merger to $59.6 million at year-end 2004. Total deposits which were $78.8 million at time of merger were $76.1 million at December 31, 2004. This shift away from more rate sensitive deposit liabilities to core, relationship oriented deposits is expected to benefit the Bank going forward. It should be noted that some of the principal employees in the former Ojai Valley Bank are involved with the start-up of the new Ojai Community Bank, which received regulatory approval July 21, 2004, raised the necessary equity capital and is expected to open in early 2005. The impact of the opening of this new community bank on the Company is unknown at this time.

The Company s stock repurchase program continued in 2004 with 658,867 shares repurchased, which compares to 800,006 and 477,264 shares repurchased in 2003 and 2002, respectively. The average price paid for the stock over this three year period was $25.26, $20.27 and $17.57, respectively. As of December 31, 2004, the Company had 520,357 shares remaining to repurchase on its January 2004 authorization approved by the Board of Directors to re-purchase up to 1,178,352 additional shares. The authorization does not have an expiration date.

Also during 2004, the Company streamlined its corporate banking and business banking efforts under one umbrella internally known as the commercial banking group. Eight regional commercial banking groups under the direction of Senior Vice President, Steven Harding are responsible for the Company s commercial, commercial real estate and construction lending. The new alignment of this group has created efficiencies, cost savings and a more focused sales effort.

EXTERNAL FACTORS IMPACTING THE BANK

Economic Conditions

At the start of 2004, in last year s annual report we noted that, Entering 2004, Management believes that the economy is entering a sustained recovery which will lead to lower unemployment rates, increases in inflation and eventually, a need to raise interest rates to combat fears of excessive growth and inflationary pressures. Management further believes that increases in interest rates will likely take place in the fourth quarter of 2004 and/or first quarter of 2005 amounting to a roughly 50 basis point increase in short term interest rates. Long term interest rates will rise also, albeit at reduced levels compared to short term rates, reflecting a flatter yield curve. We note that this forecast proved reasonably accurate. The Federal Reserve increased short term rates in the second half of 2004 by 125 basis points, unemployment rates nationally have declined from 5.7% at the start of the year to 5.4% at the end of November, and inflation has averaged 2.6% for the first 11 months of the year compared to 2.3% in 2003. The yield curve, as expected, has flattened dramatically with the spread between the three month and ten year Treasury declining from 332 basis points at the start of 2004 to approximately 202 basis points at the end of the year. The ten year Treasury is actually little changed from its 4.27% level at the start of the year having closed at 4.24% at the end of 2004.

The most comprehensive review of local economic conditions in our market known to Management comes from the University of California at Santa Barbara (UCSB) Economic Forecast Project. According to UCSB, Gross County Product in the tri-county area was estimated at $75.5 billion in 2004, up 5.9% from the $71.3 level in the prior year. Adjusted for real dollars, it was up 2.7% following a 2.8% growth rate in 2003 and 2.1% in 2002. While these rates of growth were down from the double digit increases witnessed in the late 1990 s, they have been running better than those exhibited by the State as a whole. California s real State Product was -0.9% in 2002, +0.2% in 2003 and is estimated to grow at +1.4% in 2004. Expectations for 2005 are for further improvements with the real State Product growing 1.8% and the real Tri County Gross Product growing 3.1%. The difficulties experienced at the State level have certainly had a negative effect on the local tri-county area. It is estimated by UCSB that the public sector has lost some 3,892 jobs in the tri-county area over the last two years, a 3.7% decline, at a time when the private sector added some 15,567 jobs, a 3.2% increase. This drag clearly contributed to the slower growth rate in economic activity experienced locally over the past few years. This notwithstanding, the tri counties continue to be fortunate in experiencing significantly lower unemployment rates compared to the 5.4% level experienced nationally. The San Luis Obispo Metropolitan Statistical Area (MSA) was estimated by the Bureau of Labor Statistics to have an unemployment rate of 3.0% at the end of November 2004 with the Santa Barbara MSA at 3.8% and the Ventura MSA at 4.7%. Management expects these levels to remain little changed in 2005 as their low absolute levels would generally be difficult to improve upon.

Median home prices are at historical highs throughout the Bank s service area. The median price of a home as of November 2004 totaled $476 thousand in San Luis Obispo County, up 23.5% from a year earlier. In Santa Barbara County, that figure reached $669 thousand, up 72.3% from one year earlier. And in Ventura County, the median home price was $507 thousand, up 25.8% from one year before. In spite of numerous residential building projects in the Bank s trade area and housing affordability indices falling below 20% in most locales, the local real estate market continues strong with a combination of favorable interest rate levels and demand far outpacing supply. The strong trends in both residential and non-residential real estate continue with no signs of abating. Lenders are more prudent in their lending practices having learned the lessons of the early 1990 s and hence building is far less speculative. Management does not see significant risk of a slowdown in real estate in 2005. However, it should be noted that high real estate prices are creating a demographic trend of aging home owners replacing working-class residents who find first time home ownership difficult. This is contributing to an out-migration by young families with working-aged heads of households. The impact of this demographic trend on the local economy and the types of businesses that operate here is unclear at the present time.

