UMPQUA HOLDINGS CORP
Form 10-Q
November 08, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended: September 30, 2006**

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from __________ to __________ .**

Commission File Number: 000-25597
Umpqua Holdings Corporation
(Exact Name of Registrant as Specified in Its Charter)

OREGON	**93-1261319**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

One SW Columbia Street, Suite 1200
Portland, Oregon 97258
(Address of Principal Executive Offices)(Zip Code)
(503) 727-4100
(Registrant s Telephone Number, Including Area Code)

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

þ Yes o No

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

þ Large accelerated filer o Accelerated filer o Non-accelerated filer

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

o Yes þ No

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

Common stock, no par value: 58,036,404 shares outstanding as of October 31, 2006

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements (unaudited)

UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(in thousands, except shares)

	September 30, 2006	December 31, 2005
ASSETS		
Cash and due from banks	$ 151,334	$ 151,521
Temporary investments	40,700	10,233
Total cash and cash equivalents	192,034	161,754
Trading account assets	682	601
Investment securities available for sale, at fair value	689,841	671,868
Investment securities held to maturity, at amortized cost	9,494	8,677
Loans held for sale	18,951	9,061
Loans and leases	5,385,262	3,921,631
Allowance for loan and lease losses	(60,475)	(43,885)
Net loans and leases	5,324,787	3,877,746
Restricted equity securities	15,255	14,263
Premises and equipment, net	99,251	88,865
Goodwill and other intangible assets, net	680,722	408,503
Mortgage servicing rights, net	10,427	10,890
Other assets	157,404	108,411
Total assets	$ 7,198,848	$ 5,360,639
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits		
Noninterest bearing	$ 1,246,499	$ 987,714
Interest bearing	4,403,839	3,298,552
Total deposits	5,650,338	4,286,266
Securities sold under agreements to repurchase and federal funds purchased	65,471	113,865
Term debt	57,072	3,184
Junior subordinated debentures	203,955	165,725
Other liabilities	80,332	53,338
Total liabilities	6,057,168	4,622,378

COMMITMENTS AND CONTINGENCIES (NOTE 8)

SHAREHOLDERS EQUITY				
Preferred stock, no par value, 2,000,000 shares authorized; none issued and outstanding				
Common stock, no par value, 100,000,000 shares authorized; issued and outstanding: 58,028,555 in 2006 and 44,556,269 in 2005		929,893		564,579
Retained earnings		220,726		183,591
Accumulated other comprehensive loss		(8,939)		(9,909)
Total shareholders equity		1,141,680		738,261
Total liabilities and shareholders equity	$	7,198,848	$	5,360,639

See notes to condensed consolidated financial statements

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(in thousands, except per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2006	**2005**	**2006**	**2005**
INTEREST INCOME				
Interest and fees on loans	$ 106,320	$ 65,579	$ 265,444	$ 182,735
Interest and dividends on investment securities				
Taxable	6,797	6,558	20,201	19,359
Exempt from federal income tax	1,127	427	2,685	1,839
Dividends	105	40	205	121
Other interest income	389	617	892	1,304
Total interest income	114,738	73,221	289,427	205,358
INTEREST EXPENSE				
Interest on deposits	34,121	16,101	81,112	40,910
Interest on securities sold under agreements to repurchase and federal funds purchased	2,155	511	6,346	1,419
Interest on term debt	692	89	2,775	633
Interest on junior subordinated debentures	3,971	2,719	10,359	7,663
Total interest expense	40,939	19,420	100,592	50,625
Net interest income	73,799	53,801	188,835	154,733
Provision for loan and lease losses	2,352		2,427	2,400
Net interest income after provision for loan losses	71,447	53,801	186,408	152,333
NON-INTEREST INCOME				
Service charges on deposit accounts	7,606	5,778	19,540	16,026
Brokerage commissions and fees	2,506	2,735	7,408	8,743
Mortgage banking revenue, net	1,445	3,256	5,792	4,834
Net (loss) gain on sale of investment securities		28	(1)	1,426
Other income	1,919	1,985	6,745	5,279
Total non-interest income	13,476	13,782	39,484	36,308
NON-INTEREST EXPENSE				
Salaries and employee benefits	26,387	20,708	71,525	61,348
Net occupancy and equipment	8,540	6,291	22,907	18,533
Communications	1,744	1,511	4,689	4,334
Marketing	1,780	1,151	4,596	3,218
Services	4,199	3,245	11,016	9,592
Supplies	925	793	2,276	2,030
Intangible amortization	1,195	555	2,533	1,875

