Baker Boyer Bancorp

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BAKER BOYER BANCORP

FIRST QUARTER REPORT 2015

Letter to Our Shareholders

April 24, 2015

Dear Baker Boyer Shareholder:

I have just returned from the Annual Meeting of the San Francisco Federal Reserve Bank where I had a chance to exchange views with bankers from across the Western U.S. I was particularly interested in hearing how they are faring in today's extremely challenging environment. I will share what was discovered; but first, want to put into context just how vital community banks are to small businesses and the health of the U.S. economy.

Family enterprises and small businesses employ 62% of the U.S. workforce and generate 64% of the U.S. GDP. These businesses depend upon community banks to fund their daily operations and to provide loans to purchase facilities and equipment. This means our country needs a healthy community banking industry to support this important sector of our economy.

Since the beginning of the Great Recession, the Federal Reserve has acted aggressively and has kept interest rates near zero to help create job growth. This has significantly lowered loan and investment security yields, pushing margins and profits across the banking industry to historically low levels. Looking back 100 years, the U.S. 10-Year Treasury hit an all-time low at 1.4% in July of 2012. Bank margins in the San Francisco 12th District have fallen from an average of 5% in 2000–2006 to below 4% today. Just to give you a perspective, for a bank our size, a 1% reduction in margin reduces revenue by more than $5 million pre-tax.

So what are most bankers doing? There appear to be two common paths. Both are very different from Baker Boyer's. First, banks weakened by the historically low rate environment are exiting the banking business. In 2012 and 2013, approximately 300 banks disappeared each year. Over eighty percent of those were small banks below $500 million in assets. This trend concerns me because small community banks are so vital to the health of our communities. The second path is focused on short-term revenues at the expense of long-term stability. Many banks are stretching for yield and are extending the maturities on their fixed rate loans and buying longer term investment securities at today's very low rates. The risk is that as interest rates rise, their cost of deposits will increase much more rapidly than their yield on these loans and securities. In addition, loan underwriting standards are loosening which can lead to future earnings losses as well. This second path is an urgent effort to increase short-term earnings, putting their future at risk.

In comparison to what our peers are doing, Baker Boyer is fording its own distinctly unique path that positions us well for the future. There are two things working to our advantage. First, individuals and corporations seeking a safe haven are choosing Baker Boyer's banking and asset management services. Banking average assets have grown from $389 million in 2008 to $558 million in 2014, a 43% increase. Asset management average assets have also grown from $700 million to $1.224 billion in the same period, a 74% increase. Second, our asset management margin is stable which, combined with the growth in this area, has added $3.3 million in revenue.

Your management team has worked these advantages aggressively along with measures to contain costs. The cost of our deposits has fallen to near zero at 0.09% in the first quarter. Non-interest expenses are up only 2% this year through the first quarter and are running 8.5% under budget. As a result, net income year-to-date through the first quarter is 2% ahead of last year at this time, at $1.16 million. Today, there is very little opportunity to drive expenses lower.

So what path is Baker Boyer taking? Baker Boyer intends to grow in the way that has sustained it for the past 145 years. We are a community bank who has stuck to its roots of assisting entrepreneurs, professionals, and other leaders to strengthen the economies of our local communities. Baker Boyer has found the services that we provide of advising clients on business strategies, investments, family counseling as well as trust and legacy planning are highly valued by our clients and our community—and they are not susceptible to temporary pricing wars instigated by our competitors. Baker Boyer is the only local family of Wealth Management experts that help grow, protect and secure family legacies for generations. All of our resources in the coming years will be to strengthen our advisory work through our newly unveiled brand of "D.S. Baker Advisors." The quality and depth of services provided by our advisors as a team is unmatched by any of our competitors and is the culmination of both history, experience, evolution and perseverance. These services are not only what our clients need; they are what they value and where we have a distinctly unique advantage.

We have been conservative and have avoided the two paths that so many of our competitors have taken. We are not putting your bank's future at risk by stretching for yield or lowering our credit underwriting standards. We are gaining market share and focusing on profitable growth. We are helping local families manage assets to build local legacies. Our future looks bright and we will continue to chart a prudent course. A path that supports family enterprises and small businesses which are so vital to the communities we serve.