With positive indicators being revealed in the national economic statistics and a solid economic base locally, Management is encouraged that 2005 should again be a solid year for the economy in the Company s trade area. This optimism, however, must be tempered by the potential for disruption resulting from geopolitical issues surrounding homeland security and terrorism. As we noted last year, the effects of episodes such as the 9/11 terrorist attacks, the wars in Afghanistan and Iraq, and the international tensions surrounding these events, can have a significant on economic activity. In spite of this caveat, our local trade area again appears to be in a solid position at the start of 2005 to continue the recovery underway and maintain low unemployment rates. The Board of Governors of the Federal Reserve System have started raising short term interest rates and Management expects this trend to continue with the target Fed Funds rate reaching the mid 3% range by year-end. Management also expects that longer term rates will rise much more modestly, if at all, in-keeping with a continue trend towards a flatter yield curve.

Competitive Factors

Competitive pressures from other financial institutions continue to be intense both in the Company s trade area and throughout the nation. Many banks are suffering from insufficient loan volumes and have become very aggressive on the pricing of those good credits available. In the Company s tri-counties service area, 66 financial institutions (banks and savings institutions) operate 321 offices serving $23.1 billion in deposits based on data as of June 30, 2004.

It should be noted that the trend toward consolidation of banking assets exhibited over the past few years in California continued in 2004. Statewide, through November 2004, 21 banks are merging out of existence based on announced merger transactions. According to the State Department of Financial Institutions however, 14 new banks have filed in 2004 to start a new bank in California, through November.

ANALYSIS OF STATEMENT OF FINANCIAL POSITION

Loans

The Bank experienced an increase in net loans from $1,138.9 million at the end of 2003, to $1,408.1 million at the end of 2004. This represents an increase in the loan portfolio of $269.2 million following the $68.7 million increase in 2002. The loan portfolio represents approximately 61.4% of the Bank s assets. Additionally, loans held for sale (which are single family residential mortgages pending sale) total $13.0 million at the end of 2004, down from $13.4 million one year earlier.

Mid-State Bancshares
Trends in Loan Categories

The graph above displays the trend over the five year period ended December 31, 2004 in the various components of the loan portfolio. Construction loans have risen from their level five years earlier $167.5 million at December 31, 2000 compared to $227.6 million at year-end 2004. Real Estate loans generally trended up from $445.2 million at the end of 2000 to $759.2 million at the end of 2004. Home Equity Credit Lines have generally increased from $55.6 million at the end of 2000 compared to $160.0 million at the end of 2004. Consumer loans (installment and credit reserve) have decreased from $40.3 million at December 31, 2000 to $22.9 million at year-end 2004 which is in part due to the sale in December 2001 of the Company s Credit Card receivables. Commercial and other loans have grown in recent years through 2002, with a decrease in 2003, but grew to $212.0 million at December 31, 2004. Agricultural production loans have remained flat until 2004, ending at $40.3 million in December. The Bank expects to continue to emphasize all types of lending activity in order to diversify the risk in its portfolio. The larger growth in real estate loans, especially in 2004, reflects an expanded use of jumbo adjustable rate mortgage loans in the portfolio ($96.4 million at the end of the year) along with the purchase of certain of these same type of loan assets in the secondary market ($43.0 million at the end of the year). Economic activity in the Central Coast will determine the types of credit the Bank will be able to extend and hence its ability to achieve this objective.

The Bank s allowance for losses stands at $15.6 million, or 1.1% of gross loans, and represents losses not yet realized, but inherent in the loan portfolio and on unfunded commitments. The allowance for losses is down from the $18.0 million at December 31, 2003. The year-end 2004 balance now represents 146% of non-performing loans identical to the level at the end of 2003. A five-year review of activity in the allowance for losses and an allocation by loan type of the allowance is shown in the tables below.

Allowance for Losses (in 000 s)	**2004**	**2003**	**2002**	**2001**	**2000**
Allowance for loan losses beginning of year	$ 16,063	$ 17,370	$ 19,073	$ 10,920	$ 10,905
Allowance for losses unfunded commitments	1,941	1,771	1,586	2,360	2,200
Total allowance for losses	$ 18,004	$ 19,141	$ 20,659	$ 13,280	$ 13,105
Provision for loan losses charged to operating expense	(2,700)	(969)	600	4,100	700
Provision for losses unfunded commitments charged to operating expense	(158)	170			
Adjustments acquisition through merger		391		5,464	
Loans charged off:					
Real estate loans	(5)	(1,106)		(7)	(163)
Installment loans	(148)	(234)	(275)	(275)	(278)
Commercial loans	(746)	(488)	(2,475)	(2,377)	(512)
Credit cards and related loans	(41)	(66)	(88)	(255)	(239)
Recoveries of loans previously charged off:					
Real estate loans	41	45	24	149	102
Installment loans	111	96	196	186	134
Commercial loans	1,179	963	451	309	330
Credit cards and related loans	45	61	49	85	101
Total Allowance for Losses	$ 15,582	$ 18,004	$ 19,141	$ 20,659	$ 13,280