Merger related expenses	2,451		4,358	262
Other expenses	3,465	2,829	9,009	7,747
Total non-interest expense	50,686	37,083	132,909	108,939
Income before income taxes	34,237	30,500	92,983	79,702
Provision for income taxes	11,381	10,577	33,069	28,754
Net income	$ 22,856	$ 19,923	$ 59,914	$ 50,948
Basic earnings per share	$ 0.40	$ 0.45	$ 1.19	$ 1.15
Diluted earnings per share	$ 0.39	$ 0.44	$ 1.17	$ 1.13

See notes to condensed consolidated financial statements

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
(UNAUDITED)

(in thousands, except shares)

	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Loss	Total
BALANCE AT JANUARY 1, 2005	44,211,075	$ 560,611	$ 128,112	$ (1,110)	$ 687,613
Net income			69,735		69,735
Other comprehensive loss, net of tax:					
Unrealized losses on securities arising during the year (1)				(8,799)	(8,799)
Comprehensive income					$ 60,936
Stock-based compensation		693			693
Stock repurchased and retired	(84,185)	(1,904)			(1,904)
Issuances of common stock under stock plans and related tax benefit	429,379	5,179			5,179
Cash dividends ($0.32 per share)			(14,256)		(14,256)
Balance at December 31, 2005	44,556,269	$ 564,579	$ 183,591	$ (9,909)	$ 738,261
BALANCE AT JANUARY 1, 2006	44,556,269	$ 564,579	$ 183,591	$ (9,909)	$ 738,261
Net income			59,914		59,914
Other comprehensive loss, net of tax:					
Unrealized gains on securities arising during the year (2)				970	970
Comprehensive income					$ 60,884
Stock-based compensation		1,563			1,563
Stock repurchased and retired	(1,392)	(39)			(39)
Issuances of common stock under stock plans and related tax benefit	728,349	10,069			10,069
Stock issued in connection with acquisitions	12,745,329	353,721			353,721
Cash dividends ($0.42 per share)			(22,779)		(22,779)
Balance at September 30, 2006	58,028,555	$ 929,893	$ 220,726	$ (8,939)	$ 1,141,680

(1) Net unrealized holding loss on securities of $7.9 million (net of $5.3 million tax benefit),

plus reclassification adjustment for net gains included in net income of $863,000 (net of $576,000 tax expense).

(2) Net unrealized holding gain on securities of $969,000 (net of $648,000 tax expense), plus reclassification adjustment for net losses included in net income of $1,000.

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

(in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2006	**2005**	**2006**	**2005**
Net income	$ 22,856	$ 19,923	$ 59,914	$ 50,948
Unrealized gains (losses) arising during the period on investment securities available for sale	16,008	(7,289)	1,617	(8,439)
Reclassification adjustment for (gains) losses realized in net income, net of tax (expense of $11 and $570 for the three and nine months ended September 30, 2005, respectively)		(17)	1	(856)
Income tax (expense) benefit related to unrealized losses/(gains) on investment securities, available for sale	(6,403)	2,916	(648)	3,376
Net unrealized gains (losses) on investment securities available for sale	9,605	(4,390)	970	(5,919)
Comprehensive income	$ 32,461	$ 15,533	$ 60,884	$ 45,029

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(in thousands)

	Nine months ended September 30, 2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 59,914	$ 50,948
Adjustments to reconcile net income to net cash provided by operating activities of continuing operations:		
Resticted equity securities stock dividends	(205)	(161)
Deferred income tax benefit	(409)	
Amortization of investment premiums, net	907	793
Origination of loans held for sale	(194,856)	(240,942)
Proceeds from sales of loans held for sale	186,873	242,613
Net (increase) decrease in trading account assets	(36)	747
Provision for loan losses	2,427	2,400
Loss (gain) on sale of investment securities available-for-sale	1	(1,426)
Increase in mortgage servicing rights	(470)	(1,118)
Depreciation and amortization	9,571	8,306
Tax benefits from the exercise of stock options		1,936
Excess tax benefits from the exercise of stock options	(855)	
Net decrease (increase) in other assets	24,074	(9,080)
Net (increase) decrease in other liabilities	(2,068)	9,705
Other, net	(372)	(138)
Net cash provided by operating activities	84,496	64,583
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investment securities available-for-sale		(168,603)
Sales and maturities of investment securities available-for-sale	56,303	138,629
Redemption of restricted equity securities	9,242	120
Maturities of investment securities held-to-maturity	2,237	1,156
Net loan and lease originations	(523,928)	(227,354)
Purchase of loans	(15,338)	(29,271)
Disposals of furniture and equipment	193	155
Sales of real estate owned	93	
Cash acquired in merger, net of cash consideration paid	36,950	
Proceeds from sales of loans	100,770	25,252
Purchases of premises and equipment	(8,196)	(9,509)
Net cash used by investing activities	(341,674)	(269,425)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposit liabilities	348,851	294,301

