

2015

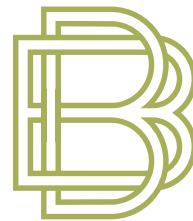
THIRD QUARTER REPORT



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BAKER BOYER

FAMILY LEGACIES GROWN LOCALLY

Walla Walla Tri-Cities Yakima

Dear Baker Boyer Shareholder:

I recently spoke at the “Community Banking in the 21st Century” conference in St. Louis. Fed Chair Janet Yellen opened the conference with the following remarks:

“The Fed instituted this conference because we believe that research can help us better understand the benefits that community banks provide to society. I expect participants over the next two days will tackle some of the most important issues facing community banks. These banks provide essential financial services to households, small businesses, and farms in communities throughout the country.”

My panel followed Chair Yellen and our topic was Small Business Lending. This is an important issue for the Fed because community banks provide 54% of the loans to small businesses. Therefore, these small banks are a critical driver of the Fed’s dual mandate supporting our nation’s GDP and job growth.

The panel explored the competitive advantages and disadvantages between: 1) relationship lending practices of community banks; versus 2) technology driven lending practices of big banks and non-bank technology firms. One panelist wrote, “The historic advantage community banks have had in making small business loans was their ability to leverage “soft” information like knowledge of a business’s cash flow. Now community banks’ competitors have developed technology that uses multiple sources of online information to make speedy lending decisions, greatly reducing the competitive advantage of community banks.”

I posed the questions, “How will COMPUTER BASED trends in small business lending affect small business competitiveness and financial success? Will they be more financially secure, successfully deliver higher growth and produce more job opportunities? Or will faster access to cheaper credit result in too much leverage and decisions that put the health of small businesses at risk, especially in economic downturns?” I tend to believe it is this latter point that regulators need to be concerned about because it is eerily familiar to the sub-prime lending fiasco that drove us into the most recent recession.

I used a real life example of one of our winery clients. Our client produced excellent wines, had great marketing intuition and had built a really strong team. Their early success made them want to grow rapidly. But rapid growth coupled with price reductions and tight margins could put their business at risk because cash flow might fall short of what’s needed to make debt payments. Our D.S. Baker Business Advisor showed the client how using debt to grow the business was adding a lot of risk and they worked together to develop a moderate growth plan that flourished.

A computer underwriting process WILL NOT do that. It will be analyzing current conditions to estimate debt capacity without understanding that by adding the debt the environment for the client had also changed. A computer might conclude the business can support the expense of a new much larger wine press. But, if that wine press leads to higher volume, higher financing costs due to a larger inventory and the need to cut pricing, the computer could loan the business into bankruptcy. This is the value community banks provide to clients when they have a face-to-face advising and consulting partnership with their lender.

I ended with three questions to the panel researchers (you can view my speech at www.bakerboyer.com):

1. Will technology driven underwriting systems lead to more small business bankruptcies?
2. Can technology driven underwriting systems deliver a debt structure for long-term success?
3. Will technology driven underwriting systems better support small businesses in times of an economic downturn?

I know from experience that relationships matter in businesses success. The degree of involvement and time spent with your Business Advisor matters as well. Throughout time, Baker Boyer has advised our clients setting them up for success in both good economic times and bad. This is a foundation that has delivered strong shareholder returns for decades. Net Income through the third quarter is 4.3% ahead of last year at this time, at \$4.106 million.

Community bankers provide value way beyond the pure yes or no of an underwriting decision. Education and guidance helps avoid disasters and provides a competitive advantage to small businesses by helping them in the important field of risk management. Baker Boyer provides a very safe place for our clients to do business. We are advisors that happen to have banking powers. This allows us to make a big difference in the lives of many small business clients as well as a positive contribution to our local economy—adding jobs and helping local families manage their assets to build local legacies.