Allocation of Allowance for Losses (in 000 s)					
Allowance for loan losses	$ 13,799	$ 16,063	$ 17,370	$ 19,073	$ 10,920
Allowance for losses unfunded commitments	1,783	1,941	1,771	1,586	2,360
Total Allowance for Losses	$ 15,582	$ 18,004	$ 19,141	$ 20,659	$ 13,280
Ratio of Net Loan Losses to Average Loans Outstanding	(0.03)%	0.06 %	0.19 %	0.22 %	0.06 %

Allocation of the allowance for losses compared to loan type as a percent of total at December 31:

(dollars in 000 s) **Balance applicable to:**	**2004**	**Type as a % of Loans**	**2003**	**Type as a % of Loans**	**2002**	**Type as a % of Loans**	**2001**	**Type as a % of Loans**	**2000**	**Type as a % of Loans**
Construction and Land	$ 5,120	16.1 %	$ 2,680	20.8 %	$ 2,636	19.7 %	$ 1,969	18.8 %	$ 2,095	18.3 %
Real Estate	1,757	53.5 %	2,164	49.1 %	4,047	48.4 %	2,949	46.8 %	3,993	48.4 %
H.E.C.L.	308	11.2 %	250	7.8 %	295	6.8 %	443	6.0 %	390	6.0 %
Installment	160	1.3 %	244	2.2 %	254	2.5 %	780	3.1 %	292	3.4 %
Credit Card and Related	86	0.3 %	229	0.6 %	97	0.3 %	393	0.3 %	1,203	1.0 %
Commercial, Other	3,237	17.6 %	6,468	19.5 %	6,296	22.3 %	5,712	25.0 %	2,247	22.9 %
Unfunded commitments	1,783	N/A	1,941	N/A	1,771	N/A	1,586	N/A	2,360	N/A
Unallocated	3,131	N/A	4,028	N/A	3,745	N/A	6,827	N/A	700	N/A
Balance at End of Year	$ 15,582	100.0 %	$ 18,004	100.0 %	$ 19,141	100.0 %	$ 20,659	100.0 %	$ 13,280	100.0 %

Non-accrual loans within the Bank s portfolio decreased from $12.3 million as of December 31, 2003, to $10.7 million, at the end of 2004. Loans 90 days or more past due, and still accruing, remained at zero

for the periods ending December 31, 2003 and December 31, 2004. Additional information on non-accrual loans, past due loans and troubled debt restructurings can be found in Footnote 5 to the financial statements. The level of non-accrual loans at the end of 2004 is centered primarily in one real estate secured loan (total $8.5 million). Management has established specific reserves that would offset potential losses, if any, arising from less than full recovery of the loan from the supporting collateral. Recoveries in 2004 of loans previously charged-off totaled $1.4 million compared to charge-offs of $0.9 million taken during the year resulting in net recoveries of $436 thousand. This net recoveries figure compares to net charge-offs incurred of $0.7 million and $2.1 million in 2003 and 2002, respectively. The Bank anticipates that charge-offs (actual losses) will continue during 2005. Management does not anticipate that recoveries would again exceed charge-offs in the coming year.

With the combination of the collateral securing the problem loans and the size of the allowance for losses, Management feels that the allowance is sufficient to cover inherent losses. Management reviews the adequacy of the allowance and also employs an independent third party loan review group to, among other things, review the reasonableness of individual asset classifications. Management, as necessary, adjusts the allowance on a regular basis. The allowance is also examined annually by one or more of the Bank s regulatory bodies including the FDIC and DFI. During the fourth quarter of 2003, based on its review of the allowance, Management took a benefit to the provision for loan losses of $1.2 million resulting in a net benefit to the provision for loan losses of just under $1.0 million for the full year. Again during the second quarter of 2004, Management took a further benefit to the provision for loan losses of $2.7 million. These actions reflected strong credit quality standards, consistent performance of the loan portfolio in recent years, improving trends in classified loans, improving trends in delinquencies and charge-offs, an improved outlook for the collection of the Company s non accrual loans, and an improved outlook for economic activity in general. The need for additional provision for loan losses or for further benefit to the provision for loan losses in 2005 will be dependent upon Management s on-going analysis of the adequacy of the allowance for loan losses. While Management believes it to be adequate at the present time, the appropriate value can fluctuate over time in response to economic conditions and the subjective decisions which must be made in response to those conditions.

