# BEO Bancorp and Subsidiary

## Consolidated Financial Statements

Years Ended December 31, 2006 and 2005

**The Federal Deposit Insurance Corporation has not reviewed the financial data and related data in this statement for accuracy or relevance.**


**ISLER CPA, LLC**
CERTIFIED PUBLIC ACCOUNTANTS
EUGENE, OREGON

# BEO Bancorp and Subsidiary

# C O N T E N T S

# Message to Our Stockholders

BEO Bancorp and its subsidiary, Bank of Eastern Oregon, reached new levels of profitability in 2006. Net Income of $1,465,189 was recorded compared to $959,795 in 2005, an increase of 52.6%. This is a new record of profitability for the organization. Net Income per share increased from $2.18 in 2005 to $3.33 in 2006. Return on average assets and return on equity were .80% and 16.85%, both significant improvements over 2005 levels of .56% and 12.12%, respectively.

Total assets increased 5.4%, growing from $174,991,145 to $184,375,521. Total loans increased 10.5%, double digit growth for the third year in a row, from $108,361,675 to $119,783,377. Deposits continued to increase with year end totals at $162,453,911, a 4.2% improvement from 2005 year end of $155,949,196. Profits from the year were plowed back into stockholders equity, which after the payment of a cash dividend for the 19th consecutive year, grew 16.6% from $8,016,290 to $9,349,997. This capital level is supporting the company's strong, measured growth of the past three years. Tier 1 Capital at the bank level improved from 2005 to 2006 from 7.69% to 8.17%. The Bank continues to be "well capitalized" by FDIC standards.

The staff of the Bank of Eastern Oregon celebrated another year of professional growth and continues to focus on improving operational efficiency. All operating divisions showed positive results during the past year. We are constantly impressed by the loyalty of our employees and their determination to provide the best in customer service.

With this annual report, you will find proxy information for our annual stockholders meeting. It will be held at 7pm at the Port of Morrow offices in Boardman, Oregon on March 28, 2007. The Board of Directors invites each of you to attend as we review the results of 2006 and transact the business of your organization.

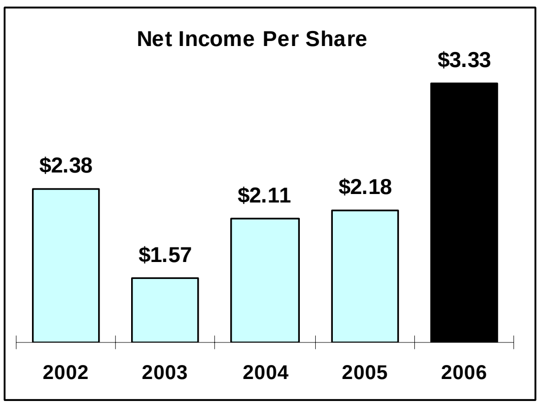
Respectfully,

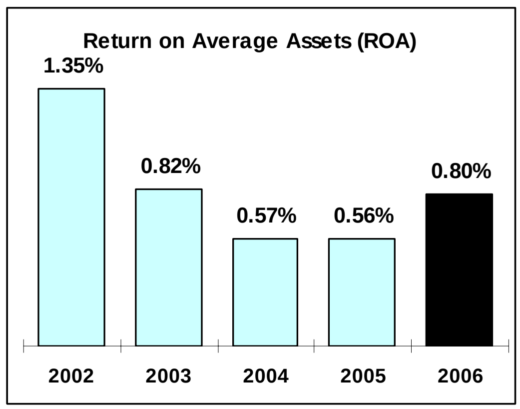
E. George Koffler
President
BEO Bancorp

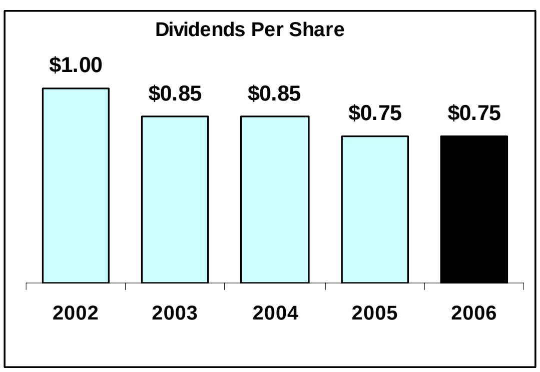
# FINANCIAL HIGHLIGHTS

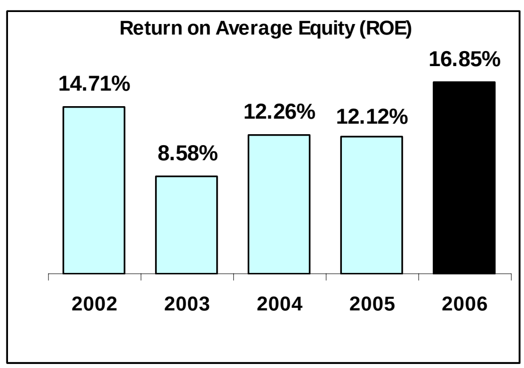
**2002-2006**

| | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|
| **Return on Average Assets** | 1.35% | 0.82% | 0.57% | 0.56% | 0.80% |
| **Return on Average Equity** | 14.71% | 8.58% | 12.26% | 12.12% | 16.85% |
| **Net Income** | $ 1,043,678 | $ 688,724 | $ 926,128 | $ 959,795 | $ 1,465,189 |
| **Net Income Per Share** | $ 2.38 | $ 1.57 | $ 2.11 | $ 2.18 | $ 3.33 |
| **Total Equity** | $ 7,298,404 | $ 7,699,474 | $ 7,931,180 | $ 8,016,290 | $ 9,349,997 |
| **Total Assets** | $ 77,955,673 | $ 150,875,392 | $ 162,154,261 | $ 174,991,145 | $ 184,375,521 |




| | | | | | |
|---|---|---|---|---|---|
| **Dividends Per Share** | $ 1.00 | $ 0.85 | $ 0.85 | $ 0.75 | $ 0.75 |