Sincerely,

Megan F. Clubb
Chairman & CEO

Consolidated Balance Sheet - Average ytd

(Unaudited)

	Sept 30,		% Chg.
	2015	2014	
<i>(Dollars in Thousands)</i>			
ASSETS			
Cash and amounts due from banks	\$ 4,441	\$ 4,124	7.7
FFS and Int-bearing deposits at other financial institutions	45,904	62,183	(26.2)
Total Cash and Cash Equivalents	50,345	66,307	(24.1)
Investment securities:			
Available-for-sale, at fair value	199,117	195,021	2.1
Held-to-maturity at cost	1,492	1,538	(3.0)
Other investments, at cost	1,541	1,808	(14.8)
Total Investments	202,150	198,367	1.9
Loans	289,307	279,449	3.5
Allowance for credit losses	(6,001)	(6,427)	(6.6)
Net Loans	283,306	273,022	3.8
Bank premises and equipment, net	13,666	14,102	(3.1)
Accrued interest receivable	2,506	2,330	7.6
Other assets	3,275	2,906	12.7
TOTAL ASSETS	\$ 555,248	\$ 557,034	(0.3)
LIABILITIES AND SHAREHOLDERS' EQUITY			
Deposits			
Noninterest bearing	\$ 143,000	\$ 131,782	8.5
Interest bearing	340,262	354,910	(4.1)
Total Deposits	483,262	486,692	(0.7)
Federal funds purchased and security repurchase agreements	22,255	22,474	(1.0)
Other borrowed funds	51	0	-
Accrued interest payable	29	42	(31.0)
Other liabilities	160	14	1,042.9
TOTAL LIABILITIES	505,757	509,222	(0.7)
SHAREHOLDERS' EQUITY			
Common stock (no par value, stated value \$3.125 per share)			
	9/30/15	9/30/14	
Shares authorized	4,000,000	4,000,000	
Shares issued and			
outstanding	1,305,662	1,301,982	4,077 4,087 (0.2)
Additional paid-in capital	1,031	1,278	(19.3)
Retained earnings	43,753	41,811	4.6
Accumulated other comprehensive income (loss)	630	636	(0.9)
TOTAL SHAREHOLDERS' EQUITY	49,491	47,812	3.5
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 555,248	\$ 557,034	(0.3)

Consolidated Statements of Income

(Unaudited)

	Nine Months Ending Sept 30,		% Chg.
	2015	2014	
<i>(Dollars in Thousands, except per share amounts)</i>			
Interest and Dividend Income			
Loans, including fees	\$ 11,340	\$ 11,202	1.2
Federal funds sold and deposits at other financial institutions	188	175	7.4
Investment securities:			
Taxable	773	658	17.5
Tax-exempt	1,262	1,073	17.6
Other investment income and dividends	30	31	(3.2)
Total Interest and Dividend Income	13,593	13,139	3.5
Interest Expense			
Deposits	230	318	(27.7)
Federal funds purchased and security repurchase agreements	16	15	6.7
Other borrowed funds	0	0	-
Total Interest Expense	246	333	(26.1)
Net Interest Income	13,347	12,806	4.2
Provision for credit losses	219	45	386.7
Net Interest Income after Provision for Credit Losses	13,128	12,761	2.9
Non-Interest Income			
Investment Management and Trust fees	5,130	4,930	4.1
DS Baker Investment fees (brokerage)	881	1,163	(24.2)
Service charges on deposit accounts	725	677	7.1
Other service charges and fees	939	1,003	(6.4)
Other operating income	907	688	31.8
Total Non-Interest Income	8,582	8,461	1.4
Non-Interest Expense			
Salaries, wages, and other compensation	7,979	7,974	0.1
Retirement and employee benefits	2,526	2,393	5.6
Net occupancy expense	841	910	(7.6)
Furniture and equipment expense	422	479	(11.9)
Other operating expense	4,378	4,071	7.5
Total Non-Interest Expense	16,146	15,827	2.0
Income Before Income Taxes	5,564	5,395	3.1
Provision For Income Taxes	1,458	1,457	0.1
NET INCOME	\$ 4,106	\$ 3,938	4.3
Basic Earnings Per Common Share	\$ 3.18	\$ 3.03	5.0
Weighted Average Number of Shares Outstanding	1,292,673	1,297,484	