The allowance for losses consists of a statistically allocated portion and a specifically allocated portion. The total of these components is considered adequate to provide for losses, which can be reasonably anticipated. However, since these amounts are based on estimates, ultimate losses relating to these loans may vary and Management believes that qualitative factors make it prudent to carry a reasonable level of an unallocated portion to absorb losses in excess of the allocated portion. Qualitative factors considered include, but are not limited to, portfolio composition, concentrations, off balance sheet risks, delinquencies and non-accruals, criticized and classified loans, non performing loans, gross and net loan losses, changes in lending function, changes in management, the Bank s organizational structure, the special assets group, lending and credit approval authorities, loan officer training, the credit review function, and real estate appraisal policies.

Management continuously monitors residential real estate reports and markets, and is aware of press articles that have discussed a possible slow down and/or drop in value of residential real estate in the Bank s service area. While long term interest rates remain historically low and the Bank s service area is marked by limited supply and strong demand, residential projects financed by the Bank are underwritten with a requirement of a percentage of cash equity to the total cost of the project in addition to prudent exposures to current appraised values. To further mitigate this risk, individual projects financed are analyzed using direct, current and historical project trends with limitations to production unit starts ahead of sales using the projected absorption analysis contained in the appraisal of each project. The Bank believes, based upon past experience, that this process helps mitigate against the production of a supply of units that would exceed the current market demand.

Additionally, due to the popularity of our market area to urban retirees and others wanting to enjoy the environment and life style it provides, we have seen and continue to see a migration of wealthier individuals and families absorb the residential housing production with greater cash equities than is typical of other areas throughout the country. This assumption is supported by the fact that the Bank s portfolio of residential mortgages have an average loan to value ratio of less than 60% along with average credit scores substantially exceeding industry standards with low delinquency ratios.

A summary of maturities and sensitivities of loans to changes in interest rates at December 31, 2004 is shown in the table below. A more complete discussion of the Bank s exposure to changes in interest rates can be found in the MD&A under the section titled Net Interest Income and Interest Rate Risk .

Loan Portfolio as of 12/31/04

(dollars in 000 s) Fixed Rate Loans	3 Months or less	Over 3 through 12 Months	Due after After 1 to 3 Years	Due After After 3 to 5 Years	Due After 5 Years	Total
Construction/Land Development	11,021	29,723	14,766	788		56,298
Real estate	3,746	2,584	40,886	50,253	220,937	318,406
Home equity credit lines	3	23	1	412	792	1,231
Installment	217	920	4,251	6,000	5,638	17,026
Cash reserve	31		3			34
Agricultural production	197	666	1,261	3,098	197	5,419
Commercial, other	2,054	6,469	14,655	25,750	15,909	64,837
Total	**17,269**	**40,385**	**75,823**	**86,301**	**243,473**	**463,251**

Variable Rate Loans	3 Months or less	Over 3 through 12 Months	Due after After 1 to 3 Years	Due After After 3 to 5 Years	Due After 5 Years	Total
Construction/Land Development	163,104	2,196	5,921	200	1,850	173,271
Real estate	95,549	16,919	154,731	161,177	15,165	443,541
Home equity credit lines	158,819					158,819
Installment	2,180					2,180
Cash reserve	3,573					3,573
Agricultural production	34,837					34,837
Commercial, other	144,631	1,071	109	603		146,414
Total	**602,693**	**20,186**	**160,761**	**161,980**	**17,015**	**962,635**
Total loans, gross (excludes allowance for loan losses, net deferred loan fees and loans held for sale)						**1,425,886**

Investment Portfolio

The Bank s investment portfolio primarily consists of U.S. Treasury Notes and Bills, Federal Agency Notes, Mortgage Backed Securities, and Municipal Bonds. See Footnote No. 4 to the consolidated financial statements for a detailed composition of the investment portfolio. Overall, the portfolio showed a net reduction in outstanding balances over the course of 2004 as 1) the Bank redirected these earning assets into the loan portfolio and 2) to a lesser extent the market value relative to amortized cost of the 100% available for sale the investment portfolio declined. The Treasury and Agency portion of the portfolio decreased by $132.9 million from one year ago. The Bank maintained its holdings in the Municipal Bond portfolio fairly steady from a market value of $377.1 million at the end of 2003, to a

market value of $377.0 million at the end of 2004. Mortgage Back Securities increased somewhat by $1.7 million. In total however, the Bank decreased its investment portfolio from a market value of $774.7 million at the end of 2003 to a market value of $644.8 million at the end of 2004, a $129.9 million decrease.

The Bank may segregate its portfolio into three categories a Trading Portfolio (which is carried at market value, with changes in market value reflected in the income statement), a Held to Maturity portfolio (which is carried at amortized cost, with changes in market value having no impact on the financial statements) and an Available for Sale portfolio (which is carried at market value, with changes in market value reflected in comprehensive income). The Bank holds no securities that should be classified as Trading or Held to Maturity securities. The Bank has determined that since its securities may be sold prior to maturity because of interest rate changes, to meet liquidity needs, or to better match the re-pricing characteristics of funding sources, that the entire portfolio should be classified as Available for Sale.