# BEO Bancorp and Subsidiary
December 31, 2006

## Board of Directors

Joel Peterson, Chairman
Farmer

Brad Anderson, Vice Chairman
Farmer/Rancher

Linda K. LaRue
Retired Banker

E. George Koffler
President and Chief Executive Officer
Bank of Eastern Oregon

Gary Neal
General Manager of Port of Morrow

Ned Clark
Rancher

Bob Armstrong
Certified Public Accountant

### Officers

E. George Koffler, President and Chief Executive Officer
Gary Propheter, Executive Vice President and Chief Operations Officer
Jeff Bailey, Executive Vice President and Chief Credit Officer
Mark Lemmon, Executive Vice President and Chief Financial Officer
Melissa Lindsay, Vice President and Mortgage Loan Officer/Manager
Harley Sager, Vice President and Loan Officer
Richard Wood, Vice President and Loan Officer
Jim Gardner, Vice President and Loan Officer
Bill Hubble, Vice President and Loan Officer
Kevin McCabe, Vice President and IS Manager
Anda Kay Zastrow, Assistant Vice President and BEO Financial Services Manager
Becky Kindle, Assistant Vice President, Branch Administrator
Mardean Patton, Assistant Vice President, Irrigon Branch Manager, and Loan Officer
Sherry Walters, Assistant Vice President and Arlington Branch Manager
Tricia Gunderson, Assistant Vice President and Human Resources Manager
Janet Dezellem, Assistant Vice President and Finance Officer
John Qualls, Loan Officer
Jill Peck, Loan Officer
Robert Quinton, Assistant Vice President, Loan Officer
Ed Rollins, Assistant Vice President, Loan Officer
Rhonda Shaffer, Assistant Vice President, Loan Officer
Joyce Moser, Assistant Vice President, Burns Branch Manager and Loan Officer
Karen Cossitt, Fossil Branch Manager and Loan Officer
Jennifer Miller, Moro Branch Manager and Loan Officer
Sharon Harrison, Assistant Vice President, Heppner Branch Manager and Loan Officer
Kathy Burres, Condon Branch Manager
Julie Gisi, Boardman Branch Manager
Sharon Rietmann, Ione Branch Manager
Janice Provencher, John Day Branch Manager
Andrea Moles, Prairie City Branch Manager

ISLER CPA
CERTIFIED PUBLIC ACCOUNTANTS
& BUSINESS ADVISORS

**Independent Auditor's Report**

The Board of Directors
BEO Bancorp:

We have audited the accompanying balance sheets of BEO Bancorp and Subsidiary (the "Company") as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of BEO Bancorp and Subsidiary as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Isler CPA, LLC

Eugene, Oregon
January 11, 2007

# BEO Bancorp and Subsidiary
## Consolidated Balance Sheets

| | December 31 | |
|---|---|---|
| | **2006** | **2005** |
| **ASSETS** | | |
| Cash and cash equivalents: | | |
| Cash and due from banks | **$ 5,072,290** | $ 7,687,353 |
| Federal Funds Sold | **2,090,000** | - |
| Total cash and cash equivalents | **7,162,290** | 7,687,353 |
| Investment securities available-for-sale | **46,102,208** | 47,847,194 |
| Loans, less allowance for loan losses | **119,783,377** | 108,361,675 |
| Interest receivable | **1,836,434** | 1,456,370 |
| Federal Home Loan Bank stock | **559,700** | 559,700 |
| Property, less accumulated depreciation | **5,053,093** | 5,023,176 |
| Core deposit intangible, less accumulated amortization | **1,250,021** | 1,504,527 |
| Other assets | **2,628,398** | 2,551,150 |
| | **177,213,231** | 167,303,792 |
| Total assets | **$ 184,375,521** | $ 174,991,145 |
| **LIABILITIES and STOCKHOLDERS' EQUITY** | | |
| Liabilities: | | |
| Deposits: | | |
| Noninterest-bearing demand | **$ 26,162,771** | $ 26,587,699 |
| Savings and interest-bearing demand | **90,725,456** | 86,101,399 |
| Time, $100,000 and over | **13,068,973** | 12,985,689 |
| Other time | **32,496,711** | 30,274,409 |
| | **162,453,911** | 155,949,196 |
| Repurchase agreements | **3,553,497** | 2,690,771 |
| Junior subordinated debentures | **7,217,000** | 7,217,000 |
| Accrued interest payable | **298,803** | 255,320 |
| Income taxes payable | **488,670** | - |
| Other liabilities | **1,013,643** | 862,568 |
| Total liabilities | **175,025,524** | 166,974,855 |
| Stockholders' equity: | | |
| Common stock, $5 par value; 500,000 shares | | |
| authorized, 440,329 shares outstanding | **2,201,645** | 2,201,645 |
| Additional paid-in capital | **1,486,546** | 1,486,546 |
| Retained earnings | **6,039,714** | 4,904,772 |
| Accumulated other comprehensive income (loss) | **(377,908)** | (576,673) |
| Total stockholders' equity | **9,349,997** | 8,016,290 |
| Total liabilities and stockholders' equity | **$ 184,375,521** | $ 174,991,145 |

The accompanying notes are an integral part of these consolidated financial statements.

# BEO Bancorp and Subsidiary
## Consolidated Statements of Income

| | Year Ended December 31 | |
|---|---|---|
| | **2006** | **2005** |
| Interest income: | | |
| Interest and fees on loans | **$ 10,026,673** | $ 7,767,209 |
| Interest on investment securities: | | |
| Taxable | **1,425,571** | 1,475,701 |
| Nontaxable | **484,593** | 489,261 |
| Interest on federal funds sold and short-term time deposits | **215,029** | 94,437 |
| | **12,151,866** | 9,826,608 |
| Interest expense | **4,678,873** | 3,131,252 |
| Net interest income | **7,472,993** | 6,695,356 |
| Provision for loan losses | **279,500** | 940,000 |
| Net interest income after provision for loan losses | **7,193,493** | 5,755,356 |
| Noninterest income: | | |
| Service charges | **1,363,387** | 1,288,903 |
| Mortgage banking income | **370,512** | 374,726 |
| Other, principally financial services income | **192,654** | 203,341 |
| | **1,926,554** | 1,866,970 |
| Noninterest expense: | | |
| Salaries and employee benefits | **4,214,017** | 3,691,879 |
| Occupancy expense | **473,835** | 454,380 |
| Equipment expense | **683,636** | 645,543 |
| Losses on property dispositions | **23,311** | 5,854 |
| Asset impairment charge | **-** | 5,500 |
| Other | **1,818,059** | 1,792,375 |
| | **7,212,857** | 6,595,531 |
| Income before income taxes | **1,907,189** | 1,026,795 |
| Provision for income taxes | **442,000** | 67,000 |
| Net income | **$ 1,465,189** | $ 959,795 |
| Earnings per share | **$ 3.33** | **$ 2.18** |

The accompanying notes are an integral part of these consolidated financial statements.

