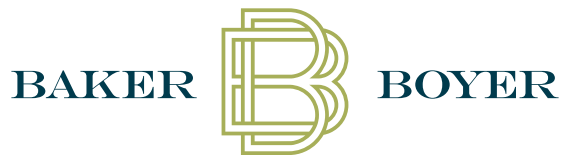


# 2015

## SECOND QUARTER REPORT



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### BOARD OF DIRECTORS

|                       |                  |
|-----------------------|------------------|
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## BAKER BOYER

FAMILY LEGACIES GROWN LOCALLY

*Walla Walla Tri-Cities Yakima.*

## Dear Baker Boyer Shareholder:

The U.S. economy is rebounding and Baker Boyer's earnings are increasing right along with it. Net Income through the second quarter is 7% ahead of last year at this time, at \$2.42 million. There are many factors that will maintain this upward trend. The most important is higher general rates of interest.

Throughout the Great Recession we avoided stretching for yield or lowering our credit underwriting standards. Thus, Baker Boyer will deliver strong Net Interest Income growth when the Fed normalizes interest rates. Two very important questions are when will "liftoff" begin and how quickly will rates rise?

Recent comments from San Francisco Fed President John Williams provide insight to the first question. He said, "All in all, things are looking good. I see growth on a solid trajectory, full employment just in front of us, wages on the rise, and inflation gradually moving back up to meet our goal... I still believe this will be the year (2015) for liftoff."

And the June FOMC minutes provide clues on the second question. On average the Committee expects Fed Funds to increase 50 basis points (0.5%) this year and increase by an additional 100 basis points (1.0%) by the end of 2016. If this is indeed the trajectory, then Baker Boyer will benefit from significant Net Interest Income growth through the next several quarters.

I see many trends which are positively impacting Baker Boyer; economic conditions in our markets are solid and small businesses are looking for loans, monetary policy is likely to finally move in our favor, and the Great Recession has improved our competitive position. One challenge that will remain is the preferential tax treatment of credit unions.

The best explanation of the credit union issue was in an op-ed in the *Puget Sound Business Journal* entitled "It's Time to End Credit Unions' Tax Break", by Jim Pishue, President & CEO Washington Bankers Association. He wrote:

"One of the key factors in the growth of local credits unions is a competitive advantage that can no longer be justified by their organizational structure. More importantly, this advantage takes money out of the pockets of everyone else in our state. Most people are unaware that credit unions—unlike banks—don't pay federal income tax or state business taxes.

This exemption may have been appropriate during their infancy before World War I, when credit unions served distinct and narrowly defined groups of members with some common bond. Back then, credit union members were individuals of modest means with limited access to traditional banking services. Today, banks serve a larger percentage of modest income consumers than credit unions.

Credit unions portray themselves as banks all the way up until it's time to make out that tax check to the government. There are 55 credit unions located in our state with \$50 million or more in assets. Major credit unions headquartered elsewhere operate here, too. If these institutions were to pay business taxes at the same rate that banks do, it would add more than \$30 million annually to the state treasury. That \$30 million could pay for about 400 more teachers to improve education across the state. Or it could be used to enhance public safety or provide services to those who need them.

There's precedent for eliminating credit unions' tax-exempt status. In 1951, Congress eliminated tax-exemptions for savings and loan associations and mutual savings banks, whose cooperative ownership structure is very similar to that of credit unions. The rationale given then was that these entities had outgrown their tax-exempt status because they were "actively in competition" with tax-paying financial institutions. It's exactly the situation with credit unions today.

The Washington Legislature is under a Supreme Court order to fully fund basic education. That means seriously tackling the budget challenges facing our state. It's time for lawmakers to start asking why big credit unions not only don't pay their fair share — but also why they pay no share at all!

Tax-exempt credit unions were a big consideration when we expanded into the Tri-Cities and Yakima markets. We chose not to go head-to-head with credit unions. Instead, in these two markets as well as the Walla Walla Valley, we developed D.S. Baker Advisors. We are the only local family of wealth management experts that help grow, protect and secure family legacies for generations. The quality and depth of services provided by our advisors as a team is unmatched by any of our competitors. These services are not only what our clients need; they are what they value and where we have a distinctly unique advantage.