Adjustments to the Available for Sale portfolio for changes in market values resulted in an unrealized gain of $6.9 million included in accumulated other comprehensive income as of December 31, 2004 compared to an unrealized gain of $12.3 million at December 31, 2003, net of related taxes. Maturities and sales over the full year exceeded purchases and the total investment portfolio decreased by $129.9 million from the end of 2003 to the end of 2004.

Shown below is a summary maturity distribution of the investment portfolio, by type and weighted taxable equivalent yield as of December 31, 2004. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Maturity information for Mortgage Backed securities shown below is based on contractual maturities.

(dollars in 000 s)	One Year Or Less	After One Year to Five Years	After Five Years to Ten Years	After Ten Years	Total
Maturity Distribution:					
U.S. Treasury Securities	$ 13,047	$ 11,931	$ 510	$	$ 25,488
U.S. Government Agencies	86,538	130,123			216,661
Mortgage Backed Securities	145	570	6,539	2,163	9,417
Municipal Bonds, Other	28,295	167,762	189,451	7,743	393,251
Total	$ 128,025	$ 310,386	$ 196,500	$ 9,906	$ 644,817

	One Year Or Less	After One Year to Five Years	After Five Years to Ten Years	After Ten Years	Total
Weighted Average Yield:					
U.S. Treasury Securities	1.58 %	2.42 %	4.22 %		1.94 %
U.S. Government Agencies	3.47 %	2.77 %			3.05 %
Mortgage Backed Securities	6.17 %	6.14 %	6.04 %	5.56 %	5.94 %
Municipal Bonds, Other	5.68 %	5.89 %	5.63 %	6.00 %	5.75 %
Total	3.77 %	4.45 %	5.64 %	5.90 %	4.70 %

Other Real Estate Owned (OREO)

The Company did not hold any OREO from foreclosure as of December 31, 2004 compared to $3.4 million held as of December 31, 2003. Future OREO activity will depend, among other things, on how many borrowers the Bank may need to foreclose upon, and the strength of the real estate market and general economic activity.

Goodwill and Core Deposit Intangibles

Goodwill totaled $47.8 million at December 31, 2004 and 2003. Of this total, $14.4 million was the result of the acquisition of Ojai Valley Bank that was completed on October 31, 2003, $32.2 million was the result of the acquisition of American Commercial Bank that was completed on September 28, 2001 and $1.2 million dates to a May 3, 1996 acquisition of Citizens Bank of Paso Robles by BSM Bancorp which the Company acquired in 1998.

On an annual basis, the Company tests its Goodwill for impairment. The Goodwill is entirely attributable to the Company s community banking segment. Results of this test have indicated that there was no impairment of Goodwill in any of the past three years (2002 through 2004) since the testing commenced.

Core deposit intangibles total $7.7 million at December 31, 2004 compared to $9.1 million one year earlier. Of the year-end 2004 amounts, $5.4 million represents the net un-amortized value of the core deposit intangible created with the American Commercial Bank acquisition and $2.3 million represents the net un-amortized value of the core deposit intangible created upon the acquisition of Ojai Valley Bank. In connection with these acquisitions, the Company recognizes core deposit intangibles which represent the fair value of long-term deposit relationships acquired. Such amounts are then amortized over originally expected useful economic lives of 8.25 and 9.00 years, respectively. Absent adjustments to the amortization schedules in future periods, the core deposit intangibles will be fully amortized in December 2009 with respect to the American Commercial Bank acquisition and October 2012 with respect to the Ojai Valley Bank acquisition

Deposits

While the Bank is competitive with major institutions in terms of its structure of interest rates on deposit products offered, Management was not overly aggressive during 2004 in terms of pricing to attract additional deposits, a decision which reflects the Bank s strong liquidity at the present time.

As discussed in the Income Statement Analysis, many of the Bank s deposit rates have risen in concert with the general increase in rates. A comparison of the rates paid on the Bank s deposit products at December 31, 2004 and 2003 is as follows:

Selected Quoted Interest Rates	**2004**	**2003**	**Change**
Demand Deposits	0 %	0 %	0 %
NOW Account (50 & Better over $2,500)	0.10 %	0.05 %	0.05 %
Money Market Deposits (over $100,000)	0.80 %	0.75 %	0.05 %
Passbook Savings Account	0.25 %	0.25 %	0.00 %
Individual Retirement Account (2 Year term)	2.75 %	1.75 %	1.00 %
Time Deposit ($100,000 6 month term)	1.85 %	1.05 %	0.75 %
Wall Street Journal Prime Rate	5.25 %	4.00 %	1.25 %

Average deposits have risen steadily over the past three years reflecting growth at Mid-State Bank & Trusts existing offices and the acquisition of Ojai Valley Bank on October 31, 2003 which had deposits of approximately $78.8 million at the time of the acquisition. Below is a summary of the average deposits outstanding and the average rate paid by category over the last three years.