Sincerely,

Megan F. Clubb

Megan F. Clubb
Chairman & CEO

Consolidated Balance Sheet - Average ytd

(Unaudited)

	March 31, 2015	March 31, 2014	% Chg.
ASSETS	*(Dollars in Thousands)*		
Cash and amounts due from banks	$ 4,345	$ 4,166	4.3
FFS and Int-bearing deposits at other financial institutions	47,345	83,567	(43.3)
Total Cash and Cash Equivalents	51,690	87,733	(41.1)
Investment securities:			
Available-for-sale, at fair value	204,662	187,551	9.1
Held-to-maturity at cost	1,490	1,537	(3.1)
Other investments, at cost	1,770	1,820	(2.7)
Total Investments	207,922	190,908	8.9
Loans	284,936	274,869	3.7
Allowance for credit losses	(6,022)	(6,652)	(9.5)
Net Loans	278,914	268,217	4.0
Bank premises and equipment, net	13,385	14,306	(6.4)
Accrued interest receivable	2,141	2,011	6.5
Other assets	3,282	3,025	8.5
TOTAL ASSETS	$ 557,334	$ 566,200	(1.6)
LIABILITIES AND SHAREHOLDERS' EQUITY			
Deposits			
Noninterest bearing	$ 142,985	$ 131,873	8.4
Interest bearing	342,587	363,295	(5.7)
Total Deposits	485,572	495,168	(1.9)
Federal funds purchased and security repurchase agreements	22,166	22,708	(2.4)
Other borrowed funds	0	0	-
Accrued interest payable	30	47	(36.2)
Other liabilities	295	330	(10.6)
TOTAL LIABILITIES	508,063	518,253	(2.0)

SHAREHOLDERS' EQUITY

Common stock (no par value, stated value $3.125 per share)

	3/31/15	3/31/14	2015	2014	% Chg.
Shares authorized	4,000,000	4,000,000			
Shares issued and outstanding	1,305,017	1,313,640	4,073	4,101	(0.7)
Additional paid-in capital			977	1,640	(40.4)
Retained earnings			43,550	41,580	4.7
Accumulated other comprehensive income (loss)			671	626	7.2
TOTAL SHAREHOLDERS' EQUITY			49,271	47,947	2.8

Consolidated Statements of Income

(Unaudited)

	Three Months Ending March 31, 2015	Three Months Ending March 31, 2014	% Chg.
Interest and Dividend Income	*(Dollars in Thousands, except per share amounts)*		
Loans, including fees	$ 3,648	$ 3,630	0.5
Federal funds sold and deposits at other financial institutions	62	67	(7.5)
Investment securities:			
Taxable	300	202	48.5
Tax-exempt	363	351	3.4
Other investment income and dividends	12	12	-
Total Interest and Dividend Income	**4,385**	**4,262**	**2.9**
Interest Expense			
Deposits	79	120	(34.2)
Federal funds purchased and security repurchase agreements	5	5	-
Other borrowed funds	0	0	-
Total Interest Expense	**84**	**125**	**(32.8)**
Net Interest Income	**4,301**	**4,137**	**4.0**
Provision for credit losses	23	0	-
Net Interest Income after Provision for Credit Losses	**4,278**	**4,137**	**3.4**
Non-Interest Income			
Investment Management and Trust fees	1,624	1,550	4.8
Investor Services	296	364	(18.7)
Service charges on deposit accounts	229	223	2.7
Other service charges and fees	263	343	(23.3)
Other operating income	168	95	76.8
Total Non-Interest Income	**2,580**	**2,575**	**0.2**
Non-Interest Expense			
Salaries, wages, and other compensation	2,647	2,556	3.6
Retirement and employee benefits	874	815	7.2
Net occupancy expense	281	304	(7.6)
Furniture and equipment expense	131	139	(5.8)
Other operating expense	1,352	1,366	(1.0)
Total Non-Interest Expense	**5,285**	**5,180**	**2.0**
Income Before Income Taxes	**1,573**	**1,532**	**2.7**
Provision For Income Taxes	414	395	4.8
NET INCOME	**$ 1,159**	**$ 1,137**	**1.9**
Basic Earnings Per Common Share	**$ 0.90**	**$ 0.87**	**2.7**
Weighted Average Number of Shares Outstanding	**1,291,323**	**1,301,647**	