Net (decrease) increase in Fed funds purchased	(55,000)	56,000
Net increase in securities sold under agreements to repurchase	6,606	1,284
Dividends paid on common stock	(17,664)	(7,999)
Excess tax benefits from the exercise of stock options	855	
Proceeds from stock options exercised	8,936	2,260
Retirement of common stock	(39)	(1,899)
Term debt borrowings	600,000	
Repayment of term debt	(605,087)	(85,147)
Net cash provided by financing activities	287,458	258,800
Net increase in cash and cash equivalents	30,280	53,958
Cash and cash equivalents, beginning of period	161,754	118,207
Cash and cash equivalents, end of period	$ 192,034	$ 172,165

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid during the period for:		
Interest	$ 95,172	$ 47,771
Income taxes	$ 38,808	$ 19,418

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 Summary of Significant Accounting Policies

The accounting and financial reporting policies of Umpqua Holdings Corporation (referred to in this report as we , our or the Company) conform with accounting principles generally accepted in the United States of America. The accompanying interim consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Umpqua Bank (Bank), and Strand, Atkinson, Williams & York, Inc. (Strand). All material inter-company balances and transactions have been eliminated. The consolidated financial statements have not been audited. A more detailed description of our accounting policies is included in the 2005 Annual Report filed on Form 10-K. There have been no significant changes to these policies. These interim condensed consolidated financial statements should be read in conjunction with the financial statements and related notes contained in the 2005 Annual Report filed on Form 10-K.

In management s opinion, all accounting adjustments necessary to accurately reflect the financial position and results of operations on the accompanying financial statements have been made. These adjustments include normal and recurring accruals considered necessary for a fair and accurate presentation. The results for interim periods are not necessarily indicative of results for the full year or any other interim period. Certain reclassifications of prior year amounts have been made to conform with current classifications.

Note 2 Stock-Based Compensation

The Company adopted the 2003 Stock Incentive Plan (2003 Plan) in April 2003 that provides for grants of up to 2 million shares. The plan further provides that no grants may be issued if existing options and subsequent grants under the 2003 Plan exceed 10% of the Company s outstanding shares on a diluted basis. Generally, options vest ratably over a period of five years. Under the terms of the 2003 Plan, the exercise price of each option equals the market price of the Company s stock on the date of the grant, and the maximum term is ten years.

The Company has options outstanding under two prior plans adopted in 1995 and 2000, respectively. With the adoption of the 2003 Plan, no additional grants can be issued under the previous plans. The Company also assumed various plans in connection with mergers and acquisitions but does not make grants under those plans.

Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, *Share Based Payments*, a revision to the previously issued guidance on accounting for stock options and other forms of equity-based compensation. SFAS No. 123R requires companies to recognize in the income statement the grant-date fair value of stock options and other equity-based forms of compensation issued to employees over the employees requisite service period (generally the vesting period). Prior to January 1, 2006, we accounted for share-based compensation to employees under the intrinsic value method prescribed in Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. Under the intrinsic value method, compensation expense is recognized only to the extent an option s exercise price is less than the market value of the underlying stock on the date of grant. We also followed the disclosure requirements of SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure.* We adopted SFAS No. 123R under the *modified prospective* method which means that the unvested portion of previously granted awards and any awards that are granted or modified after the date of adoption will be measured and accounted for under the provisions of SFAS No. 123R. Accordingly, financial statement amounts for prior periods presented have not been restated to reflect the fair value method of recognizing compensation cost relating to stock options. The Company will continue to use straight-line recognition of expenses for awards with graded vesting.