(dollars in 000 s)	Average Balance	2004 Interest	Rate	Average Balance	2003 Interest	Rate	Average Balance	2002 Interest	Rate
Interest Bearing Demand and Money Market Investment Accounts	$ 741,230	$ 1,712	0.23 %	$ 651,285	$ 1,527	0.23 %	$ 581,439	$ 2,639	0.45 %
Savings Accounts	322,665	853	0.26 %	287,435	1,077	0.37 %	245,615	2,255	0.92 %
Time Deposits	399,806	5,691	1.42 %	399,448	6,944	1.74 %	418,536	11,275	2.69 %
Total Interest Bearing Deposits	1,463,701	8,256	0.56 %	1,338,168	9,548	0.71 %	1,245,590	16,169	1.30 %
Non Interest Bearing Demand	506,547			425,047			377,920		
Total Deposits	$ 1,970,248	$ 8,256	0.42 %	$ 1,763,215	$ 9,548	0.54 %	$ 1,623,510	$ 16,169	0.99 %

The majority of the Bank s time deposits (approximately 58%) have balances that are under $100,000 in size. While all time deposits are somewhat more rate sensitive than the Bank s other deposit categories, the smaller time deposit balances tend to be more stable and less sensitive to absolute rate levels than do time deposits of $100,000 or more. Approximately 86% of the Bank s time deposits mature within one year and would be potentially subject to a change in rate on their maturity date. The following table as of December 31, 2004, displays summary size and maturity information on the Bank s time deposits.

(dollars in 000 s) Balance by Size	Three Months or Less	After Three Months to Six Months	After Six Months to One Year	After One Year	Total
Under $100,000	$ 84,477	$ 58,462	$ 44,543	$ 40,490	$ 227,972
$100,000 or More	83,331	48,741	20,276	13,947	166,295
Total Time Deposits	$ 167,808	$ 107,203	$ 64,819	$ 54,437	$ 394,267

Other Borrowings

While not a significant component of the Bank s structure, other borrowings were $7.6 million, at the end of 2003 compared to $6.6 million at the end of 2004. These consist of borrowings under the U.S. Treasury Tax and Loan note account, Federal Home Loan Bank borrowings and mortgages payable. The Bank had outstanding borrowings of $4.6 million and $5.6 million at December 31, 2004 and 2003, respectively, under the U.S. Treasury Tax and Loan note account program. The Bank had one borrowing from the Federal Home Loan Bank for $2.0 million at December 31, 2004 and 2003. Mortgages payable were zero and $31 thousand at year-end 2004 and 2003, respectively.

The Company may increase its Other Borrowings during 2005 in an effort to purchase earning assets which create a positive spread for the income statement and allow it to more profitably leverage its strong capital base. Management could borrow up to $100 million of mostly shorter term borrowings (up to five years) from sources such as the Federal Home Loan Bank. Funds raised this way would be used to purchase earning assets such as investment securities or generate additional loans at sufficiently positive spreads to justify the additional leverage.

Capital

Capital ratios for commercial banks and their holding companies in the United States are generally calculated using three 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. The Company and the Bank are subject to certain standards concerning these ratios. These standards were developed through the 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 goodwill and certain other intangibles that a bank may have) by the total 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 weighting 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 allowance for loan losses, long-term capital debt, preferred stock and other instruments. Summarized below are the capital ratios at December 31, 2004 and 2003, for both Mid-State Bancshares and Mid-State Bank & Trust. Additionally, the standards for a well-capitalized institution, as defined by the federal banking agencies, are displayed.

	Minimum Regulatory Standard	**Well-Capitalized Regulatory Standard**	**Mid-State Bancshares**		**Mid-State Bank & Trust**	
			2004	**2003**	**2004**	**2003**
Leverage Ratio	4.0 %	5.0 %	9.3 %	9.6 %	9.2 %	9.4 %
Tier One Risk Based Capital Ratio	4.0 %	6.0 %	12.1 %	13.8 %	12.0 %	13.5 %
Total Risk Based Capital Ratio	8.0 %	10.0 %	13.0 %	15.0 %	12.9 %	14.7 %

While it is the intent of management to continue to maintain strong capital ratios, the Board of Directors has initiated a stock repurchase program and increased the quarterly dividend payments in an effort to further leverage its equity and enhance shareholder value. The Company also expects to modestly increase its other borrowings as noted above under Other Borrowings and increase its capital leverage.

Without deducting for goodwill and other intangibles from equity, two other commonly followed ratios related to capital have trended as follows over the past three years.

	2004	**2003**	**2002**
Dividend Payout Ratio	38.6 %	35.3 %	32.8 %
Average Common Equity to Average Assets	12.2 %	12.8 %	12.9 %

Liquidity

The focus of the Bank s liquidity management is to ensure its ability to meet cash requirements. Sources of liquidity include cash, due from bank balances (net of Federal Reserve requirements to maintain reserves against deposit liabilities), fed funds sold, investment securities (net of pledging requirements), loan repayments, deposits and fed funds borrowing lines. Typical demands on liquidity are deposit run-off from demand deposits and savings accounts, maturing time deposits, which are not renewed, and anticipated funding under credit commitments to customers.