# BEO Bancorp and Subsidiary
## Consolidated Statements of Changes in Stockholders' Equity
For the Years Ended December 31, 2006 and 2005

| | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
|---|---|---|---|---|---|
| Balance, January 1, 2005 | $ 2,199,370 | $ 1,471,495 | $ 4,275,224 | $ (14,909) | $ 7,931,180 |
| Net income | | | 959,795 | | 959,795 |
| Other comprehensive income (loss): | | | | | |
| Unrealized losses on investment securities | | | | (823,219) | |
| Deferred income taxes | | | | 261,455 | |
| Total other | | | | (561,764) | (561,764) |
| Comprehensive income | | | | | 398,031 |
| Issuance of 455 shares of common stock | 2,275 | 15,051 | | | 17,326 |
| Cash dividends ($.75 per share) | | | (330,247) | | (330,247) |
| Balance, December 31, 2005 | 2,201,645 | 1,486,546 | 4,904,772 | (576,673) | 8,016,290 |
| Net income | | | **1,465,189** | | **1,465,189** |
| Other comprehensive income (loss): | | | | | |
| Unrealized losses on investment securities | | | | **291,276** | |
| Deferred income taxes | | | | **(92,511)** | |
| Total other | | | | **198,765** | **198,765** |
| Comprehensive income | | | | | **1,663,954** |
| Cash dividends ($.75 per share) | | | **(330,247)** | | **(330,247)** |
| Balance, December 31, 2006 | **$ 2,201,645** | **$ 1,486,546** | **$ 6,039,714** | **$ (377,908)** | **$ 9,349,997** |

The accompanying notes are an integral part of these consolidated financial statements.

# BEO Bancorp and Subsidiary
## Consolidated Statements of Cash Flows

| | Year Ended December 31 | |
|---|---|---|
| | **2006** | **2005** |
| Cash flows from operating activities: | | |
| Net income | **$ 1,465,189** | $ 959,795 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | **448,769** | 432,803 |
| Losses on property dispositions and impairment charge | **23,311** | 11,354 |
| Amortization of investment premiums, net | **187,911** | 328,030 |
| Amortization, other | **323,101** | 350,594 |
| Provision for loan losses | **279,500** | 940,000 |
| Losses on foreclosed assets | **-** | 4,538 |
| Increase in cash value of life insurance | **(33,878)** | (33,736) |
| Deferred income taxes | **(156,000)** | (55,000) |
| Federal Home Loan Bank stock dividends | **-** | (2,200) |
| Change in: | | |
| Interest receivable and other assets | **(424,697)** | (150,519) |
| Deferred loan fees | **17,019** | 21,790 |
| Accrued interest and other liabilities | **169,559** | 161,722 |
| Income taxes payable | **488,670** | (62,893) |
| Net cash provided by operating activities | **2,788,453** | 2,906,278 |
| Cash flows from investing activities: | | |
| Proceeds from maturities of investment securities | **11,043,726** | 11,196,424 |
| Purchase of investment securities | **(9,195,375)** | (1,673,011) |
| Purchase of loans | **(5,784,144)** | (61,219) |
| Proceeds from sale of loans | **1,018,503** | 518,519 |
| Proceeds from sale of property | **11,000** | 3,385 |
| Proceeds from sale of foreclosed assets | **-** | 93,462 |
| Loans originated, net of principal collected | **(6,927,580)** | (21,350,672) |
| Purchase of property | **(512,997)** | (712,871) |
| Purchase of State of Oregon income tax credits | **(3,843)** | (148,339) |
| Net cash used in investing activities | **(10,350,710)** | (12,134,322) |
| Cash flows from financing activities: | | |
| Repurchase agreements and federal funds purchased | **862,726** | (4,793,898) |
| Net increase in deposits | **6,504,715** | 14,361,812 |
| Net proceeds from issuance of trust preferred securities | **-** | 3,000,000 |
| Issuance of common stock | **-** | 17,326 |
| Dividends paid | **(330,247)** | (330,247) |
| Net cash provided by financing activities | **7,037,194** | 12,254,993 |
| Net increase (decrease) in cash and cash equivalents | **(525,063)** | 3,026,949 |
| Cash and cash equivalents, beginning of year | **7,687,353** | 4,660,404 |
| Cash and cash equivalents, end of year | **$ 7,162,290** | $ 7,687,353 |

# BEO Bancorp and Subsidiary
**Consolidated Statements of Cash Flows**, Continued

| | 2006 | 2005 |
|---|---|---|
| Supplemental information: | | |
| Cash paid during the year for: | | |
| Income taxes | **$ 118,975** | $ 139,000 |
| Interest | **4,635,390** | 3,041,068 |
| Change in unrealized losses on investment securities available-for-sale, net of deferred income taxes | **198,765** | (561,764) |
| Transfer of loans to foreclosed assets | **-** | 98,000 |

The accompanying notes are an integral part of these consolidated financial statements.

# BEO Bancorp and Subsidiary
## Notes to Consolidated Financial Statements

1. **Summary of Significant Accounting Policies**:

**Basis of Presentation –** The consolidated financial statements include the accounts of BEO Bancorp (“Bancorp”), a bank holding company, and its wholly-owned subsidiary, Bank of Eastern Oregon (the “Bank”). All significant intercompany accounts and transactions have been eliminated in consolidation. Bancorp has also established subsidiary grantor trusts in connection with the issuance of trust preferred securities (see Note 10). In accordance with the requirements of Financial Accounting Standards Board (FASB) Interpretation No. 46(R), “Consolidation of Variable Interest Entities” the accounts and transactions of these trusts are not included in the accompanying consolidated financial statements.

**Description of Business -** The Bank provides commercial and consumer financing, banking and mortgage lending and other services in Northeastern Oregon. Its activities include the usual lending and deposit functions of a commercial bank: commercial, agricultural, real estate, installment, credit card and mortgage loans; checking, money market, time deposit and savings accounts; internet banking and bill payment; automated teller machines and safe deposit facilities. Additionally, the Bank originates and sells mortgage loans into the secondary market and offers investment services.

**Use of Estimates –** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and Cash Equivalents –** For purposes of presentation in the consolidated statements of cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption “cash and due from banks”. Such amounts include federal funds sold on a short-term basis.

**Investment Securities –** The Bank classifies all investment securities as available-for-sale. Securities available-for-sale are held for indefinite periods of time and may be sold in response to changes in market interest rates, shifts in the maturity mix or concentration of bank assets or liabilities or to alleviate liquidity demands. Securities designated as available-for-sale are carried at estimated fair value. Unrealized gains and losses are excluded from earnings and are credited or charged to other comprehensive income in stockholders’ equity, net of applicable deferred taxes.

Interest income on debt securities is included in income using the effective interest method. Gains and losses realized on sales of securities are recognized on the specific identification method.

1. **Summary of Significant Accounting Policies**, Continued:

**Loans Held-for-Sale –** There were no loans held-for-sale at December 31, 2006 or 2005.

**Loans and Income Recognition –** Loans are stated at the amount of unpaid principal, reduced by deferred loan origination fees and an allowance for loan losses. Interest on loans is calculated using the simple-interest method on daily balances of the principal amount outstanding. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of the interest is doubtful. Loan origination fees, net of associated direct costs, if significant, are amortized by the straight-line method over the contractual life of the loan.