As a result of adopting SFAS No. 123R on January 1, 2006, the Company s results for the three and nine months ended September 30, 2006 reflected the following changes:

(in thousands, except per share data)

	Three months ended	Nine months ended

	September 30, 2006	September 30, 2006
	Increase/(Decrease)	
Salaries and employee benefits	$ 331	$ 1,029
Income before income taxes	$ (331)	$ (1,029)
Provision for income taxes	$ (132)	$ (412)
Net income	$ (199)	$ (617)
Basic earnings per share	$ 0.00	$ (0.01)
Diluted earnings per share	$ 0.00	$ (0.01)

The compensation cost related to stock options, including costs related to unvested options assumed in connection with acquisitions, that has been charged against income (included in salaries and employee benefits) was $342,000 and $1.1 million for the three and

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nine months ended September 30, 2006, respectively, as compared to $15,000 and $45,000 for the same periods in 2005, respectively. The total income tax benefit recognized in the income statement related to stock options was $137,000 and $425,000 for the three and nine months ended September 30, 2006, respectively, as compared to $6,000 and $18,000 for the same periods in 2005, respectively.

The fair value of each option grant is estimated as of the grant date using the Black-Scholes option-pricing model using assumptions noted in the following table. Expected volatility is based on the historical volatility of the price of the Company s stock. The Company uses historical data to estimate option exercise and stock option forfeiture rates within the valuation model. The expected term of options granted is derived from the vesting period and contractual term using an allowed short-cut method and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. There were no stock option grants in the three months ended September 30, 2006.

	Nine months ended September 30, 2006
Dividend yield	2.68%
Expected life (years)	6.4
Expected volatility	35%
Risk-free rate	4.30%
Weighted average grant date fair value of options granted	$ 9.18

Under APB No. 25, for all options originally granted by the Company, no compensation cost was recognized related to stock options in the three and nine months ended September 30, 2005. Compensation cost, net of tax, of $9,000 and $27,000, was recognized as salaries and benefits expense for the three and nine months ended September 30, 2005, respectively, for certain unvested options that were assumed in connection with the acquisitions of Centennial Bancorp and Humboldt Bancorp that continued to vest after acquisition. The following table presents the effect on net income and earnings per share if the fair value based method prescribed by SFAS No. 123, using straight-line expense recognition, had been applied to all outstanding and unvested awards in the three and nine months ended September 30, 2005:

(in thousands, except per share data)

	Three months ended September 30, 2005	**Nine months ended September 30, 2005**
NET INCOME, AS REPORTED	$19,923	$ 50,948
Deduct: Additional stock-based employee compensation determined under the fair value based method for all awards, net of tax effects	(481)	(696)
Pro forma net income	$19,442	$ 50,252
NET INCOME PER SHARE:		
Basic as reported	$ 0.45	$ 1.15
Basic pro forma	$ 0.44	$ 1.13
Diluted as reported	$ 0.44	$ 1.13
Diluted pro forma	$ 0.43	$ 1.12

The following weighted-average assumptions were used to determine the fair value of option grants as of the grant date to determine compensation cost under SFAS No. 123. There were no stock option grants in the three months ended September 30, 2005.

	Nine months ended September 30, 2005
Dividend yield	1.66%
Expected life (years)	7.5
Expected volatility	38%
Risk-free rate	4.20%
Weighted average grant date fair value of options granted	$ 9.41

The following table summarizes information about stock option activity for the nine months ended September 30, 2006:

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(In thousands, except per share data)

	Nine months ended September 30, 2006			
	Options Outstanding	Weighted-Avg Exercise Price	Weighted-Avg Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Balance, beginning of period	1,846	$ 13.75		
Granted	25	$ 28.43		
Acquisitions	723	$ 14.32		
Exercised	(716)	$ 12.43		
Forfeited/expired	(18)	$ 19.93		
Balance, end of period	1,860	$ 14.62	5.92	$ 26,017
Options exercisable at end of period	1,313	$ 11.74	5.20	$ 22,138

The total intrinsic value (which is the amount by which the stock price exceeded the exercise price on the date of exercise) of options exercised during the three and nine months ended September 30, 2006 was $4.1 million and $10.4 million, respectively. This compared to the total intrinsic value of options exercised during the three and nine months ended September 30, 2005 of $652,000 and $5.3 million, respectively. During the three and nine months ended September 30, 2006, the amount of cash received from the exercise of stock options was $5.8 million and $8.9 million, respectively. As of September 30, 2006, there was $3.5 million of total unrecognized compensation cost related to non-vested stock options which is expected to be recognized over a weighted-average period of 3.5 years.