The Bank has adequate liquidity at the present time. Its loan to deposit ratio at year-end 2004 was 71.3% versus 60.4% one year earlier. The Bank normally strives for a loan to deposit ratio in the 65% to 75% range. The Bank s internally calculated liquidity ratio stands at 34.2% at December 31, 2004 compared to 45.2% one year earlier. These levels are above the Bank s minimum policy of 15%.

Management is not aware of any trend, demand, commitment or event that would result in a material change in the Bank s liquidity at the present time.

Capital Commitments

As of December 31, 2004, neither the Company or the Bank have any material commitment for capital expenditures.

Contractual Obligations

As of December 31, 2004, the Bank had the following contractual obligations.

	Less Than One Year	One to Three Years	Three to Five Years	Over Five Years	Total
Long Term Debt	$	$	$	$ 2,000	$ 2,000
Operating Leases	1,892	3,563	2,831	4,137	12,423
Total Contractual Obligations	$ 1,892	$ 3,563	$ 2,831	$ 6,137	$ 14,423

Off Balance Sheet and Other Related Party Transactions

As noted in Footnote 12 to the financial statements, the Company is contingently liable for letter of credit accommodations made to its customers in the ordinary course of business totaling $30.2 million at December 31, 2004, down from $31.0 million one year earlier. Additionally, the Company has undisbursed loan commitments, also made in the ordinary course of business, totaling $626.4 million, which was up from the $523.4 million outstanding one year earlier. The Company has an allowance for losses-unfunded commitments totaling $1,783,000 and $1,941,000 at December 31, 2004 and 2003, respectively, to cover losses inherent in its letter of credit accommodations and undisbursed loan commitments.

There are no Special Purpose Entity (SPE) trusts, corporations, or other legal entities established by Mid-State which reside off-balance sheet. There are no other off-balance sheet items other than the aforementioned items related to letter of credit accommodations and undisbursed loan commitments.

As noted in Footnote 5 to the financial statements, the Company does make loans and leases to related parties (directors and officers) in the ordinary course of business at prevailing rates and terms. These loans and leases totaled $8.7 million and $1.2 million at the end of 2004 and 2003, respectively.

INCOME STATEMENT ANALYSIS

Net Interest Income and Interest Rate Risk

Net Interest Income is the difference between interest and fees earned on all earning assets and interest paid on interest bearing liabilities. Net Interest Income for 2004 was $101.5 million, up from $95.5 million recorded in 2003 and $93.0 million in 2002. The components of net interest income change in response to both changes in rate, average balance and mix of both earning assets and liabilities. The following tables present an analysis of yields/rates, interest income and expense, and average balances for 2004, 2003, and 2002.

ANALYSIS OF CHANGES IN INTEREST INCOME AND EXPENSE

	2004			**2003**			**2004 Compared to 2003 Composition of Change**		
(dollars in 000's)	**Average Balance**	**Interest Income/ Expense**	**Average Yield / Rate**	**Average Balance**	**Interest Income/ Expense**	**Average Yield / Rate**	**Change Due To: Volume**	**Rate**	**Total Change**
EARNING ASSETS:									
Loans	$ 1,310,842	$ 85,127	6.49 %	$ 1,131,932	$ 80,372	7.10 %	$ 12,161	$ (7,406)	$ 4,755
Investment Securities	701,996	24,329	3.47 %	640,888	24,040	3.75 %	2,205	(1,916)	289
Fed Funds, Other	37,380	480	1.28 %	84,421	828	0.98 %	(533)	185	(348)
TOTAL EARNING ASSETS	$ 2,050,218	$ 109,936	5.36 %	$ 1,857,241	$ 105,240	5.67 %	$ 13,833	$ (9,137)	$ 4,696
INTEREST BEARING LIABILITIES:									
NOW, Savings, and Money Market Accounts	$ 1,063,895	$ 2,565	0.24 %	$ 938,720	$ 2,604	0.28 %	$ 325	$ (364)	$ (39)
Time Deposits	399,806	5,691	1.42 %	399,448	6,944	1.74 %	5	(1,258)	(1,253)
Interest Bearing Deposits	1,463,701	8,256	0.56 %	1,338,168	9,548	0.71 %	330	(1,622)	(1,292)
Other Borrowings	4,401	194	4.41 %	4,423	151	3.41 %	(1)	44	43
TOTAL INTEREST BEARING LIABILITIES	1,468,102	8,450	0.58 %	1,342,591	9,699	0.72 %	329	(1,578)	(1,259)
NET INTEREST INCOME	$ 2,050,218	$ 101,486	4.95 %	$ 1,857,241	$ 95,541	5.14 %	$ 13,504	$ (7,559)	$ 5,945