**Allowance for Loan Losses –** The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. The allowance is an amount that management considers adequate to absorb possible losses on existing loans that may become uncollectible based on evaluations of the collectibility of loans and prior loss experience. The evaluations take into consideration such factors as changes in the nature and value of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay.

A loan is considered impaired when management believes that it is probable that all amounts will not be collected according to the contractual terms. An impaired loan is valued using the present value of expected cash flows discounted at the loan's effective interest rate, the observable market price of the loan or the estimated fair value of the loan's collateral or related guaranty. Loans deemed impaired are specifically allocated for in the allowance for loan losses.

The Company classifies reserves for commitments to loan in other liabilities.

Federal and State of Oregon bank regulatory agencies, as an integral part of their examination process, periodically review the Bank's reserve for loan losses. Such agencies may require the Bank to recognize additions to the reserve in the future based on their judgment of the information available to them at the time of their examinations.

1. **Summary of Significant Accounting Policies**, Continued:

**Federal Home Loan Bank Stock –** The investment in Federal Home Loan Bank ("FHLB") stock is carried at cost, which approximates its fair value. As a member of the FHLB system, the Bank is required to maintain a minimum level of investment in FHLB stock based on specific percentages of its outstanding mortgages, total assets or FHLB advances. At December 31, 2006, the minimum required investment was $166,500. The Bank may request redemption at par value of any stock in excess of the amount it is required to hold.

**Property** – Property is stated at cost, net of accumulated depreciation. Additions, betterments and replacements of major units are capitalized. Expenditures for normal maintenance, repairs and replacements of minor units are charged to expense as incurred. Gains or losses realized from sales or retirements are reflected in operations currently. Depreciation is computed by the straight-line method over the estimated useful lives of the assets.

**Core Deposit Intangible –** Core deposit intangible is stated at cost, net of accumulated amortization. Amortization is recorded on an accelerated basis over 10 years, with periodic evaluation for impairment.

**Impairment of Long-Lived Assets Held-for-Sale –** Long-lived assets classified as held-for-sale (Note 7) are stated at the lower of carrying amount or fair value less costs to sell. Fair value is determined by current appraised value. An impairment loss is recognized when the carrying value exceeds fair value.

**Foreclosed Assets –** Assets acquired through, or in lieu of, loan foreclosure are held-for-sale and are initially recorded at fair value at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other noninterest expense.

**Advertising –** Advertising costs are generally charged to expense during the year in which they are incurred.

**Income Taxes –** Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are calculated on differences between financial statement and tax bases of assets and liabilities using tax rates in effect for the year in which the differences are expected to reverse.

1. **Summary of Significant Accounting Policies**, Continued:

**Recently Issued Accounting Pronouncements –** In February 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 155 (SFAS 155), "*Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140*" effective January 1, 2007. SFAS 155 amends SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*", to permit fair value remeasurement for any hybrid financial instrument with an embedded derivative that otherwise would require bifurcation, provided that the whole instrument is accounted for on a fair value basis. The Company does not currently hold derivatives or engage in hedging activities.

In March 2006, the FASB issued Statement No. 156, "*Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140*" ("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. The Company does not have recorded amounts of servicing assets or liabilities at December 31, 2006 and does not expect the new standard to have a significant impact on the its financial condition or results of operations.

In July 2006, FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No 109* ("FIN 48"). FIN 48 establishes a recognition threshold and measurement for income tax positions recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 also prescribes a recognition and meassurement evaluation process for tax positions. For recognition, an enterprise judgmentally determines whether it is more-likely-than-not that a tax position will be sustained upon examination, based on the technical merits of the position. If the tax position meets the more-likely-than-not recognition threshold the benefit is measured and recognized in the financial statements. Tax positions that meet the more-likely-than-not recognition threshold at the effective date of FIN 48 may be recognized or, continue to be recognized, upon adoption of this Interpretation. The cumulative effect of applying the provisions of FIN 48 shall be reported as an adjustment to the opening balance of retained earnings for that fiscal year. FIN 48 is effective for fiscal years beginning after December 15, 2006. Accordingly, the Company plans to adopt FIN 48 on January 1, 2007. The Company is evaluating the impact of adoption of FIN 48 and at this point does not believe it will have a material impact on the Company's consolidated financial statements.

1. **Summary of Significant Accounting Policies**, Continued:

In September 2006, the FASB issued Statement No. 157, *"Fair Value Measurement."* defining fair value, establishing a framework for measuring fair value in generally accepted accounting principles, and expanding 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.

**Reclassifications –** Certain 2005 amounts have been reclassified where appropriate to conform with the financial statements presentation used in 2006. These reclassifications had no effect on previously reported net income.

**Earnings Per Share –** Earnings per share are computed on the basis of the weighted average number of shares outstanding during each year.

2. **Cash and Due From Banks**:

The Bank is required to maintain an average reserve balance with the Federal Reserve Bank or maintain such reserve balance in the form of cash. The required reserve balances at December 31, 2006 and 2005 were approximately $95,000 and $2,752,000, respectively, and was met by holding cash and maintaining an average balance with the Federal Reserve Bank.

3. **Investment Securities Available-for-Sale**:

The amortized cost and estimated fair values of investment securities available-for-sale at December 31, 2006 and 2005 are as follows:

| | December 31, 2006 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Obligation of U.S. Government agencies | **$ 12,893,795** | **$ 122,501** | **$ (36,713)** | **$ 12,979,583** |
| Mortgage-backed securities | **21,676,375** | **419** | **(688,885)** | **20,987,909** |
| Obligations of states and political subdivisions | **12,085,830** | **122,046** | **(73,160)** | **12,134,716** |
| | **$ 46,656,000** | **$ 244,966** | **$ (798,758)** | **$ 46,102,208** |

| | December 31, 2005 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Obligation of U.S. Government agencies | $ 9,975,693 | $ 6,841 | $ (116,230) | $ 9,866,304 |
| Mortgage-backed securities | 26,230,918 | 681 | (868,181) | 25,363,418 |
| Obligations of states and political subdivisions | 12,485,651 | 190,111 | (58,290) | 12,617,472 |
| | $ 48,692,262 | $ 197,633 | $ (1,042,701) | $ 47,847,194 |

3. **Investment Securities Available-for-Sale**, Continued:

Investment securities that were in unrealized loss positions as of December 31, 2006 and 2005 are presented in the following tables, based on the length of time that individual securities were in unrealized loss positions. In the opinion of management, these securities are considered only temporarily impaired due to interest rate differentials as compared to current market conditions:

| | Securities in Unrealized Loss Positions as of December 31, 2006 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or Longer | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligation of U.S. | | | | | | |
| Government agencies | $ 1,478,850 | $ (10,351) | $ 4,464,395 | $ (26,362) | $ 5,943,245 | $ (36,713) |
| Mortgage-backed securities | - | - | 20,912,186 | (688,885) | 20,912,186 | (688,885) |
| Obligations of states and | | | | | | - |
| political subdivisions | 1,256,770 | (5,981) | 4,362,889 | (67,179) | 5,619,659 | (73,160) |
| Total | $ 2,735,620 | $ (16,332) | $ 29,739,470 | $ (782,426) | $ 32,475,090 | $ (798,758) |

| | Securities in Unrealized Loss Positions as of December 31, 2005 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or Longer | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligation of U.S. | | | | | | |
| Government agencies | $ 975,625 | $ (13,296) | $ 7,394,430 | $ (102,934) | $ 8,370,055 | $ (116,230) |
| Mortgage-backed securities | - | - | 25,319,303 | (868,181) | 25,319,303 | (868,181) |
| Obligations of states and | | | | | | |
| political subdivisions | 1,858,148 | (18,007) | 2,641,952 | (40,283) | 4,500,100 | (58,290) |
| Total | $ 2,833,773 | $ (31,303) | $ 35,355,685 | $ (1,011,398) | $ 38,189,458 | $ (1,042,701) |

The unrealized losses on obligations of U.S. Government agencies and political subdivisions were caused by interest rate increases subsequent to the purchase of the securities. Management monitors published credit ratings of these securities and no adverse ratings changes have occurred since the date of purchase on these obligations in an unrealized loss position as of December 31, 2006. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Bank has the ability and intent to hold these investments until a market price recovery or to maturity, the unrealized losses on these investments are not considered other-than-temporarily impaired.

3. **Investment Securities Available-for-Sale**, Continued:

The unrealized losses on mortgage-backed securities were caused by interest rate increases subsequent to the purchase of the securities. It is expected that the securities will not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Bank has the ability and intent to hold these investments until a market price recovery or to maturity, the unrealized losses on these investments are not considered other-than-temporarily impaired.

The amortized cost and estimated fair value of investment securities at December 31, 2006 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Due in one year or less | $ 4,341,605 | $ 4,338,803 |
| Due after one year through five years | 8,111,794 | 8,136,321 |
| Due after five years | 12,526,226 | 12,639,175 |
| Mortgage-backed securities | 21,676,375 | 20,987,909 |
| | $ 46,656,000 | $ 46,102,208 |

No investment securities were sold in 2006 or 2005.

At December 31, 2006, investment securities with amortized costs of $26,713,926 and estimated fair values of $26,477,134 were pledged for public deposits, repurchase agreements and Federal Home Loan Bank borrowings ($24,169,366 and $24,037,940 in 2005, respectively).

4. **Loans**:

Major classifications of loans by type of collateral at December 31 are as follows:

| | 2006 | 2005 |
|---|---|---|
| Commercial loans | **$ 14,293,042** | $ 12,930,491 |
| Agriculture loans | **30,789,234** | 27,288,847 |
| Commercial Real Estate loans | **19,467,702** | 20,708,182 |
| Municipal loans | **5,161,317** | 3,544,212 |
| Real estate loans | **47,122,640** | 39,411,076 |
| Consumer loans | **4,704,436** | 5,966,760 |
| | **121,538,371** | 109,849,568 |
| Deferred loan origination fees | **(308,646)** | (291,627) |
| | **121,229,725** | 109,557,941 |
| Allowance for loan losses | **(1,446,348)** | (1,196,266) |
| | **$ 119,783,377** | $ 108,361,675 |

The loan portfolio at December 31, 2006 and 2005 includes $85,463,215 and $76,363,789, respectively, of loans which have a variable rate of interest. The December 31, 2006 amount includes $33,737,754 of loans with interest rates at their contractual floors.

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balance of such serviced loans was $5,005,807 and $5,319,579 at December 31, 2006 and 2005, respectively.

The total loans outstanding on December 31 which were on a nonaccrual basis, contractually past due 90 days or more as to interest or principal payments or modified as to the original agreement to terms more favorable than market conditions, are as follows:

| | Nonaccrual Loans | Loans Past Due 90 Days or More and Still Accruing | Renegotiated Loans |
|---|---|---|---|
| **2006**: | | | |
| Commercial | | **$ -** | **$ 166,393** |
| Commercial Real Estate | **$ 46,431** | | |
| Real estate | | **-** | **112,242** |
| | **$ 46,431** | **$ -** | **$ 278,635** |
| 2005: | | | |
| Commercial | $ 25,000 | $ - | $ 178,403 |
| Real estate | 51,068 | - | 112,636 |
| | $ 76,068 | $ - | $ 291,039 |

4. **Loans**, Continued:

Changes in the allowance for loan losses for the years ended December 31 are as follows:

| | 2006 | 2005 |
|---|---|---|
| Balance, beginning of year | **$ 1,196,266** | $ 1,212,079 |
| Loans charged off | **(13,241)** | (960,015) |
| Provision charged to income | **279,500** | 940,000 |
| Recoveries credited to allowance | **8,823** | 4,202 |
| Transferred to liability for unfunded commitments | **(25,000)** | - |
| Balance, end of year | **$ 1,446,348** | $ 1,196,266 |

Restructured and other loans considered impaired, including all non-accrual loans, totaled $721,052 and $620,964 at December 31, 2006 and 2005, respectively. The specific valuation allowance for loan losses related to these impaired loans was $75,703 and $24,642 at December 31, 2006 and 2005, respectively. The average recorded investment in impaired loans was approximately $670,000 and $800,000 in 2006 and 2005, respectively. Interest income recognized on impaired loans totaled $51,958 and $42,523 in 2006 and 2005 respectively. Interest income which would have been realized on non-accrual loans if they had remained current and still accruing was approximately $1,333 and $2,900 in 2006 and 2005, respectively.

**Concentration of Credit Risk –** The Bank grants agricultural, commercial, consumer and mortgage loans to customers throughout Northeastern Oregon. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent upon the region's agribusiness economic sector. Credit losses from agricultural loans does not differ significantly from the Bank's credit loss experience on its loan portfolio as a whole. The Bank's policy for requiring collateral on agricultural loans does not differ substantially from collateral requirements in its other lending.