The Company grants restricted stock periodically as a part of the 2003 Plan for the benefit of employees. Restricted shares issued currently vest on an annual basis over five years for all grants issued. Recipients of restricted stock do not pay any cash consideration to the Company for the shares, and receive all dividends with respect to such shares, whether or not the shares have vested. Restrictions are based on continuous service.

The following table summarizes information about non-vested restricted shares as of September 30, 2006 and changes for the nine months ended September 30, 2006:

(In thousands, except per share data)

	Nine months ended September 30, 2006	
	Restricted Shares Outstanding	Average Grant Date Fair Value
Balance, beginning of period	47	$ 21.28
Granted	92	$ 27.96
Vested	(10)	$ 19.49
Forfeited/expired	(4)	$ 23.37
Balance, end of period	125	$ 26.29

The compensation cost related to restricted stock that has been charged against income (included in salaries and employee benefits) was $203,000 and $501,000 for the three and nine months ended September 30, 2006, respectively, as compared to $59,000 and $179,000 for the same periods in 2005, respectively. The total income tax benefit recognized in the income statement related to restricted stock was $81,000 and $200,000 for the three and nine months ended September 30, 2006, respectively as compared to $24,000 and $72,000 for the same periods in 2005, respectively. The total fair value of shares vested during the three and nine months ended September 30, 2006 was $292,000 and $300,000. This compared to total fair value of shares vested during the three and nine months ended September 30, 2005 of $295,000 and $313,000, respectively. As of September 30, 2006, there was $2.9 million of total unrecognized compensation cost related to non-vested restricted stock which is expected to be recognized over a weighted-average period of 3.9 years.

For the three months ended September 30, 2006 and 2005, the Company received income tax benefits of $1.6 million and $345,000, respectively, related to the exercise of non-qualified employee stock options, disqualifying dispositions in the exercise of incentive stock options and the vesting of restricted shares. For the nine months ended September 30, 2006 and 2005, the Company received

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income tax benefits of $3.5 million and $1.9 million, respectively. Prior to the adoption of SFAS No. 123R, the Company presented all tax benefits resulting from the exercise of stock options as operating cash flows in the Statement of Cash Flows. SFAS No. 123R requires the cash flows from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. The amount of excess tax benefit classified as a financing cash flow in the current period was $855,000.

Note 3 Business Combinations

On June 2, 2006, the Company acquired all of the outstanding common stock of Western Sierra Bancorp (Western Sierra) of Cameron Park, California, and its principal operating subsidiaries, Western Sierra Bank, Central California Bank, Lake Community Bank and Auburn Community Bank, in an acquisition accounted for under the purchase method of accounting. The results of Western Sierra s operations have been included in the consolidated financial statements since that date. This acquisition added Western Sierra s complete network of 31 Northern California branches, including locations in the Sacramento, Auburn, Lakeport and Sonora areas, to our network of 96 California, Oregon and Washington locations. This merger was consistent with the Company s community banking expansion strategy and provides further opportunity to enter growth markets in Northern California.

The aggregate purchase price was $353.7 million and included 12.7 million common shares valued at $343.0 million, and 723,000 stock options valued at $10.7 million. Western Sierra shareholders received 1.61 shares of the Company s common stock for each share of Western Sierra common stock (exchange ratio of 1.61:1). The value of the common shares issued was determined as $26.91 per share based on the average closing market price of the Company s common stock for the two trading days before and after the last trading day before public announcement of the merger. Outstanding Western Sierra stock options were converted (using the exchange ratio of 1.61:1) at a weighted average fair value of $14.80 per option.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition:

	June 2, 2006
Assets Acquired:	
Cash and equivalents	$ 36,978
Investment securities	76,229
Loans, net	1,009,860
Premises and equipment, net	10,109
Core deposit intangible asset	27,625
Goodwill	247,799
Other assets	82,866
Total assets acquired	$ 1,491,466
Liabilities Assumed:	
Deposits	$ 1,016,053
Term debt	59,030
Junior subordinated debentures	38,094
Other liabilities	24,540
Total liabilities assumed	1,137,717
Net Assets Acquired	$ 353,749

Additional adjustments to the purchase price allocation may be required, specifically related to other assets, taxes and compensation adjustments. At September 30, 2006, the goodwill asset recorded in connection with the Western Sierra acquisition was $246.8 million. The $1.0 million change from June 2, 2006 is related primarily to the tax benefit of fully vested acquired options of $1.2 million, partially offset by asset write-offs and the recognition of unrecorded liabilities.