Focusing on D.S. Baker Advisory services has paid off. For the eighth year in a row Baker Boyer was ranked by *American Banker* as one of the Top 200 Community Banks. With a three year average ROE of 14% we rank #29 in the nation. Year-to-date 2015 our ROE is approaching 10% which is higher than last year but still short of the goal. Based on our current profile of loans and deposits, I am encouraged by the positive trends and how they could drive our profitability in future quarters. D.S. Baker Advisors positions us for success for decades to come as Eastern Washington's trusted financial advisor.

Sincerely,

Megan F. Clubb  
Chairman & CEO

## Consolidated Balance Sheet - Average ytd

(Unaudited)

|  | June 30,          |                   | % Chg.        |
|--|-------------------|-------------------|---------------|
|  | 2015              | 2014              |               |
| <i>(Dollars in Thousands)</i>                                |                   |                   |               |
| <b>ASSETS</b>  |                   |                   |               |
| Cash and amounts due from banks                              | \$ 4,538          | \$ 4,181          | (111.0)       |
| FFS and Int-bearing deposits at other financial institutions | 44,921            | 72,340            | (37.9)        |
| <b>Total Cash and Cash Equivalents</b>                       | <b>49,459</b>     | <b>76,521</b>     | <b>(41.9)</b> |
| Investment securities:                                       |                   |                   |               |
| Available-for-sale, at fair value                            | 203,529           | 192,205           | 5.9           |
| Held-to-maturity at cost                                     | 1,491             | 1,537             | (3.0)         |
| Other investments, at cost                                   | 1,686             | 1,814             | (7.1)         |
| <b>Total Investments</b>                                     | <b>206,706</b>    | <b>195,556</b>    | <b>5.7</b>    |
| Loans  | 287,207           | 275,753           | 4.2           |
| Allowance for credit losses                                  | (6,043)           | (6,527)           | (7.4)         |
| <b>Net Loans</b>   | <b>281,164</b>    | <b>269,226</b>    | <b>4.4</b>    |
| Bank premises and equipment, net                             | 13,627            | 14,289            | (4.6)         |
| Accrued interest receivable                                  | 2,407             | 2,251             | 6.9           |
| Other assets   | 3,318             | 2,993             | 10.9          |
| <b>TOTAL ASSETS</b>  | <b>\$ 556,681</b> | <b>\$ 560,836</b> | <b>(1.6)</b>  |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                  |                   |                   |               |
| Deposits   |                   |                   |               |
| Noninterest bearing  | \$ 142,719        | \$ 131,159        | 8.8           |
| Interest bearing   | 342,088           | 359,394           | (4.8)         |
| <b>Total Deposits</b>  | <b>484,807</b>    | <b>490,553</b>    | <b>(1.2)</b>  |
| Federal funds purchased and security repurchase agreements   | 22,177            | 22,323            | (0.7)         |
| Other borrowed funds   | 77                | 0                 | -             |
| Accrued interest payable                                     | 29                | 44                | (34.1)        |
| Other liabilities  | 268               | 68                | 294.1         |
| <b>TOTAL LIABILITIES</b>                                     | <b>507,358</b>    | <b>512,988</b>    | <b>(1.1)</b>  |
| <b>SHAREHOLDERS' EQUITY</b>                                  |                   |                   |               |
| Common stock (no par value, stated value \$3.125 per share)  |                   |                   |               |
|  | 6/30/15           | 6/30/14           |               |
| Shares authorized  | 4,000,000         | 4,000,000         |               |
| Shares issued and outstanding                                | 1,305,017         | 1,301,440         | 4,075         |
| Additional paid-in capital                                   | 998               | 1,489             | (33.0)        |
| Retained earnings  | 43,570            | 41,607            | 4.7           |
| Accumulated other comprehensive income (loss)                | 680               | 656               | 3.7           |
| <b>TOTAL SHAREHOLDERS' EQUITY</b>                            | <b>49,323</b>     | <b>47,848</b>     | <b>3.1</b>    |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>            | <b>\$ 556,681</b> | <b>\$ 560,836</b> | <b>(0.7)</b>  |