5. **Property**:

Property at December 31 consists of the following:

| | 2006 | 2005 |
|---|---|---|
| Land | **$ 573,768** | $ 573,767 |
| Buildings and improvements | **4,954,347** | 4,803,442 |
| Furniture and equipment | **2,762,030** | 2,811,208 |
| | **8,290,145** | 8,188,417 |
| Accumulated depreciation | **3,237,052** | 3,165,241 |
| | **$ 5,053,093** | $ 5,023,176 |

6. **Core Deposit Intangible**:

Core deposit intangible consists of the following:

| | 2006 | 2005 |
|---|---|---|
| Purchase cost in 2003 | **$ 2,109,512** | $ 2,109,512 |
| Accumulated amortization | **859,491** | 604,985 |
| | **$ 1,250,021** | $ 1,504,527 |

Forecasted amortization for the next five years is as follows:

| | |
|---|---|
| 2007 | 231,142 |
| 2008 | 210,450 |
| 2009 | 192,082 |
| 2010 | 175,740 |
| 2011 | 161,174 |

7. **Other Assets**:

Other assets at December 31 consist of the following:

| | 2006 | 2005 |
|---|---|---|
| Cash value of life insurance (Note 12) | **$ 1,053,290** | $ 1,019,412 |
| Prepaid expenses | **298,768** | 240,374 |
| Capitalized trust preferred securities issuance costs, net of $72,000 and $48,000 amortization in 2006 and 2005, respectively | **48,000** | 72,000 |
| Long-lived assets held-for-sale (former branch office), net of $66,494 impairment loss in 2006 and 2005 | **104,500** | 104,500 |
| Investment in unconsolidated subsidiaries (Trusts) (Note 10) | **217,000** | 217,000 |
| Purchased Oregon income tax credits, net of $90,226 and $45,631 amortization in 2006 and 2005, respectively | **61,956** | 102,708 |
| Income tax deposits | **-** | 14,031 |
| Deferred income taxes (Note 14) | **844,884** | 781,125 |
| | **$ 2,628,398** | $ 2,551,150 |

8. **Deposits**:

The scheduled maturities of time deposits at December 31 are as follows:

| | 2006 | 2005 |
|---|---|---|
| Less than one year | **$ 36,655,032** | $ 29,972,612 |
| One to three years | **6,264,499** | 10,956,787 |
| Over three years | **2,646,153** | 2,330,699 |
| | **$ 45,565,684** | $ 43,260,098 |

9. **Borrowings**:

Borrowings at December 31, 2006 consist of $3,553,497 in repurchase agreements (average rate 2.0%). At December 31, 2005, borrowings consisted of $2,690,771 in repurchase agreements (average rate 1.9%).

Investment securities are pledged as collateral in an amount equal to the repurchase agreements.

At December 31, 2006, the Bank has lines of credit available totaling approximately $13,979,731 from the Federal Home Loan Bank of Seattle and $16,000,000 of federal funds lines with correspondent banks.

The Federal Home Loan Bank line of credit, when borrowed against, is secured by certain investment securities and real estate loans.

10. **Junior Subordinated Debentures**:

As of December 31, 2006, Bancorp had two wholly-owned trusts ("Trusts") that were formed to issue trust preferred securities and related common securities. The Trusts issued Capital Securities ("Trust Preferred Securities") and invested the proceeds in a like amount of Junior Subordinated Debentures ("Debentures") of BEO Bancorp. Interest distributions on the Trust Preferred Securities are payable quarterly and are deferrable, at Bancorp's option, for up to five years. The Debentures bear the same terms and interest rates as the related Trust Preferred Securities. The Debentures are the sole assets of the Trusts. Bancorp has unconditionally guaranteed all of the obligations of the Trusts.

Following are the terms of the Trust Preferred Securities:

| | BEO Statutory Trust I | BEO Statutory Trust II |
|---|---|---|
| Amount outstanding | $4,124,000 | $3,093,000 |
| Date of original issue | December 17, 2003 | March 17, 2005 |
| Stated maturity | December 17, 2033 | March 17, 2035 |
| Optional redemption date | December 17, 2008 | March 17, 2010 |
| Interest rate | 3-month LIBOR plus 2.85% | 6.42% fixed for 5 years |
| | (8.21% at December 31, 2006) | then 3-month LIBOR plus 1.90% |

The Trust Preferred Securities are mandatorily redeemable, in whole or in part, upon repayment of the underlying Debentures at their stated maturities or their earlier redemption. The Debentures are redeemable prior to maturity at Bancorp's option on or after the above noted optional redemption dates.

In accordance with provisions of FIN 46, the Trusts have not been consolidated in these financial statements. The $7,217,000 of Debentures issued to the Trusts as of December 31, 2006 are reflected as junior subordinated debentures in the consolidated balance sheets. The common stock issued by the Trusts is recorded in other assets (Note 7) in the consolidated balance sheets.

## 11. **Interest Expense**:

Interest expense for the years ended December 31 is comprised of the following:

| | 2006 | 2005 |
|---|---|---|
| Savings and interest-bearing demand | **$ 2,265,985** | $ 1,256,434 |
| Time deposits in excess of $100,000 | **570,138** | 446,150 |
| Other time deposits | **1,227,245** | 926,340 |
| Interest expense on deposits | **4,063,368** | 2,628,924 |
| Interest on junior subordinated debentures (Note 10) | **515,066** | 401,559 |
| Interest expense on short-term borrowings | **100,439** | 100,769 |
| Total interest expense | **$ 4,678,873** | $ 3,131,252 |

## 12. **Benefit Plans**:

The Bank has a 401(k) profit sharing plan covering substantially all employees. Employer contributions are determined annually by the Board of Directors. Employer contributions were $151,971 and $147,154 in 2006 and 2005, respectively.

The Bank has deferred compensation plans covering certain key officers. At December 31, 2006 and 2005, the liabilities related to these plans included in the accompanying consolidated balance sheets totaled $588,166 and $501,302, respectively. The amount of expense charged to income in 2006 and 2005 was $86,864 and $107,836, respectively. To assist in the funding of the plans, the Bank is owner and beneficiary of life insurance on the key officers. The cash surrender value of these policies at December 31, 2006 and 2005, respectively, was $1,053,290 and $1,019,412, and is included in other assets (Note 7).