The core deposit intangible asset shown in the table above represents the value ascribed to the long-term deposit relationships acquired. This intangible asset is being amortized on a straight-line basis over a weighted average estimated useful life of ten years. The core deposit intangible asset is not estimated to have a significant residual value. Goodwill represents the excess of the total purchase price paid for Western Sierra over the fair values of the assets acquired, net of the fair values of liabilities assumed. Goodwill has been assigned to the Community Banking segment. Goodwill is not amortized, but is evaluated for possible impairment at least annually and more frequently if events and circumstances indicate that the asset might be impaired. No impairment losses were recognized in connection with core deposit intangible or goodwill assets during the period from acquisition (June 2, 2006) to September 30, 2006.

The following tables present unaudited pro forma results of operations for the nine months ended September 30, 2006 and three and nine months ended September 30, 2005 as if the acquisition of Western Sierra had occurred on January 1, 2005. The Company

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expects to realize significant cost savings as a result of the Western Sierra merger that are not reflected in the pro forma consolidated condensed statements of income. No assurance can be given with respect to the ultimate level of such cost savings. The pro forma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisitions actually occurred on January 1, 2005:

Pro Forma Financial Information Unaudited

(in thousands, except per share data)

	Nine Months Ended September 30, 2006			
	Umpqua	Western Sierra (a)	Pro Forma Adjustments	Pro Forma Combined
Net interest income	$188,835	$25,834	$ (99)(b)	$214,570
Provision for loan and lease losses	2,427	350		2,777
Non-interest income	39,484	5,040		44,524
Non-interest expense	132,909	18,168	(3,270)(c)	147,807
Income before income taxes	92,983	12,356	3,171	108,510
Provision for income taxes	33,069	4,898	1,268(d)	39,235
Net income	$ 59,914	$ 7,458	$ 1,903	$ 69,275
Earnings per share:				
Basic	$ 1.19			$ 1.21
Diluted	$ 1.17			$ 1.19
Average shares outstanding:				
Basic	50,378	4,401	2,685(e)	57,464
Diluted	51,010	4,517	2,755(e)	58,282

(a) Western Sierra amounts represent results from January 1, 2006 to acquisition date of June 2, 2006.

(b) Consists of additional net accretion of fair value adjustments related to the Western Sierra acquisition.

(c) Consists of merger related expenses of

$4.4 million, partially offset by additional core deposit intangible amortization of $1.1 million.

(d) Income tax effect of pro forma adjustments at 40%.

(e) Additional shares issued at an exchange ratio of 1.61:1.

(in thousands, except per share data)

	Three Months Ended September 30, 2005			
	Umpqua	**Western Sierra**	**Pro Forma Adjustments**	**Pro Forma Combined**
Net interest income	$53,801	$15,339	$ 1,108(a)	$70,248
Provision for loan and lease losses		540		540
Non-interest income	13,782	3,430		17,212
Non-interest expense	37,083	10,813	688(b)	48,584
Income before income taxes	30,500	7,416	420	38,336
Provision for income taxes	10,577	2,706	168(c)	13,451
Net income	$19,923	$ 4,710	$ 252	$24,885
Earnings per share:				
Basic	$ 0.45			$ 0.44
Diluted	$ 0.44			$ 0.43
Average shares outstanding:				
Basic	44,468	7,729	4,715(d)	56,912
Diluted	45,022	7,987	4,872(d)	57,881

(a) Consists of net accretion of fair value adjustments related to the Western Sierra acquisition.

(b)

Consists of amortization of core deposit intangible asset related to the Western Sierra acquisition.

(c) Income tax effect of pro forma adjustments at 40%.

(d) Additional shares issued at an exchange ratio of 1.61:1.