## Consolidated Statements of Income

(Unaudited)

|   | Six Months Ending June 30, |                  | % Chg.        |
|---|----------------------------|------------------|---------------|
|   | 2015                       | 2014             |               |
| <i>(Dollars in Thousands, except per share amounts)</i>         |                            |                  |               |
| <b>Interest and Dividend Income</b>                             |                            |                  |               |
| Loans, including fees   | \$ 7,419                   | \$ 7,361         | 0.8           |
| Federal funds sold and deposits at other financial institutions | 125                        | 127              | (1.6)         |
| Investment securities:  |                            |                  |               |
| Taxable   | 564                        | 425              | 32.7          |
| Tax-exempt  | 781                        | 706              | 10.6          |
| Other investment income and dividends                           | 23                         | 19               | 21.1          |
| <b>Total Interest and Dividend Income</b>                       | <b>8,912</b>               | <b>8,638</b>     | <b>3.2</b>    |
| <b>Interest Expense</b>   |                            |                  |               |
| Deposits  | 156                        | 225              | (30.7)        |
| Federal funds purchased and security repurchase agreements      | 11                         | 10               | 10.0          |
| Other borrowed funds  | 0                          | 0                | -             |
| <b>Total Interest Expense</b>                                   | <b>167</b>                 | <b>235</b>       | <b>(28.9)</b> |
| <b>Net Interest Income</b>                                      | <b>8,745</b>               | <b>8,403</b>     | <b>4.1</b>    |
| <b>Provision for credit losses</b>                              | <b>46</b>                  | <b>22</b>        | <b>-</b>      |
| <b>Net Interest Income after Provision for Credit Losses</b>    | <b>8,699</b>               | <b>8,381</b>     | <b>3.8</b>    |
| <b>Non-Interest Income</b>                                      |                            |                  |               |
| Investment Management and Trust fees                            | 3,429                      | 3,206            | 7.0           |
| Investor Services   | 568                        | 693              | (18.0)        |
| Service charges on deposit accounts                             | 474                        | 453              | 4.6           |
| Other service charges and fees                                  | 573                        | 648              | (11.6)        |
| Other operating income  | 383                        | 339              | 13.0          |
| <b>Total Non-Interest Income</b>                                | <b>5,427</b>               | <b>5,339</b>     | <b>1.6</b>    |
| <b>Non-Interest Expense</b>                                     |                            |                  |               |
| Salaries, wages, and other compensation                         | 5,358                      | 5,264            | 1.8           |
| Retirement and employee benefits                                | 1,752                      | 1,629            | 7.6           |
| Net occupancy expense   | 556                        | 603              | (7.8)         |
| Furniture and equipment expense                                 | 280                        | 321              | (12.8)        |
| Other operating expense   | 2,896                      | 2,820            | 2.7           |
| <b>Total Non-Interest Expense</b>                               | <b>10,842</b>              | <b>10,637</b>    | <b>1.9</b>    |
| <b>Income Before Income Taxes</b>                               | <b>3,284</b>               | <b>3,083</b>     | <b>6.5</b>    |
| <b>Provision For Income Taxes</b>                               | <b>861</b>                 | <b>819</b>       | <b>5.1</b>    |
| <b>NET INCOME</b>   | <b>\$ 2,423</b>            | <b>\$ 2,264</b>  | <b>7.0</b>    |
| <b>Basic Earnings Per Common Share</b>                          | <b>\$ 1.88</b>             | <b>\$ 1.74</b>   | <b>7.7</b>    |
| <b>Weighted Average Number of Shares Outstanding</b>            | <b>1,292,195</b>           | <b>1,300,950</b> |               |