13. **Other Expense:**

Other expenses for the years ended December 31 are comprised of the following:

| | 2006 | 2005 |
|---|---|---|
| Supplies, printing and postage | **$ 242,295** | $ 224,584 |
| Amortization of core deposit intangible (Note 6) | **254,506** | 280,963 |
| Other amortization | **68,595** | 69,631 |
| Advertising and public relations | **249,130** | 187,181 |
| Professional services and examination expense | **171,741** | 201,168 |
| Communications | **69,071** | 95,079 |
| Other noninterest expense | **762,721** | 733,769 |
| | **$ 1,818,059** | $ 1,792,375 |

14. **Income Taxes**:

The provision for income taxes for the years ended December 31 consists of the following:

| | 2006 | 2005 |
|---|---|---|
| Currently payable: | | |
| Federal | **$ 512,000** | $ 105,000 |
| State | **86,000** | 17,000 |
| | **598,000** | 122,000 |
| Deferred benefits: | | |
| Federal | **(129,000)** | (46,000) |
| State | **(27,000)** | (9,000) |
| | **(156,000)** | (55,000) |
| | **$ 442,000** | $ 67,000 |

The provision for income taxes results in effective tax rates less than the federal income tax statutory rate. The reasons for the differences are as follows:

| | 2006 | 2005 |
|---|---|---|
| Tax on income at statutory rate (34%) | **$ 648,444** | $ 349,109 |
| State income tax, net of federal benefit | **57,592** | 7,776 |
| Nontaxable interest income, net of allocable interest expense | **(247,746)** | (274,149) |
| Other | **(16,290)** | (15,736) |
| | **$ 442,000** | $ 67,000 |

14. **Income Taxes**, Continued:

The provision for deferred income taxes (benefit) results from timing differences in the recognition of transactions for financial statement and tax purposes. The nature and tax effects of these differences for the years ended December 31 are as follows:

| | **2006** | 2005 |
|---|---|---|
| Deferred compensation not deducted for tax purposes | **$ (33,443)** | $ (39,684) |
| Loan origination costs | **6,290** | 7,235 |
| Loan loss deduction for tax purposes more (less) than provision for financial reporting purposes | **(105,907)** | 63,993 |
| Depreciation and amortization | **(68,428)** | (90,171) |
| Vacation Pay | **34,014** | (3,540) |
| Other | **11,473** | 7,167 |
| | **$ (156,000)** | $ (55,000) |

The components of deferred tax assets and liabilities at December 31 are as follows:

| | | |
|---|---|---|
| Assets: | | |
| Allowance for loan losses | **$ 452,443** | $ 346,932 |
| Deferred compensation | **226,409** | 192,554 |
| Accrued vacation pay | **-** | 33,886 |
| Excess book over tax depreciation, amortization and impairment charges | **142,927** | 73,353 |
| Unrealized loss on investment securities available-for-sale | **175,884** | 268,394 |
| Total deferred tax assets | **997,663** | 915,119 |
| Liabilities: | | |
| Excess tax over book depreciation, amortization and impairment charges | | - |
| Loan origination costs | **53,140** | 46,873 |
| Prepaid Expenses | **68,433** | 55,916 |
| Federal Home Loan Bank stock dividends | **31,205** | 31,205 |
| Total deferred tax liabilities | **152,778** | 133,994 |
| Net deferred tax assets (Note 7) | **$ 844,884** | $ 781,125 |

Management believes that net deferred taxes will be recognized in the normal course of operations and, accordingly, management has not reduced net deferred tax assets by a valuation allowance.

15. **Financial Instruments with Off-Balance-Sheet Risk**:

In order to meet the financing needs of its customers, the Bank commits to extensions of credit and issues standby letters of credit. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Financial instruments with off-balance-sheet risk at December 31 are as follows:

| | 2006 | 2005 |
|---|---|---|
| Commitments to extend credit | **$ 36,756,356** | $ 30,625,688 |
| Standby letters of credit and financial guarantees written | **245,000** | 335,000 |

16. **Loans to Related Parties**:

The Bank has granted loans to officers and directors. Such loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated parties. The aggregate dollar amount of these loans outstanding was $1,616,031 and $1,253,430 at December 31, 2006 and 2005, respectively. Activity with respect to these loans during the year ended December 31 was as follows:

| | 2006 | 2005 |
|---|---|---|
| Balance, January 1 | **$ 1,253,430** | $ 1,268,607 |
| Additions or renewals | **2,246,675** | 1,368,397 |
| Reclassification due to Director retirements | | (54,275) |
| Amounts collected or renewed | **(1,884,074)** | (1,329,299) |
| Balance, December 31 | **$ 1,616,031** | $ 1,253,430 |

In addition, there were $752,587and $817,012 in commitments to extend credit to directors and officers at December 31, 2006 and 2005, respectively, which are included as part of commitments in Note 15.

17. **Fair Value Disclosures of Financial Instruments**:

The following disclosures are made in accordance with provisions of Statement of Financial Accounting Standards ("SFAS") No. 107, *Disclosures About Fair Value of Financial Instruments*. The use of different assumptions and estimation methods could have a significant effect on fair value amounts. Accordingly, the estimates of fair value herein are not necessarily indicative of the amounts that might be realized in a current market exchange.

The estimated fair values of the financial instruments at December 31, 2005 are as follows:

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial assets: | | | | |
| Cash and cash equivalents | $ 7,162,290 | $ 7,162,290 | $ 7,687,353 | $ 7,687,353 |
| Securities | 46,102,208 | 46,102,208 | 47,847,194 | 47,847,194 |
| Loans, net of allowance for loan losses | 119,783,377 | 117,106,458 | 108,361,675 | 106,459,809 |
| Interest receivable | 1,836,434 | 1,836,434 | 1,456,370 | 1,456,370 |
| Federal Home Loan Bank stock | 559,700 | 559,700 | 559,700 | 559,700 |
| Financial liabilities: | | | | |
| Deposits | 162,453,911 | 162,502,346 | 155,949,196 | 155,893,146 |
| Repurchase agreements | 3,553,497 | 3,553,497 | 2,690,771 | 2,690,771 |
| Junior subordinated debentures | 7,217,000 | 7,037,945 | 7,217,000 | 7,097,995 |
| Accrued interest payable | 298,803 | 298,803 | 255,320 | 255,320 |

Cash and Cash Equivalents – The fair value approximates carrying amount.

Securities – Fair value is based on quoted market prices. If a quoted market price is not available, fair value is estimated using quoted market prices from similar securities.

Loans – Fair value of fixed-rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Variable rate loans not at contractual floors have carrying amounts that are a reasonable estimate of fair value.

Deposits – Fair value of demand, interest-bearing demand and savings deposits is the amount payable on demand at the reporting date. Fair value of time deposits is estimated using the interest rates currently offered for the deposits of similar remaining maturities. In accordance with provisions of SFAS No. 107, the estimated fair values of deposits do not take into account the benefit that results from low-cost funding such deposits provide.

17. **Fair Value Disclosures of Financial Instruments**, Continued:

Repurchase agreements – The carrying amount is a reasonable estimate of fair value because of the short-term nature of these borrowings.

Junior subordinated debentures – The fair value of fixed rate issuances is estimated using a discounted cash flow calculation. For variable rate issuances, the carrying amount approximates fair value.

Off-Balance-Sheet Financial Instruments – The carrying amount and fair value are based on fees charged for similar commitments and are not material.