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(in thousands, except per share data)

	Nine Months Ended September 30, 2005			
	Umpqua	Western Sierra	Pro Forma Adjustments	Pro Forma Combined
Net interest income	$154,733	$43,539	$4,609(a)	$202,881
Provision for loan and lease losses	2,400	1,450		3,850
Non-interest income	36,308	9,570		45,878
Non-interest expense	108,939	31,694	2,152(b)	142,785
Income before income taxes	79,702	19,965	2,457	102,124
Provision for income taxes	28,754	7,141	983(c)	36,878
Net income	$ 50,948	$12,824	$1,474	$ 65,246
Earnings per share:				
Basic	$ 1.15			$ 1.15
Diluted	$ 1.13			$ 1.13
Average shares outstanding:				
Basic	44,412	7,696	4,695(d)	56,803
Diluted	44,984	7,976	4,865(d)	57,825

(a) Consists of net accretion of fair value adjustments related to the Western Sierra acquisition.

(b) Consists of amortization of core deposit intangible asset related to the Western Sierra acquisition.

(c) Income tax effect of pro forma adjustments at 40%.

(d) Additional shares issued at an exchange ratio of 1.61:1.

The following table summarizes activity in the Company s accrued restructuring charges related to the Western Sierra acquisition which are recorded in other liabilities:

(in thousands)

	Accrued Restructuring Charges
Beginning balance	$
Additions:	
Severance, retention and other compensation	5,698
Other	53
Utilization:	
Cash payments	(1,078)
Non-cash write-downs and other adjustments	(87)
Ending Balance	$ 4,586

The Company expects to incur approximately $500,000 of additional merger-related expenses, generally consisting of professional fees and compensation costs, in connection with the Western Sierra merger.

Note 4 Per Share Information

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. *Diluted earnings per share* is computed in a similar manner, except that the denominator is increased to include the number of additional common shares that would have been outstanding if potentially dilutive common shares were issued using the treasury stock method. For all periods presented, stock options and unvested restricted shares are the only potentially dilutive instruments issued by the Company.

The following is a computation of basic and diluted earnings per share for the three and nine months ended September 30, 2006 and 2005:

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Earnings Per Share
(in thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Basic earnings per share:				
Weighted average shares outstanding	57,802	44,468	50,378	44,412
Net income	$ 22,856	$ 19,923	$ 59,914	$ 50,948
Basic earnings per share	$ 0.40	$ 0.45	$ 1.19	$ 1.15
Diluted earnings per share:				
Weighted average shares outstanding	57,802	44,468	50,378	44,412
Net effect of the assumed exercise of stock options and vesting of restricted shares, based on the treasury stock method	650	554	632	572
Total weighted average shares and common stock equivalents outstanding	58,452	45,022	51,010	44,984
Net income	$ 22,856	$ 19,923	$ 59,914	$ 50,948
Diluted earnings per share	$ 0.39	$ 0.44	$ 1.17	$ 1.13

Note 5 Segment Information

The Company operates three primary segments: Community Banking, Mortgage Banking and Retail Brokerage. The Community Banking segment s principal business focus is the offering of loan and deposit products to its business and retail customers in its primary market areas. The Community Banking segment operates 127 stores located throughout Oregon, Northern California and Washington.

The Mortgage Banking segment, which operates as a division of the Bank, originates, sells and services residential mortgage loans.

The Retail Brokerage segment consists of the operations of Strand, which offers a full range of retail brokerage services and products to its clients who consist primarily of individual investors. The Company accounts for intercompany fees and services between Strand and the Bank at an estimated fair value according to regulatory requirements for services provided. Intercompany items relate primarily to management services and interest on intercompany borrowings.

Summarized financial information concerning the Company s reportable segments and the reconciliation to the consolidated financial results is shown in the following tables:

Segment Information
(in thousands)

	Three Months Ended September 30, 2006			
	Community Banking	Retail Brokerage	Mortgage Banking	Consolidated
Interest income	$ 109,731	$ 15	$ 4,992	$ 114,738
Interest expense	37,784		3,155	40,939
Net interest income	71,947	15	1,837	73,799
Provision for loan and lease losses	2,352			2,352
Non-interest income	9,331	2,608	1,537	13,476

Non-interest expense	43,091	2,447	2,697	48,235
Merger-related expense	2,451			2,451
Income before income taxes	33,384	176	677	34,237
Provision for income taxes	11,047	63	271	11,381
Net income	$ 22,337	$ 113	$ 406	$ 22,856