	2003			**2002**			**2003 Compared to 2002 Composition of Change**		
(dollars in 000's)	**Average Balance**	**Interest Income/ Expense**	**Average Yield / Rate**	**Average Balance**	**Interest Income/ Expense**	**Average Yield / Rate**	**Change Due To: Volume**	**Rate**	**Total Change**
EARNING ASSETS:									
Loans	$ 1,131,932	$ 80,372	7.10 %	$ 1,109,245	$ 84,962	7.66 %	$ 1,674	$ (6,264)	$ (4,590)
Investment Securities	640,888	24,040	3.75 %	533,427	23,201	4.35 %	4,352	(3,513)	839
Fed Funds, Other	84,421	828	0.98 %	75,608	1,169	1.55 %	111	(452)	(341)
TOTAL EARNING ASSETS	$ 1,857,241	$ 105,240	5.67 %	$ 1,718,280	$ 109,332	6.36 %	$ 6,138	$ (10,230)	$ (4,092)
INTEREST BEARING LIABILITIES:									
NOW, Savings, and Money Market Accounts	$ 938,720	$ 2,604	0.28 %	$ 827,054	$ 4,894	0.59 %	$ 485	$ (2,775)	$ (2,290)
Time Deposits	399,448	6,944	1.74 %	418,536	11,275	2.69 %	(423)	(3,908)	(4,331)
Interest Bearing Deposits	1,338,168	9,548	0.71 %	1,245,590	16,169	1.30 %	62	(6,683)	(6,621)
Other Borrowings	4,423	151	3.41 %	7,595	212	2.79 %	(98)	37	(61)
TOTAL INTEREST BEARING LIABILITIES	1,342,591	9,699	0.72 %	1,253,185	16,381	1.31 %	(36)	(6,646)	(6,682)
NET INTEREST INCOME	$ 1,857,241	$ 95,541	5.14 %	$ 1,718,280	$ 92,951	5.41 %	$ 6,174	$ (3,584)	$ 2,590

During 2004 there was a $4.7 million increase in interest income along with a decrease of $1.2 million in interest expense compared to 2003. The resulting $5.9 million increase in net interest income for 2004 was a result of a number of dynamics affecting both average balance and interest rate considerations. First, the Company experienced an increase in its average earning assets outstanding of $193.0 million. The increase was primarily attributable to the net increase in average loans, which were up by $178.9 million, and to a lesser extent to an increase in average investments of $61.1 million. These increases were partially offset by a decrease in average federal funds sold of $47.0 million. Second, while the Company s average

interest bearing liabilities increased by $125.5 million, earning assets increased by a larger $193.0 million. Third, earning asset yields were somewhat lower in 2004 compared to the average for 2003 and liability costs did not drop as quickly.

During 2003 there was a $4.1 million decrease in interest income along with a decrease of $6.7 million in interest expense compared to 2002. The resulting $2.6 million increase in net interest income for 2003 was a result of a number of dynamics affecting both average balance and interest rate considerations. First, the Company experienced an increase in its average earning assets outstanding of $139.0 million. The increase was divided amongst a net increase in average loans of $22.7 million, an increase in average investments of $107.5 million and an increase in average federal funds sold of $8.8 million. Second, while the Company s average interest bearing liabilities increased by $89.4 million, earning assets increased by a larger $139.0 million. The increases in earning assets and interest bearing liabilities are partly attributable to the acquisition of Ojai Valley Bank on October 31, 2003 which affected the averages of these categories (through the influence of their balances for the last two months of the year) in 2003 with no corresponding influence in 2002. Third, interest rates were lower in 2003 compared to the average for 2002. For example, the Prime Rate averaged 4.12% in 2003 compared to 4.68% in 2002.

The Bank expects its risk exposure to changes in interest rates to remain manageable and well within acceptable policy ranges. A recent review as of the end of 2004 of the potential changes in the Bank s net interest income over a 12 month time horizon showed that it could fluctuate under extreme alternative rate scenarios from between +4.0% and -8.5% of the base case (rates unchanged) of $110.8 million. The Bank s policy is to maintain a structure of assets and liabilities which are such that net interest income will not vary more than plus or minus 15% of the base forecast over the next 12 months. Management expects that its exposure to interest rate risk is manageable and it will continue to strive for an optimal trade-off between risk and earnings.

The following table presents a summary of the Bank s net interest income forecasted for the coming 12 months under alternative interest rate scenarios.

	Change From Base
Rates Down Very Significant	-8.5 %
(Prime down to 3.50% over 6 months)	
Rates Down Significant	-4.0 %
(Prime down to 4.00% over 7 months)	
Rates Down Modestly	-2.2 %
(Prime down to 4.50% over 7 months)	
Base Case Rates Unchanged	
(Prime unchanged at 5.25% over 12 months)	
Rates Up Modestly	+0. 7%
(Prime up to 6.25% over 10 months)	
Rates Up Aggressive	