18. **Regulatory Matters**:

Bancorp and the Bank are subject to the regulations of certain federal and state agencies and receive periodic examinations by those regulatory authorities. In addition, Bancorp and the Bank are subject to various regulatory capital requirements administered by the Federal Reserve Board (“FRB”) and Federal Deposit Insurance Corporation (“FDIC”). Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Bancorp and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Bancorp’s and the Bank’s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require Bancorp and the Bank to maintain minimum amounts and ratios (set forth in the following table below) of Total and Tier I capital to risk-weighted assets, and of Tier I capital to leverage assets, all as defined in the regulations. Management believes, as of December 31, 2006, that Bancorp and the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2006, the most recent notification from the FRB and FDIC categorized Bancorp and the Bank as well capitalized. To be categorized as well capitalized Bancorp and the Bank must maintain minimum Total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution’s category.

18. **Regulatory Matters**, Continued:

Debentures issued to the Trusts, less the common stock of the Trusts, qualify as Tier 1 capital, subject to a 25% of Tier 1 capital limitation (Note 10). In April 2005, the FRB issued a rule that continues to allow the inclusion of trust preferred securities in Tier 1 capital, but with stricter quantitative limits. Under this rule, after a five-year transition period, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital elements, net of goodwill, including core deposit intangibles. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions.

The Company's actual capital amounts (in thousands) and ratios are also presented in the following table.

| | Actual | | For Capital Adequacy Purposes | | To be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | **Amount** | **Ratio** | **Amount** | **Ratio** | **Amount** | **Ratio** |
| As of December 31, 2006: | | | | | | |
| Total capital (to risk-weighted assets) | **$ 16,887** | **11.78%** | **$ 11,466** | **8%** | **$ 14,332** | **10%** |
| Tier I capital (to risk-weighted assets) | **11,659** | **8.13%** | **5,733** | **4%** | **8,599** | **6%** |
| Tier I capital (to leverage assets) | **11,659** | **6.21%** | **7,512** | **4%** | **9,390** | **5%** |
| | | | | | | |
| As of December 31, 2005: | | | | | | |
| Total capital (to risk-weighted assets) | $ 15,182 | 11.57% | $ 10,499 | 8% | $ 13,123 | 10% |
| Tier I capital (to risk-weighted assets) | 9,850 | 7.51% | 5,249 | 4% | 7,874 | 6% |
| Tier I capital (to leverage assets) | 9,850 | 5.59% | 7,055 | 4% | 8,823 | 5% |

The Bank's actual capital amounts (in thousands) and ratios are also presented in the following table.

| | Actual | | For Capital Adequacy Purposes | | To be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | **Amount** | **Ratio** | **Amount** | **Ratio** | **Amount** | **Ratio** |
| As of December 31, 2006: | | | | | | |
| Total capital (to risk-weighted assets) | **$ 16,808** | **11.73%** | **$ 11,470** | 8% | **$ 14,337** | 10% |
| Tier I capital (to risk-weighted assets) | **15,337** | **10.70%** | **5,735** | 4% | **8,602** | 6% |
| Tier I capital (to leverage assets) | **15,337** | **8.17%** | **7,508** | 4% | **9,385** | 5% |
| | | | | | | |
| As of December 31, 2005: | | | | | | |
| Total capital (to risk-weighted assets) | $ 14,754 | 11.24% | $ 10,493 | 8% | $ 13,116 | 10% |
| Tier I capital (to risk-weighted assets) | 13,558 | 10.33% | 5,247 | 4% | 7,870 | 6% |
| Tier I capital (to leverage assets) | 13,558 | 7.69% | 7,051 | 4% | 8,814 | 5% |

19. **Parent Company Financial Information**:

Financial information for BEO Bancorp is presented below:

BALANCE SHEETS

| | December 31 | |
|---|---|---|
| | **2006** | **2005** |
| Assets: | | |
| Cash, deposited with the Bank | **$ 51,216** | $ 374,127 |
| Investments in: | | |
| Bank subsidiary | **16,271,672** | 14,588,265 |
| Nonbank subsidiaries (Trusts) | **217,000** | 217,000 |
| Trust preferred securities issuance costs, net of amortization | **48,000** | 72,000 |
| | **$ 16,587,888** | $ 15,251,392 |
| Liabilities and stockholders' equity: | | |
| Liabilities: | | |
| Accrued interest payable | **$ 20,890** | $ 18,102 |
| Junior subordinated debentures (Trusts) | **7,217,000** | 7,217,000 |
| Total liabilities | **7,237,890** | 7,235,102 |
| Stockholders' equity: | | |
| Common stock | **2,201,645** | 2,201,645 |
| Surplus | **1,486,546** | 1,486,546 |
| Retained earnings and accumulated other comprehensive income | **5,661,807** | 4,328,099 |
| Total stockholders' equity | **9,349,998** | 8,016,290 |
| Total liabilities and stockholders' equity | **$ 16,587,888** | $ 15,251,392 |

# BEO Bancorp and Subsidiary
## Notes to Consolidated Financial Statements, Continued

19. **Parent Company Financial Information**, Continued:

STATEMENTS OF INCOME

| | Year Ended December 31 | |
|---|---|---|
| | **2006** | **2005** |
| Cash dividends from Bank | **330,247** | $ 927,747 |
| Less: | | |
| Interest expense | **(515,066)** | (401,559) |
| Professional fees and administrative expenses | **(26,632)** | (24,368) |
| Amortization of trust preferred securities issuance costs | **(24,000)** | (24,000) |
| Income before equity in undistributed earnings of the Bank | **(235,451)** | 477,820 |
| Equity in undistributed earnings of Bank | **1,484,640** | 311,975 |
| Credit for income taxes | **216,000** | 170,000 |
| Net income | **$1,465,189** | $ 959,795 |

STATEMENTS OF CASH FLOWS

| | Year Ended December 31 | |
|---|---|---|
| | **2006** | **2005** |
| Operating activities: | | |
| Net income | **$1,465,189** | $ 959,795 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Undistributed earnings of the Bank | **(1,484,640)** | (311,975) |
| Amortization of trust preferred securities issuance costs | **24,000** | 24,000 |
| Accrued interest payable | **2,787** | 9,892 |
| Net cash provided by operating activities | **7,336** | 681,712 |
| Investing activities: | | |
| Investment in subsidiaries | **-** | (3,093,000) |
| Financing activities: | | |
| Proceeds from issuance of junior subordinated debentures | **-** | 3,093,000 |
| Issuance of common stock | **-** | 17,063 |
| Dividends paid | **(330,247)** | (330,247) |
| Net cash provided by (used in) financing activities | **(330,247)** | 2,779,816 |
| Net increase (decrease) in cash | **(322,911)** | 368,528 |
| Cash, beginning of year | **374,127** | 5,599 |
| Cash, end of year | **$ 51,216** | $ 374,127 |