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(in thousands)	Nine Months Ended September 30, 2006 Community Banking	Retail Brokerage	Mortgage Banking	Consolidated
Interest income	$280,388	$ 55	$8,984	$289,427
Interest expense	94,779		5,813	100,592
Net interest income	185,609	55	3,171	188,835
Provision for loan and lease losses	2,427			2,427
Non-interest income	25,950	7,702	5,832	39,484
Non-interest expense	114,182	7,493	6,876	128,551
Merger-related expense	4,358			4,358
Income before income taxes	90,592	264	2,127	92,983
Provision for income taxes	32,095	123	851	33,069
Net income	$ 58,497	$ 141	$1,276	$ 59,914

(in thousands)	Three Months Ended September 30, 2005 Community Banking	Retail Brokerage	Mortgage Banking	Consolidated
Interest income	$71,660	$ 15	$1,546	$73,221
Interest expense	18,432		988	19,420
Net interest income	53,228	15	558	53,801
Provision for loan and lease losses				
Non-interest income	7,475	3,011	3,296	13,782
Non-interest expense	32,177	2,722	2,184	37,083
Merger-related expense				
Income before income taxes	28,526	304	1,670	30,500
Provision for income taxes	9,801	108	668	10,577
Net income	$18,725	$ 196	$1,002	$19,923

(in thousands)	Nine Months Ended September 30, 2005 Community Banking	Retail Brokerage	Mortgage Banking	Consolidated
Interest income	$200,874	$ 48	$4,436	$205,358
Interest expense	47,923		2,702	50,625
Net interest income	152,951	48	1,734	154,733

Provision for loan and lease losses	2,400			2,400
Non-interest income	22,230	9,141	4,937	36,308
Non-interest expense	94,083	8,454	6,140	108,677
Merger-related expense	262			262
Income before income taxes	78,436	735	531	79,702
Provision for income taxes	28,279	263	212	28,754
Net income	$ 50,157	$ 472	$ 319	$ 50,948

	September 30, 2006			
(in thousands)	**Community Banking**	**Retail Brokerage**	**Mortgage Banking**	**Consolidated**
Total assets	$6,923,587	$7,219	$268,042	$7,198,848
Total loans	$5,148,318	$	$236,944	$5,385,262
Total deposits	$5,649,825	$	$ 513	$5,650,338

	December 31, 2005			
(in thousands)	**Community Banking**	**Retail Brokerage**	**Mortgage Banking**	**Consolidated**
Total assets	$5,257,333	$7,925	$95,381	$5,360,639
Total loans	$3,846,507	$	$75,124	$3,921,631
Total deposits	$4,286,227	$	$ 39	$4,286,266

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Note 6 Recently Issued Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. (SFAS) 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R).* This Standard requires the balance sheet recognition of the funded status of defined benefit pension and other postretirement plans, along with a corresponding after-tax adjustment to stockholders equity. The recognition of funded status provision of this Standard applies prospectively and is effective December 31, 2006. This Standard also requires measurement of plan assets and benefit obligations at the fiscal year end effective December 31, 2008. The Company is currently evaluating the impact of the adoption of SFAS No. 158.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements.* SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for the Company on January 1, 2008. The Company is currently evaluating the impact of the adoption of SFAS No. 157.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB SFAS No. 109, *Accounting for Income Taxes*. This Interpretation defines the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of the adoption of FIN 48.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS No. 156). SFAS No. 156 requires all separately recognized servicing assets and liabilities to be initially measured at fair value. In addition, entities are permitted to choose to either subsequently measure servicing rights at fair value and report changes in fair value in earnings, or amortize servicing rights in proportion to and over the estimated net servicing income or loss and assess the rights for impairment. Beginning with the fiscal year in which an entity adopts SFAS No. 156, it may elect to subsequently measure a class of servicing assets and liabilities at fair value. Post adoption, an entity may make this election as of the beginning of any fiscal year. An entity that elects to subsequently measure a class of servicing assets and liabilities at fair value should apply that election to all new and existing recognized servicing assets and liabilities within that class. The effect of remeasuring an existing class of servicing assets and liabilities at fair value is to be reported as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. SFAS No. 156 is effective as of the beginning of an entity s first fiscal year that begins after September 15, 2006. The Company is currently evaluating the impact of t